ROBBING PETER TO PAY PAUL

A PRINCIPLED APPROACH TO PONZI CLAWBACK CLAIMS IN NEW ZEALAND, IN LIGHT OF THE SUPREME COURT DECISION IN *MCINTOSH v FISK*

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"Merdle! O ye sun, moon, and stars, the great man! The rich man, who had in a manner revised the New Testament, and already entered into the kingdom of Heaven. The man who could have any one he chose to dine with him, and who had made the money!"

- Charles Dickens, *Little Dorrit* (1855). A description of the infamously wealthy Mr. Merdle, an early literary depiction of a Ponzi promotor.

INTRODUCTION

'Ponzi' schemes are a form of investment fraud. They are named after Charles Ponzi, who in the 1920's, concocted a scam investment scheme whereby profits paid to investors were funded by later investors.[1] Similar schemes have since appeared worldwide;[2] taking many forms, including: hedge fund schemes,[3] loan schemes,[4] securities trading,[5] and mortgage investment schemes.[6] What they have in common is that the so-called pay-outs or 'returns' paid to investors by the scheme's 'promotor' are not true profits, but rather funds from later investors.[7] This is widely accepted as the hallmark of Ponzi schemes.[8] These pay-outs perpetuate the scheme and provide an air of legitimacy.[9] Although sometimes legitimate investment schemes evolve into Ponzis, there is generally no genuine business operation accompanying the fraudulent investment programme.[10] Typically, the investors' money is not segregated but rather commingled with those of the other investors in a global pool of cash and assets. Upon collapse, unraveling such a scheme is a "messy and complicated affair",[11] worsened by the insolvency of its promotor. The nature of these schemes means that they have an equal ability bring extreme hardship to some investors and provide substantial gains to others.

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[1] *Cunningham v Brown* 265 US 1 (1924) at 7.

[2] The United States has undoubtedly seen the most Ponzi schemes, but the United Kingdom, Australia, and New Zealand, have not been immune. Equally, with the emergence and prevalence of the web, some schemes have expanded internationally.

[3] *Sullivan v Holland & Knight LLP* LEXIS 47963 (MD Fla 2010).

[4] *Clarke v Cosmo (In re Agape Litig,)* 773 F Supp 2d 298 (ED NY 2011).

[5] *SEC v Forte* LEXIS 24705 (ED Pa 2010).

[6] *People v Greenberg*, 439 NW 2d 336 (Mitch Ct App 1989).

[7] Ministry of Business, Innovation and Employment "Discussion paper: A new regime for unraveling Ponzi schemes" (10 May 2018) at 18 citing *In re the Bennett Funding Group Inc* 439 F.3d 155 (2d Cir 2006) at 157.

[8] Kathy Bazoian Phelps & Steven Rhodes, *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes*, § 1.02 (2012), citing *Hayes v Palm Seedlings Partners* (*In re Agric Research & Tech Grp Inc*) 916 F 2d 528 (9th Cir 1990) at 536. The Ninth Circuit adopted a similar definition later in *Wyle v. C.H. Rider & Family (In re United Energy Corp.),* 944 F.2d 589, 590 n.1 (9th Cir. 1991).

[9] *McIntosh v Fisk* [2017] NZSC 78, [2017] 1 NZLR 863 at [275] (*McIntosh* (SC)).

[10] Above n 8, at § 1.02.

[11] At § 1.01.

The biggest risk faced by Ponzi perpetrators[12] is the situation where there is insufficient funds in the commingled pool of cash and assets to pay purported returns to investors who are either seeking to cash out the entirety or a portion of their earnings. This situation is the result of three – usually contemporaneous – factors: a decline in the amount of investors joining the scheme, an increase in investors seeking to withdraw their purported earnings, and the promotor exhausting funds. Ponzi schemes always collapse and reveal themselves to be "an intricate web ensnaring investors, professionals, officers, directors, and countless other individuals and entities."[13] What follows is public disclosure, the criminal law, and receivership proceedings. In 2012, New Zealand's largest ever Ponzi scheme, Ross Asset Management ("RAM") collapsed with close to twelve hundred investors. Between the early 1990s and 2012 RAM purported to provide fund management services to clients,[14] many of whom knew the principal, David Ross, personally. Unfortunately for those clients, RAM did not comply with its terms of management contracts, but rather operated as a Ponzi.[15] Instead of investing clients' money,[16] RAM misappropriated the funds, which then became part of a commingled pool of cash and securities.[17] Investors' funds were used to meet RAM's expenditure and pay withdrawals sought by investors. Receivers were appointed in 2012, revealing the enormity of RAM's activities;[18] over $450 million was allegedly held on trust, with only $10.2 million discovered.[19]

This dissertation is concerned with the investors in such a scheme.[20] Provided they had no knowledge of the scheme,[21] all are equally victim to the fraudster. Intuitively, fairness may suggest the funds be distributed equally between all investors.[22] As such, it is unsurprising that

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[12] Notwithstanding the criminal law – irrelevant for the purposes of this paper.

[13] Bazoian Phelps and Rhodes, above n 8, at § 1.02.

[14] *McIntosh* (SC), above n 9, at [3].

[15] (2017) 40(20) TCL 2.

[16] For a helpful summary of RAM's modus operandi, see *Fisk v McIntosh* [2015] NZHC 1403 at [9].

[17] *McIntosh* (SC), above n 9, at [3].

[18] Trish Keeper "Recovery from Ponzi Scheme Investors: New Zealand's *Fisk v McIntosh* [2015] NZHC 1403" (2015) 33(8) CSLJ 581 at 581.

[19] At 582.

[20] It will be assumed for the purposes of this paper that the investors were without notice of the fraudulent activities.

[21] Constructive or actual knowledge.

[22] Trish Keeper and Nina Opacic "Losing Sight of Certainty: An Analysis of New Zealand's Voidable Transaction Regime in Light of *Fisk v McIntosh*" (Victoria University of Wellington, Legal Research Paper Series, 2016) at 24.

liquidators[23] often seek to clawback funds paid to those who withdrew their money in order to redistribute finance amongst all of the defrauded investors.[24] There are competing policy concerns at play within such a claim. On one hand there is fairness which demands innocent victims be treated equally. Notions of equal treatment directly compete with a desire to support commercial activity by ensuring transactions can be entered into in the ordinary course of trading, confidently and with certainty of receipt. Consider the following scenarios:[25]

Scenario 1: Investor A deposits $500,000 into an investment scheme of which Promotor is the principal. Promotor furnishes periodic statements reflecting gains, showing a substantial balance in A's account. The statements are false. By the time of the collapse, Investor A has not withdrawn any money. Once non-investor debts and expenses are paid by the liquidators, sufficient funds remain to pay all investors ten cents in the dollar. Investor A would be paid out $50,000.

Scenario 2: The same facts as Scenario 1, except Investor A has instead received $450,000 in distributions. This is more than the $50,000 Investor A would receive in the liquidation had Investor A not withdrawn any funds. Should the investor be required to return any of this amount for distribution between all?

Scenario 3: The same facts as Scenario 1, except Investor A has instead received $900,000 in distributions. Should the investor be required to return any of this amount for distribution between all?

Ponzi promotors have, and will, repeat the patterns of their predecessors.[26] In 2017, the Ministry for Business, Innovation and Employment ("MBIE") suggested that change to the

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[23] At times (and depending on jurisdiction) referred to as trustees and/or receivers.

[24] See for example *McIntosh v Fisk* (SC), above n 9.

[25] Adapted from American Law Institute *Restatement (Third) of the Law of Restitution* (American Law Institute Publishers, St Paul (Minnesota), 2011), at § 59.

[26] For summary on the increasing prevalence of Ponzi schemes, see Mallory Sullivan "When the Bezzle Bursts: Restitutionary Distributions of Assets After Ponzi Schemes Enter Bankruptcy" (2011) 68 Wash. & Lee L. Rev. 1589 at 1591-1593.

New Zealand approach may be necessary.[27] RAM and this subsequent call for reform were the impetus for this paper. This dissertation aims to determine the most justifiable approach to the clawback of funds between those who have received more than they would otherwise in liquidation (Investor A in Scenarios 2 and 3), and those who have not. In essence, this dissertation explores whether, why, and to what extent liquidators should be able to 'clawback' (recover) payments for the benefit of creditors as a whole. Ultimately, this paper provides an alternative restitutionary approach to the clawback of Ponzi funds.

Chapter One will explore the current response to Ponzi clawback claims in New Zealand, including analysing the relevant legislative framework and its application. It sets out that this approach creates an all-or-nothing result between similarly positioned victims.

Chapter Two observes that the Supreme Court in *McIntosh v Fisk* adopted an approach consistent with the increasingly criticised orthodox US response.

Chapter Three will suggest that the voidable transaction regime, while convenient, is an unsuitable mechanism for dealing with Ponzi clawbacks. It will argue that the relevant claims are restitutionary in nature and as such, need to be considered from a restitutionary position. On this view, the nature of the transaction between a Ponzi promotor and an unaware investor is properly characterised as defective.

Chapter Four applies modern restitutionary principles to argue that the Ponzi investor is best described as a beneficiary of an equitable proprietary interest in their principal investment.

[27] Ministry of Business, Innovation and Employment "Discussion paper: A new regime for unraveling Ponzi schemes" (10 May 2018).

CHAPTER ONE: THE NEW ZEALAND APPROACH TO CLAWBACKS

I Statutory Framework

A Clawback Claims

There is no targeted New Zealand legislative regime for distribution or recovery of investor funds lost or misappropriated in a Ponzi. The current approach is the application of either the voidable transaction provisions (in the Companies Act 1993 ("CA")) or the prejudicial disposition provisions (in the Property Law Act 2007 ("PLA")). Both prima facie grant the court discretion to set aside certain transactions.[28] This allows the liquidator to clawback the payment in order to return it to the general pool of assets for distribution amongst all of the creditors (rather than enriching the paid creditor at the expense of the group). A transaction is insolvent if it is; entered into at a time when the company is unable to pay its due debts, and enables another person to receive more towards satisfaction of a debt owed by the company than that person would be likely to receive in the company's liquidation.[29] An insolvent transaction is voidable if it was entered into with two years prior to liquidation.[30] Under the PLA, transactions (or dispositions) made by a debtor company within six years prior to liquidation can be challenged by the liquidator.[31] The disposition must be made "with intent to prejudice a creditor, or by way of gift, or without receiving reasonably equivalent value in exchange."[32] Additionally, the debtor must have been insolvent at the time or become insolvent as a result, of making the disposition.[33] The court has discretion to order the property be vested in another person, or reasonable compensation is required to be paid.[34] What this means for investors is that those who withdraw funds in the two years prior to liquidation of a Ponzi are vulnerable to clawback claims under both the CA and PLA regimes. Those who withdraw funds within two to six years prior to liquidation remain vulnerable under the PLA.

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[28] Companies Act 1993, s 292 and Property Law Act 2007, ss 344-350.
[29] Companies Act, s 292(2).
[30] Section 292(1).
[31] Property Law Act, s 348.
[32] Section 346(1)(b).
[33] Section 346(2)(a).
[34] Sections 348(2)(a)&(b).

A key difference between the regimes is that under the PLA an element of intent on the debtor's behalf may be required.[35] This might be a reason for a liquidator preferring the CA regime. Yet, when it is found that a debtor has been running a Ponzi, intent to prejudice should hardly be difficult to prove.[36] In the US, this is an assumption that is made in law when such a scheme is revealed.[37] A liquidator could rely on the PLA instead of the CA when the transaction concerned was made outside the CA two year limitation period. Otherwise, there is no substantial difference between claims under both provisions. Liquidators have framed clawback claims under both as alternatives.[38]

B Defending a Clawback Claim

Those facing a clawback claim may have recourse to defences under both the CA and PLA. Both Acts provide affirmatively operating 'change of position' and 'value' defences, the latter being the focus of this paper.[39] Section 296(3) of the CA provides that a court must not order the recovery of company property from A if A proves that when A received the property, she "acted in good faith, and a reasonable person in A's position would not have suspected and did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and that A gave value for the property."[40] To make out the corresponding PLA defence, the recipient must have acquired the property "for valuable consideration and in good faith without knowledge [that it was a prejudicial disposition]."[41]

The good faith and knowledge requirements contained within the CA and PLA 'value' defences are generally not at issue in the Ponzi context. After all, a key aspect of a Ponzi scheme is that (almost) all investors are defrauded.[42] This paper is not concerned with those

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[35] Note that per s 346(1) this only needs to be proven if the disposition was not made by way of a gift or without receiving reasonably equivalent value in exchange.
[36] This was easily met in *McIntosh* (SC), above n 9, at [36].
[37] Bazoian Phelps and Rhodes, above n 8, at § 1.02.
[38] See *McIntosh* (SC), above n 9.
[39] Property Law Act, ss 349(1)&(2). Companies Act, s 296(3).
[40] Section s 296(3).
[41] Section 349(1).
[42] Bazoian Phelps and Rhodes, above n 8, at § 1.02.

barred from a defence for reasons other than lack of value.[43] Given their similarity, the value defences will be considered together.[44]

C Competing Goals of the CA Voidable Transaction Regime

1 Pari passu and equal treatment

The CA voidable transactions regime seeks to give effect to the pari passu principle, "a fundamental insolvency tenet"[45] under New Zealand,[46] England & Wales[47] and US[48] law. The principle provides that all creditors of the same class should be treated equally, and none be afforded preference over others. The manner in which pari passu is given effect to differs between jurisdictions. For example, in England the focus is on the intention of the debtor: was a preference intended?[49] Australia instead focuses on the effect of the transaction: did the creditor, in fact, receive a preference?[50] The US effects-based approach is best explained by the maxim "equality is equity."[51] Essentially, "unless a creditor can clearly demonstrate that it deserves some priority in the bankruptcy pay out, the trustee will assume all creditors are equal and try to maximize the pot for that collective."[52] The principle aims to spread the effects of liquidation amongst all creditors.

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[43] This is not to say that there are no situations where a Ponzi recipient had reasonable grounds to suspect or has acted in bad faith. Of course, there will be times where a recipient is 'in on it', or where the scheme is 'too good to be true' that they could not have reasonably believed the company was solvent.

[44] As the Supreme Court did in *McIntosh*, above n 9. Differences may arise in relation to the differing policy behind the respective regimes.

[45] James Caird "The Voidable Transaction Regime and the Quest for Clarity" (2015) 21(1) NZBLQ 16 at 16.

[46] Ministry of Business, Innovation and Employment "Review of Corporate Insolvency Law: Report No. 2 of the Insolvency Working Group, on voidable transactions, Ponzi schemes and other corporate insolvency matters" (May 2017) at [41].

[47] See Insolvency Act 1986 (UK), s 239(5).

[48] Elizabeth Warren and others *The Law of Debtors and Creditors* (5th[th] ed, Aspen Publishers, 2005) at 218.

[49] For example, s 239(5) Insolvency Act 1986 (UK) prevents the Court from making an order setting aside a preference "unless the company which gave the preference was influenced in deciding to give it by a desire to produce" the preferential effect.

[50] Gabrielle Smith "In Search of Equality: New Zealand's Voidable Preference Regime" (LLB(Hons) Dissertation, University of Otago, 2011).

[51] Warren and others, above n 48, at 228

[52] Elizabeth Warren and others *The Law of Debtors and Creditors 58* (7th ed, Aspen Publishers, 2014), at 133.

New Zealand moved from an English approach to be in line with the American and Australian objective effects-based approach with the CA.[53] This represented a policy shift from 'debtor deterrence' towards a preference for pari passu sharing. Given its objectivity, the effects-based regime represents a rejection of 'creditor deterrence' theory which focuses on the creditor's state of mind.[54] The rationale for this shift can be summed up by MBIE in its 2001 report, where to assess intention was considered: "at odds with the primary object of voidable preference law, which is to achieve equality between creditors."[55] The Insolvency Working Group noted in 2017 that the 1993 reforms were "expressly based on seeking to uphold equal sharing."[56] Accordingly, the voidable transaction provisions exist to enable payments to favoured creditors to be clawed back and redistributed equally amongst the general body of creditors. In practice, this is not so easily achieved.[57] The statutory scheme of distribution is that secured creditors receive first priority, then preferential creditors, followed by any claims of unsecured creditors which are only then satisfied in accordance with pari passu.[58]

2 Commercial Confidence

The voidable transactions regime aims to balance collective justice for creditors with the principle of commercial confidence. Lomas likens the courts applying the regime to walking a "judicial tightrope."[59] The shortened two-year limitation period in the CA[60] represents the heightened value given to security of receipt in commercial transactions.[61] Of course, it will always seem harsh when an apparently ordinary commercial transaction is re-opened.[62] The two-year limit operates accordingly to reduce the vulnerability of commercial parties to clawbacks under the CA for a significantly lesser period of time than in the case of transactions

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[53] For a discussion of this, see *Allied Concrete v Meltzer* [2016] NZSC, [2016] 1 NZLR 141 at [101].
[54] MBIE, above n 46, at [58]. 'Creditor deterrence' theory is observed to have never been part of New Zealand law at [62].
[55] Ministry of Economic Development "Insolvency Law Review: Tier One Discussion Documents" (January 2001) at 55.
[56] MBIE, above n 46, at [61].
[57] Roy Goode *Principles of Corporate Insolvency Law* (3rd ed, Sweet & Maxwell, London, 2005) at 177.
[58] Liesle Theron "The Liquidation Process" in Paul Heath & Michael Whale (eds) *Heath & Whale on Insolvency* (online looseleaf, LexisNexis NZ) at [20.33].
[59] Aidan Lomas "The Judicial Tightrope: Walking the Fine Line Between Commercial Certainty and Pari Passu" (2015) 21 AULR 261 at 267.
[60] From the default six years.
[61] Ministry of Business, Innovation and Employment, above n 54, at [69].
[62] At [69].

that are not governed by that Act.[63] Considered on its own, the collective interest of creditors would dictate a longer vulnerability period given it would capture far more payments as eligible for clawback claims.[64]

II Application of the 'Value' Defence

A Approaches to Value

1 Orthodox approach to value

Company A constructs steel foundations for Company B in connection with the construction of a new pipeline.[65] Company A invoices Company B $50,000.00 for the work, which is paid in full after the work is completed. Liquidators are appointed to Company B and seek to set these payments aside under the voidable transaction provisions of the CA. It is not disputed that the payments are insolvent transactions. At the time of the payments, Company A acted in good faith and did not suspect, nor were there any reasonable grounds to suspect, that Company B was or would become insolvent. Prior to the 2016 Supreme Court decision *Allied Concrete*, value given by the recipient accepting payment in satisfaction and release of an antecedent debt would not suffice for the 'gave value' test set out in s 296(3)(c).[66] Assuming Company A has not advanced a successful alteration of position defence, the transaction will be voided. Company A will be required to disgorge value received under the transaction. As noted in *Farrell v Fences & Kerbs*, the value needs to be new, "real and substantial" and given *at the time* of the allegedly voidable transaction.[67]

2 *New approach to value:* Allied Concrete v Meltzer[68]

The appellants (Company A in the example) were trade creditors of the respondents (Company B), having supplied a range of goods and services on credit.[69] While the respondent

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[63] Limitation Act 2010, s 11.
[64] Particularly in the case of a lengthy Ponzi scheme.
[65] Adapted from the facts in *Farrell v Fences & Kerbs Ltd* [2013] NZCA 329, 3 NZLR 82. See *Allied Concrete*, above n 53 at [7]-[15] for the precise payments, which have been simplified for this example.
[66] *Farrell v Fences & Kerbs*, above n 65.
[67] At [27]-[28] (emphasis added). Note that value given after the allegedly voidable payment would also suffice under the orthodox position.
[68] *Allied Concrete,* above n 53.
[69] For a comprehensive summary of the facts of cases on appeal, see *Allied,* above n 53, at [7]-[15].

companies later repaid the appellants, those payments were 'insolvent transactions' per s 292 of the CA.[70] The liquidators of the companies applied to void the transactions. The appellants sought to thwart those claims on the basis they had provided value as per s 296(3)(c).[71]

The Court of Appeal position was reversed. It was held that antecedent debt will suffice as value for the purpose of s 296(3)(c).[72] The majority reasoned there is nothing in the statutory language to suggest payment must be at the time services are rendered (or after) despite the Court of Appeal's earlier view that Parliament's use of "when" indicated a temporal restriction was intended.[73] The Supreme Court noted that value "cannot be viewed in a vacuum."[74] Looking to the section as a whole, the Court considered the situation where a creditor receives payment from a debtor company, partly covering existing indebtedness and partly in full payment of further goods provided by the creditor on a cash-on-delivery sale. This is different to the example I have set out because the entire payment covered existing indebtedness. In the alternate scenario considered by the Court, the portion of the payment for the latter would not constitute a voidable transaction because the payee does not receive this as a creditor but for the contemporaneous supply of goods. As such, "value" must refer to something other than goods or services provided by the creditor at the time of the disputed transfer because the payment for new value would not be a voidable transaction.[75]

This interpretation is wide. It was a welcome result to creditors who receive apparently unremarkable payments in circumstances where they do not (and have no reason to) suspect

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[70] At [2]. This was not at issue.
[71] At [26]
[72] At [68].
[73] At [63] and [68]. Compare with the Court of Appeal in *Farrell v Fences & Kerbs*, above n 65, at [57] and [78].
[74] At [69].
[75] At [92].

insolvency.[76] It improves the position of individual creditors,[77] and not just trade creditors such as external suppliers.[78] Had the requirement that value be contemporaneous remained, credit-based transactions would be excluded from the defence.[79] This would have resulted in only narrow circumstances where creditors could claim relief from the provision.[80] The Supreme Court considered that there was no "rational reason" for excluding a "commonplace credit agreement" in the context at hand.[81] Of course, this context was a typical commercial transaction involving the sale of goods or services. This paper suggests that this result is less desirable when applied to Ponzis.[82]

B Application to the Ponzi Context

1 Facts

Ponzis were uncharted territory in New Zealand law.[83] As such, the liquidators brought a test case against McIntosh under both the CA and PLA voidable transaction provisions, seeking judgment on how much could be clawed back from recipients like McIntosh, who had cashed up their portfolios prior to RAM's collapse.[84] Of particular interest was the position of those who had withdrawn more money than initially invested. McIntosh deposited $500,000 to RAM in 2007. The agreement between RAM and McIntosh provided that McIntosh appoint RAM

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[76] Dale Nicholson & Darise Bennington "Bringing certainty to voidables: *Allied Concrete Ltd v Meltzer* [2015] NZSC 7" (2015) 860 LawTalk 26. Kensington Swan responded: "today's decision by the Supreme Court concludes a period of uncertainty for liquidators and creditors… the decision will be keenly received by those in the construction industry, who regularly supply goods and services on account. See Kensington Swan Lawyers, *Supreme Court decision on 'value' welcomed by creditors*, 18 February 2015. Other large commercial firms responded in a similar fashion: see Russell McVeagh, *Valuable Judgment for Those Extending Credit: liquidators lose in the Supreme Court*, 18 February 2015 <https://www.russellmcveagh.com/insights/february-2015/valuable-judgment-for-those-extending-credit-liqu>.

[77] Lomas, above n 59, at 267.

[78] The High Court has found it sufficient that a creditor had provided services through previously being employed by the debtor. See *Sprayman & Auckland Door Finishers Ltd (In Liq.) v McKenzie* [2015] NZHC 1958 at [49].

[79] *Allied Concrete,* above n 53 at [103]

[80] At [106].

[81] At [103].

[82] This paper is not concerned with the correctness of *Allied Concrete* generally.

[83] Duncan Bridgeman "Nothing's fair when it comes to Ponzi schemes" (30 October 2017) National Business Review <https://www.nbr.co.nz/article/nothings-fair-when-it-comes-ponzi-schemes-db-p-209248>.

[84] As a lawyer himself, McIntosh was likely to have been viewed as less of a sympathetic net-winner (unlike elderly, retired investors, for example) for the liquidators to bring their test claim. Additionally, the relevant transactions were in simple sums.

as agent to manage his portfolio.[85] McIntosh was to remain the beneficial owner of his investment in a bare trust relationship with RAM. RAM held possession and legal title.[86] The money was only to be invested on McIntosh's behalf, and not to be mixed. In 2011, McIntosh terminated his agreement and was paid out his original $500,000 investment ("principal") and $454,047 ("profit"), totalling $954,047 ("the total sum").[87] In McIntosh's case, eight shares held by his account were said to have been sold to realise the cash paid to him.[88] The profit was not actually profit generated by the principal sum invested but was sourced from the misappropriated funds of subsequent RAM clients. The Court accepted the liquidators' evidence that it was "highly likely" that none of these shares existed.[89] Any amount paid to an investor above their principal investment is referred to as 'fictitious profits'.[90] It will become clear that the Court accepted this categorisation and bifurcated their analysis of the value defence into principal and fictitious profits accordingly.

All defrauded investors had claims for breach of trust against RAM for the restoration of misappropriated funds and were thus creditors in the liquidation.[91] At all courts, the liquidators were awarded recovery of the fictitious profits, but not the principal sum. It was concluded in various ways that McIntosh had a defence to the transaction being set aside up to the value of the initial investment, having provided value to RAM for that amount. But, value had not been provided for the fictitious profit.[92]

2 High Court on value

An important argument over value played out in the High Court.[93] MacKenzie J noted he would take the "essence" of *Allied Concrete* and apply it to the "unusual circumstances" at hand.[94] MacKenzie J accepted that the investors had accrued claims against RAM under the

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[85] *McIntosh* (SC), above n 9, at [2].
[86] At [16].
[87] For convenience, the Supreme Court treated this as a single payment, at [7] (as will this dissertation).
[88] *Fisk v McIntosh* [2015] NZHC 1403, [2016] NZCCLR 10 at [17].
[89] *Fisk v McIntosh*, above n 88, at [17].
[90] *McIntosh* (SC), above n 9, at [10].
[91] At [18]. McIntosh and others who withdrew money also have these claims.
[92] Nor could McIntosh establish a change of position defence.
[93] Above n 88.
[94] *Fisk v McIntosh*, above n 88, at [73].

law of restitution, the genesis of these claims being the breach of the trust relationship that RAM had with its investors.[95] Given RAM's almost immediate misappropriation of funds upon receipt, RAM came under "an immediate duty to remedy that breach."[96] As such, MacKenzie J found that the investors had accrued claims in restitution, these claims were debts,[97] and the transfer to McIntosh provided value to RAM in that it satisfied that debt: "there was valuable consideration or value to the full extent of repayment of the sum invested."[98] This did not extend to the fictitious profits received in excess of the original investment.[99] MacKenzie J also considered notions of substantial fairness to general creditors:[100]

> To uphold a transaction which represents one side of an exchange of value from which the company has benefited is less unfair to the general body of creditors than is a payment which reduces the assets of the company without a corresponding increase (whether contemporaneous or previous). That balance between fairness to the individual creditor and fairness to the general body of creditors is not achieved if the exchange of value is substantially one-sided.

3 Court of Appeal on value

The Court of Appeal also bifurcated the funds into initial investment and fictitious profits for its analysis.[101] The majority concluded the liquidators could recover the fictitious profit on the basis McIntosh gave value for the $500,000 by discharging RAM's quantifiable liability to him.[102] The profits received did not discharge such a debt because the amount of RAM's liability to McIntosh was unclear when he was paid. The profit paid out "bore no tangible relationship to RAM's liability. It was simply a figure calculated from a fabricated foundation of non-existent investments."[103]

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[95] The court relied upon *Target Holdings Ltd v Redferns (a firm)* [1996] AC 421.
[96] At [45].
[97] Applying a line of English decisions that found a claim in restitution is a 'debt'.
[98] At [88].
[99] At [77]-[78].
[100] At [91].
[101] *McIntosh v Fisk* [2016] NZCA 74, [2016] 2 NZLR 783.
[102] At [38].
[103] At [44].

Miller J did not believe *Allied Concrete* was applicable. On his approach, its application should be constrained to trade creditors.[104] That case did not concern the measure of value exchanged.[105] It concerned trade creditors which Miller J observed formed their own "distinct class",[106] demanding greater finality of payment as trade credit performs a "valuable economic function."[107]

Miller J also dissented on value. He accepted *Allied Concrete's* approach that value must be "real and substantial"[108] and that this meant the value be "substantially equivalent."[109] So, RAM would have received fresh consideration if its liability was discharged by payment.[110] But, he found that the value RAM received when McIntosh advanced his initial $500,000 was not substantially equal to the value he was repaid in 2011. While McIntosh received "full value",[111] RAM did not receive the equivalent. Miller J observed "an investor's antecedent contribution to a Ponzi scheme is not nearly equivalent to the payment that the scheme makes to the same investor on his timely exit; indeed, it delivers no value at all."[112] Introducing new money "merely delays and worsens the inevitable ruin."[113]

4 Supreme Court on value

The Supreme Court had earlier found the two value defences to be closely aligned, and they were considered together.[114] The Court considered that the Court of Appeal had not erred in bifurcating the payment into capital and fictitious profit.[115] Their judgment suggests the purpose of bifurcation was in order to complete the inquiry into whether McIntosh had given

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104 At [98].
105 At [98].
106 At [101].
107 At [101].
108 At [99].
109 At [106].
110 At [106].
111 He received more than full value, but Miller J was only considering the principal payment at this point.
112 At [99] per Miller J.
113 At [107].
114 *McIntosh* (SC), above n 9, at [81] and [73], citing *Allied Concrete,* above n 53, at [76]-[77].
115 At [127].

value.[116] Section 348 PLA requires "reasonable compensation."[117] Similarly, s 295(a) CA empowers the court to order repayment of "some or all of the money" paid to that person. This was regarded as contemplating that payments could be split for the purpose of a value inquiry. As such, the application of both the CA and PLA value defences is the reason the court in *McIntosh* ardently focused on the split between profit and principal.[118] Albeit for slightly differing reasons, it was relatively straightforward to the entire bench that the $454,047 fictitious profit was recoverable.[119] The bench diverged on whether McIntosh had given value for the principal investment.

The majority affirmed that liquidators' recoveries are limited to the fictitious profits.[120] Despite the management agreement stipulating that the $500,000 was to be held on trust for the benefit of McIntosh, the $500,000 was deemed to constitute sufficient value at the point it was misappropriated.[121] The Court accepted that McIntosh had not provided value in the sense that his money became part of the pool of assets available to RAM's unsecured creditors.[122] Yet, the Court could not disregard the fact McIntosh had nevertheless transferred money to RAM.[123] The $500,000 entered a pool of funds (the pool that was misappropriated) rather than the pool available to creditors when the scheme unravelled.[124] The majority considered it would be "unfair"[125] to conclude that the sum was not value simply because it did not enter the pool available for distribution. As such, it was decided "the concept of valuable consideration and value needs to be adapted to the unique facts of this case"[126] and McIntosh's initial investment was recognised as value, the value being derived by the commingled trust fund under RAM's control.[127] Miller J's Court of Appeal analysis was rejected on the basis that value should not

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116 At [127].
117 Section 348(2)(b).
118 See [87].
119 At [128] per Arnold, O'Regan and Ellen France JJ, [222]-[223] per William Young J and [244] per Glazebrook J.
120 At [136].
121 At [101].
122 At [99].
123 At [100].
124 At [100].
125 At [100].
126 At [101].
127 At [101].

be measured by what the recipient does with it – fraudulent actions should not undermine the value given.[128]

Ultimately, all creditors were defrauded in the same manner as McIntosh, and as such had claims on both the pool available to creditors and the co-mingled trust fund.[129] While the initial deposit could be seen as value, through discharging the antecedent debt arising as a result of RAM's misappropriation, the fictitious profits could not discharge any claim against RAM for equitable damages. The 'profits' paid to McIntosh were the product of fictitious entries in reports.[130]

Dissenting, Glazebrook J failed to see how McIntosh had given value for the $500,000 and would have allowed the cross-appeal.[131] As RAM held the funds on trust for McIntosh as beneficiary, it had no value in those funds. As trustee, RAM was not entitled to use those funds for its own purposes.[132] Although upon the misappropriation of funds McIntosh also became a creditor of RAM thereby changing their legal relationship, the trust relationship nevertheless continued.[133] RAM was administering a diminishing pool of trust assets on behalf of investors. As unsecured creditors would have no claim to this, RAM did not acquire any value. This differed from the majority, who although accepting that the trust relationship continued, felt the legal consequences of the relationship were outweighed by the fact that RAM's indebtedness to McIntosh, arising from the misappropriation.[134] Citing the fraudulent nature of a Ponzi scheme, Glazebrook J found it was impossible for McIntosh to have provided value.[135] The purpose of RAM's payment to McIntosh was to defraud other investors into believing the scheme was successful. The only value was in "perpetuating and prolonging the

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[128] At [113].
[129] At [101].
[130] At [101] and [128].
[131] At [266]-[276].
[132] At [268].
[133] At [268].
[134] At [100].
[135] At [270].

fraud."[136] In finding the $500,000 was not value in the first place it was impossible for this to have generated further value, particularly given it was not invested at all.[137]

5 Remarks on the McIntosh trilogy

Two things stand out from the *McIntosh* saga. First, its conclusion replicates the lean towards commercial confidence seen in *Allied Concrete*. *Allied Concrete* placed great emphasis on the tussle between commercial confidence in transactions and the collective realisation of creditors. There, the Supreme Court ultimately concluded Parliament did not intend for the boundary to be drawn in a way that would mean only cash on delivery situations had access to a value defence.[138] As such, *Allied* represents a swing towards commercial confidence in the context of voidable transactions.[139] The Court in *McIntosh* accepted that whilst the value provided was not "real and substantial" as articulated in *Allied Concrete* in the sense of money being available to creditors, fairness suggests he should not be barred from a value defence.[140] In doing so, the Court appears to have relied in principle on *Allied*'s weighting towards commercial confidence and security of receipt by turning to the perceived unfairness McIntosh would suffer should he be required return the total amount.

Second, it is unlikely the Supreme Court's conclusion was dependent on the trust relationship. The situation in *McIntosh* was unusual, even for a Ponzi. Not all Ponzi management agreements will stipulate that the money be held on trust for the benefit of the investor. The Court was more concerned with the debtor-creditor relationship that arose upon misappropriation; the trust relationship was not determinative.[141] It did not matter that the funds entered the commingled trust fund and not the unsecured creditor pool, McIntosh was found to have nevertheless provided value.[142] The court accepted that "gave value for the property" in s 296(c) does not specify that the value had to become part of the company's estate in

[136] At [270]
[137] At [244].
[138] *Allied Concrete*, above n 53, at [96] and [103].
[139] *Allied Concrete,* above n 53, at [96].
[140] *McIntosh* (SC), above n 9, at [99]-[100].
[141] At [100]. Although note that for Glazebrook J it was.
[142] At [101].

liquidation.[143] As such, the statute was "sufficiently flexible to be applicable to the unusual situation that arose in this case."[144] A general principle can be drawn that a principal investment will constitute sufficient value in a Ponzi, regardless of the existence of a trust from the outset. It is expected liquidators will rely on this in the future.

III Conclusion

Allied Concrete greatly reduced what a liquidator may clawback from a creditor under the voidable transaction regime by expanding the notion of value. Applied to the Ponzi context in *McIntosh v Fisk*, victims who have withdrawn money prior to a scheme's collapse will, as a general rule,[145] have a value defence and be able to thwart a liquidator's claim up to the amount of their principal investment on the basis of antecedent debt. The implications of the judgment are far reaching. In particular, it means investors who have not withdrawn their funds prior to collapse will receive significantly less in liquidation than those who did, effectively granting a preference or priority to the latter. In the *Allied Concrete* trade creditor context, this swing towards security of receipt is pragmatic as it gives effect to the common practice of companies supplying their goods and services on credit. Chapter Two sets how when this approach to value is applied to clawbacks, it essentially replicates the orthodox but increasingly questioned US approach.

[143] At [102].
[144] At [102].
[145] Assuming good faith.

CHAPTER TWO: A CLOSER LOOK AT CLAWBACKS

I The Orthodox US Approach to Clawbacks

A Generally

In the US, a quirk of timing operates to determine whether, which and whose money is clawed back from those who withdrew money from a Ponzi prior to its collapse. Distributions made to creditors prior to liquidation may be recoverable in certain circumstances under constructive fraudulent transfer statutes – both at federal and state levels.[146] Section 548(a)(1)(B) of the US Bankruptcy Code allows the trustee (liquidator in New Zealand) to file avoidance actions under the Code's fraudulent transfer framework. This has the effect of setting aside a transfer and thus requiring the recipient return the money. 'Value' operates as an affirmative defence as in New Zealand law.[147]

B Application of 'Value'

In the US, the "universal and unquestioned starting assumption of the courts is that 'equality is equity'."[148] In the Ponzi clawback context there are two hurdles to this principle of equal treatment. In this context, equality could be described as pro rata (proportionate) distribution of all misappropriated funds between victims of the same fraud. The first hurdle to this distribution is that assets which are identifiable in the "wreckage of the scheme" are traceable and as such are generally recoverable by the relevant investor.[149] Generally, the commingling of Ponzi funds means this is unhelpful because assets are seldom identifiable and common law does not permit tracing through a mixed fund. Of course, the exception to this is the very last investor, who will always identify their funds.[150] The second hurdle is the operation of a good faith value or change of position defence.

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[146] Bazoian Phelps and Rhodes, above n 8, at § 3.01[2].
[147] U.S. Bankruptcy Code, § 550(b)(1).
[148] Andrew Kull "Defences to Restitution Between Victims of a Common Fraud" in Andrew Dyson, James Goudkamp and Frederick Wilmot-Smith (eds) *Defences in Unjust Enrichment* (Hart Publishing, Oxford, 2016) 229 at 250.
[149] Above n 148, at 250.
[150] See Chapter Four, below.

US law has progressed towards an expansive interpretation of value;[151] in which there is "statutory hegemony"[152] that antecedent debt qualifies as value. For example, the avoidance section of the U.S Bankruptcy Code includes discharge of antecedent debt as value.[153] When this section is applied to Ponzi schemes,[154] US courts have consistently used the 'net-loss approach'.[155] Under this approach, the amount transferred from promotor to investor is netted against the investor's principal investment.[156] If this amount is positive, the investor is a 'net-winner'. If the amount is negative, the investor is a 'net-loser'. If equal, the investor is considered to be neutral. The positive amount becomes the fictitious profit. This distinguishes funds within any withdrawals into two categories: repayment of principal, and payment of fictitious profit.[157] Applying the rule, *Donell v Kowell* articulated that a net-winner in a Ponzi is liable under the fraudulent conveyance statute for any amount received in excess of their principal investment.[158] The repayment of principal acts as a reduction in debt owed to the investor.[159] In turn, anything received above the investment is not for value: "Because they do not represent a return on legitimate investment activity."[160] This has certainly been the approach followed relatively seamlessly in the Ponzi clawback cases[161] proceeding *Donell* which

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[151] For example, the Uniform Commercial Code (UCC) §1-204(2), 3-303(a)(3) which explains "value" includes antecedent debt. Prior to the adoption of the UCC, a creditor taking goods in satisfaction of antecedent debt would not have been protected as a bona fide purchaser. The matter is not settled where transactions are not governed by statute.

[152] Andrew Kull "Ponzi, Property, and Luck" (2014) 100 Iowa Law Review 291 at 297.

[153] U.S Bankruptcy Code, § 548(d)(2)(A).

[154] Or similar state-level statute.

[155] Mark A. McDermott "Ponzi Schemes and the Law of Fraudulent and Preferential Transfers" (1998) 72 ABLJ 157 at 168-69.

[156] *Donell v Kowell* 533 F 3d 762 (9th Cir 2008) at 771.

[157] See Bazoian Phelps and Rhodes, above n 8, at § 20.04[3][c] for a helpful summary.

[158] The Court was dealing with the provisions in the Uniform Fraudulent Transfer Act (as adopted by California) which are effectively the same as the Bankruptcy Code provisions. *Calvert v Radford (In re Consol Meridian Funds)* 487 BR 263 stated "this Court is satisfied that *Donell* stands for the proposition that interest (the time value of the investor's money advanced to a Ponzi scheme operator) would not constitute "value" in the form of the satisfaction of an antecedent debt under Section 548(d)(2)(A)."

[159] The Court noted: "At the point at which the payments to Kowell exceeded the amount of Kowell's claim for restitution, Kowell was no longer a creditor of [the Ponzi promotor]. His initial, fraudulently obtained payment had been restored", at 775.

[160] *Donell v Kowell*, above n 156, at 772.

[161] For example, see *Blumenthal v Cronk (In re M & M Mktg L.L.C)* 2013 Bankr LEXIS 172; *Calvert v Brown (In re Consol Meridian Funds)* 2013 Bankr LEXIS 675 at [15].

has become widely accepted as the "orthodox and nearly unanimous" rule.[162] The rationale for the rule was described in *SEC v Credit Bancorp*: "recognising claims to profits from an illegal financial scheme is contrary to public policy because it serves to legitimate the scheme."[163] The net-loss approach remains more beneficial for those who withdrew more than their initial investment than those who did not by allowing those investors to retain up to their initial investment.[164]

It is largely settled that whichever way a clawback claim is framed in the US, the result will be that an investor can retain funds up to the amount of initial investment.[165] The others are treated as a class of creditors that share pro rata.[166] The next section will outline how New Zealand case law serves as an implicit acceptance of the US approach, before outlining the issues that this approach produces.

C **McIntosh v Fisk** *as Approval of the Orthodox US Approach*

The New Zealand approach to value is at least prima facie consistent with the US conclusion.[167] It is worth considering whether the reasoning is similar. In *McIntosh,* the Court bifurcated the payments into principal and fictitious profit to undertake a value analysis,[168] a hallmark of US Ponzi clawback law.

Both conceptions of 'value' include the discharge of antecedent debt.[169] Unlike the Bankruptcy Code, this is not provided for in the CA but has been interpreted by the New Zealand Supreme

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[162] Kull, above n 152, at 298. For an application, see *Sec. Investor Prot. Corp v Bernard L. Madoff Inv Sec LLC (In re Madoff Sec)* 476 BR 715.
[163] *SEC v Credit Bancorp* LEXIS 17171 (SD NY 2000) at 136-137.
[164] The Madoff liquidation, widely regarded as the most successful in terms of Ponzi claw-backs, has recovered around 70 cents in the dollar of investors' total principal investments ($13b US). This is considered to be "extraordinary and atypical" – with recoveries usually ranging from five to 30 cents in the dollar. See Bazoian Phelps and Rhodes, above n 8.
[165] The Supreme Court notes this in *McIntosh v Fisk* (SC), above n 9, at [224].
[166] Hanoch Dagan "Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred" 78 ABLJ 247 at 252.
[167] *McIntosh* (SC), above n 9, at [119].
[168] *Fisk v McIntosh* (HC), above n 88 at [77]-[78], *McIntosh* (CA), above n 101, at [44], *McIntosh* (SC), above n 9, at [127].
[169] Per statute in US law, above n 151; per *McIntosh* (SC), above n 9, at [84].

Court to include as much.[170] In *McIntosh* the majority expressed the position that how the Ponzi promotor uses the money does not impact the value provided.[171] What mattered was whether value was given in the sense to which it discharged a debt owed by the promotor.[172] Under the same principal, the profits above the principal investment "did not discharge his unquantified (and, indeed, unknown) claim against RAM."[173] This is because the amount of fictional profits was calculated based upon a fabricated foundation of non-existent securities.[174] In the US, *Donell v Kowell* looked to the economic exchange of the Ponzi scheme to find that: "Up to the amount that 'profit' payments return the innocent investor's initial outlay, these payments are settlements against the defrauded investor's restitution claim. Up to this amount, there is an exchange of "reasonably equivalent value" for the defrauded investor's outlay." [175] Receipt of fictitious profits do not discharge such debt. In *Sender v Buchanan* the rationale for this is helpfully summarised: "[promotor] had no debt to her for those amounts. The transfers could not have satisfied an antecedent debt."[176]

Both jurisdictions have heard arguments to the effect that one cannot in fact give 'value' to a scheme that is inherently fraudulent.[177] For example, "amounts above [the principal] are merely used to keep the fraud going by giving the false impression that the scheme is a profitable, legitimate business."[178] In the US these arguments tend to go towards the fact the pay-out of those fictitious profits do not discharge a debt owed, because any debt is illusory beyond the principal investment. When used in the context of the principal investment however, this argument has had very limited success.[179] Similarly, Miller J's approach that payment to a

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[170] *Allied Concrete*, above n 53.

[171] *McIntosh* (SC), above n 9, at [113]: "after receipt, the fact the recipient acts fraudulently in a way that destroys the value of what has been provided should not undermine the nature of the value given."

[172] At [100].

[173] At [128]

[174] At [124].

[175] *Donell v. Kowell*, above n 156, at 777.

[176] *Sender v Buchanan* (*In re Hedged-Investments Assocs*) 84 F 3d 1286 at 1290.

[177] These arguments are more rehearsed in the US due to the greater amount of Ponzi schemes. These arguments are focused on the fictitious profits and not the principal investment. For example, see *Merrill v Abbott* (In re *Independent Clearing House Co*.) 77 BR (D. Utah 1987) at 858. Also see *Noland v. Morefield* (In re *National Liquidators, Inc*.), 232 B.R. 915, 918-19 (Bankr. S.D. Ohio 1998); and *In re Taubman* 160 BR 964 (SD Ohio 1993) and 987.

[178] *Donell v. Kowell,* above n 156, at 777.

[179] Aside from three cases, see Spencer Winters "The Law of Ponzi Payouts" (2012) 111 Michigan LR 119.

promotor "creates no value but merely delays and worsens the inevitable ruin"[180] was emphatically rejected at the Supreme Court.[181] It is justifiable to conclude that the Supreme Court adopted an approach in line with the US approach to clawbacks. Critique of the US approach thus becomes important for the purposes of this paper.

D Return to Scenarios

To illustrate the operation of the net-loss approach, reconsider the scenarios from the Introduction. Recall that Investor A invested $500,000, and that upon liquidation 10 cents in the dollar is available for distribution.

In Scenario 1, where Investor A withdrew no money, Investor A will receive $50,000 in distributions.

In Scenario 2, where Investor A withdrew $450,000, Investor A will keep that $450,000 given it is less than the principal investment. Further, Investor A has a claim for the remaining $50,000, a claim which will be shared pro rata with other creditors. Based on the distribution rate of 10 cents in the dollar, Investor A will receive an additional $5,000 bringing their total distribution to $455,000.

In Scenario 3, where Investor A withdrew $900,000, Investor A will keep $500,000 given that was the total amount of principal investment. The promotor's debt to Investor A is deemed to have been satisfied in full. Investor A must return $400,000 for pro rata distribution amongst the company's creditors.

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[180] *McIntosh v Fisk* (CA), above n 101, at [107]. Although note that he was talking about the total sum (principal investment as well as the fictitious profits).
[181] At [113].

II Issues with the *Status Quo*

The statutory inclusion of antecedent debt as value means the US takes an expansive approach to value in avoidance claims. In applying this to Ponzi clawbacks, the ease with which courts find a principal investment constitutes value means that Ponzi investors who withdraw their money prior to the collapse of a scheme will always have a defence up to that amount. This has problematic consequences.

A An Arbitrary Distinction

Gabel notes that ultimately, "the time of their withdrawals separates the winners from the losers."[182] The net-loss approach lumps investors into categories of 'winner' and 'loser'. Indeed, many US cases and literature use this language.[183] One group has redeemed their funds, and the other has funded such redemption. This split between winner and loser is, in reality, a fiction. Rather, any party receiving more than what they would receive in liquidation is a winner. For example, consider Investor A in Scenario 2 of our 'return to scenarios'. While the net-loss approach considers this investor a 'loser' because they still have a claim in the liquidation up to the value of their principal, I suggest this person, is in reality, a winner. They have received more than they would receive in the liquidation.[184] After all, the purpose of voidable transactions is to protect creditors from debtor actions that cause "last-minute diminutions in the pool of assets" on the eve of bankruptcy.[185] Often, such transactions will be gratuitous. As such, the law steps in because disparity between value received and value surrendered will significantly harm innocent creditors.[186] Given avoidance is concerned with ensuring innocent creditors are not harmed by such transactions on the brink of liquidation, it seems unusual to protect those who have received more than they would otherwise in liquidation. While all investors that this paper is concerned with are innocent, it is those whose recovery is limited to the liquidator's distributions rate whom are the 'real losers'.

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182 Jessica Gabel "Midnight in the Garden of Good Faith: Using Clawback Actions to Harvest the Equitable Root of Bankrupt Ponzi Schemes" (2012) 62 Case Western Reserve Law Review 19 at 3.
183 See Bazoian Phelps and Rhodes, above n 8.
184 If for example the liquidators are distributing at a rate of ten cents in the dollar. See above n 167, for the what rate of return would generally be expected in Ponzi distributions.
185 Gabel above n 182, at 35.
186 At 35.

B All or Nothing Result

A hallmark of a Ponzi is that all investors are defrauded in the same manner.[187] Kull notes that the position of a repaid creditor is still, in essence, a defrauded creditor: "[they] occupy a dual role: he is simultaneously repaid creditor and fellow fraud victim."[188] He considers that courts are torn as to which light to view this person in – as a victim or creditor?[189] While this paper suggests that the net-loss rule's net winners are lucky, one must not forget they too were duped into parting with their money. All investors parted with funds, and all on the same basis – investment services. As such, whatever those investors provided (whether it be deemed value or not), was the same: "even the winners were defrauded, because their returns were illusory."[190] If someone who did not withdraw any funds before collapse had, in an alternate universe, withdrawn their funds the day prior to collapse, they would be entitled to the protection afforded by the net-loss rule. The central point is that the investors were in identical positions, but for a quirk of timing. Some have reduced this to an "unfortunate reality",[191] but that does not have to be the case.

Insolvency policy aims to treat similarly situated creditors equally.[192] Like creditors ought to be treated alike.[193] A primary concern is to ensure that assets are distributed fair and equally. Avoidance provisions operate to prevent payments that threaten pari passu (or proportionate) distribution upon liquidation.[194] The net-loss rule creates an all-or-nothing result for investors situated similarly. Where one victim will retain all of their principal investment, another will claim pro rata whatever cents in the dollar are being paid out in liquidation. Allowing all net-

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[187] Bazoian Phelps and Rhodes, above n 8.

[188] Kull, above n 148, at 232.

[189] Above n 188.

[190] *Donell v Kowell*, above n 156, at 779.

[191] John Fisk "Submission on discussion document: *A new regime for unravelling Ponzi schemes*" at [2]. Available at <https://fyi.org.nz/request/10357-submissions-to-the-discussion-paper-a-new-regime-for-unravelling-ponzi-schemes>.

[192] Paul Heath and Michael Whale *Heath and Whale on Insolvency* (online ed, LexisNexis) at [20.37]; Law Reform Division, Department of Justice *"Insolvency Law Reform: A Discussion Paper"* (1988) at 94.

[193] See Barry Allan "Securities" in A-*Z of New Zealand Law – Commercial Law* (online looseleaf ed, Thompson Reuters) at [14.S.17.1]: "Right from the time of Roman law the preferred option has been to collectivise the claims of creditors with like claims, in the sense that all such creditors are treated as a group. They sacrifice their individual rights of action and, in exchange, whatever assets the debtor may have will be seized, often by an independent public official."

[194] Richard Gordon and Ashley Kirk *Morison's Company Law (NZ)* (online ed, LexisNexis) at [63.2].

winners to retain principal and net-losers to retain anything short of principal inevitably lessens the pool for distribution amongst those who were not so lucky –the 'real losers'. It is evident that allowing recovery up to the principal amount generates a priority to some investors. Where this 'all-or-nothing' result falls is purely a result of timing.

III Conclusion

The New Zealand approach to Ponzi clawbacks is a replica of the orthodox US net-loss approach. Both jurisdictions justify this approach on the basis of antecedent debt. Despite being "entrenched in commonwealth law",[195] I have suggested the net-loss rule draws an arbitrary line where an investor has received their initial contribution, in order to determine whether an investor is a winner or loser. This line is drawn in a place inconsistent with the policy of avoidance in insolvency law. Moreover, it gives a priority to only some of a group of creditors in broadly identical positions. Yet, New Zealand's adoption of the US approach has neglected criticism that insolvency legislation may not be the most appropriate mechanism to deal with Ponzi clawbacks. Chapter Three asserts that voidable transaction provisions are inadequate to facilitate these clawbacks because the relevant claims and defences are restitutionary in nature.

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[195] *Re Fisk* [2018] NZHC 2007 at [143].

CHAPTER THREE: RECONSIDERING USE OF THE VOIDABLE TRANSACTION REGIME

I Why the Voidable Transaction Regime?

It is without surprise that payments to Ponzi investors are treated as voidable transactions. An object of corporate insolvency is to provide a legal mechanism to address creditors' outstanding claims,[196] and "to provide straightforward and fair procedures for realising and distributing the assets of insolvent companies."[197] The Act is intended to apply equally to all insolvency cases, and Ponzis are a case of insolvency. Within the voidable transaction regime, the concept of a 'transaction' is of wide capture and includes transfers of company property, paying money, incurring obligations and any act or omission for the purpose of either entering a transaction or giving effect to it.[198] It is not defined outside this section of the Act. In its purest form, placing funds in a Ponzi is an ordinary commercial transaction. So too is the receipt of funds from a Ponzi. The Court in *McIntosh* accepted that investors were debtors in RAM's insolvency. Yet, use of the equivalent statute in the US has received criticism. Some view restitutionary theory as underlying clawback claims. On this view, use of statutory insolvency provisions neglects to give effect to the principles underlying these claims. This criticism could too be applied to use of the CA to clawback Ponzi funds in New Zealand.

II The Principles Underlying Clawback Claims

Working within the statutory framework of insolvency means the potential that the law of restitution has to contribute to the understanding of claims between Ponzi victims has been overlooked. One conception of claims between victims – the so-called 'net-winners' and 'net-losers' – or between victims and the promotor is that they are restitutionary in nature.[199] The

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[196] MBIE, above n 46, at [140].

[197] Companies Act, preamble (e).

[198] Allan, above n 193, at [14.S.17.8.01].

[199] Andrew Kull "Common Law Restitution and the Madoff Liquidation" (2012) 92(3) BLR 939 at 944. Kull notes "SIPA was drafted against a common law background: restitution, not bankruptcy, is ultimately the source of the key provision by which a SIPA trustee is authorised to recover customer property from subsequent transferees." Note that SIPA is the Securities Investor Protection Act 1970. The design of a SIPA liquidation borrows relevant provisions of the Bankruptcy Code, which govern it "[t]o the extent consistent with the provisions of this chapter," and jurisdiction over a SIPA liquidation held by the bankruptcy court.

US *Restatement (Third) of Restitution and Unjust Enrichment* ("R3RUE") observes that claims and defences in the clawback context have their source in the law of restitution.[200] Clawbacks operate to retrieve company property disposed of two years prior to insolvency. This is for the benefit of the collective creditors – mainly comprised of those who withdrew less than their principal investment prior to collapse. Accordingly, clawback claims determine how rights and claims in funds disposed of during this time are allocated.[201] In the Ponzi context, these are allocated between victims of a common fraud. The law of restitution is well equipped to deal with relationships between victims of a common fraud; 'winners' and 'losers' as such, and can help explain what these rights may be, and who can assert and rebut them. Through this lens, it is clear that the relevant claims and defences between victims have their origins in common law restitutionary principles.

In the US and New Zealand, common-law consensual transaction focused restitution operates to produce the same orthodox answer as provided by the net-loss method.[202] Under R3RUE, someone deprived of money via fraud has a prima facie entitlement to restitution for recovery from the initial recipient (the promotor), and any subsequent transferees[203] subject to affirmative defenses. If the money of multiple victims has been commingled, restitution recognises a claim to recover the commingled fund on behalf of the victims jointly whereby they will share funds rateably. Essentially, a victim can follow her funds (if possible) and recover them, until it comes into the hands of an innocent purchaser for value who will take it free.[204] Alternatively, per § 67 of R3RUE, a 'payee' takes the payment free of a restitution claim, to the extent that the payee's receipt of funds reduces the amount of the payee's inchoate claim in restitution.[205] As Kull notes, "the defining issue in the case involves a restitution claim asserted either by or on behalf of one fraud victim against another" to retake their identifiable

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[200] American Law Institute *Restatement (Third) of the Law of Restitution* (American Law Institute Publishers, St Paul (Minnesota), 2011) (R3RUE) at 581. See Illustrations 17-18.
[201] Andrew Kull, above n 199, at 940.
[202] Kull, above n 152, at 250.
[203] R3RUE, above n 200, at § 59.
[204] At § 58(2).
[205]At §67(1)(c). The R3RUE makes it clear that this is directed towards victims of successive fraud. See Illustrations 16 and 17 of §67(1)(c): "The most notable applications of § 67(1)(c) concern the ostensible proceeds or profits of fraudulent investment schemes involving multiple victims."

property.[206] To illustrate, imagine an early investor invested $200,000 withdrew $150,000 prior to collapse. The claim in restitution for that $200,000 against the promotor is reduced by the $150,000 already received. There remains a claim in restitution for the additional $50,000 but given the promotor's insolvency it is likely the investor will share pro rata with the other creditors. If the investor had instead withdrawn $250,000, the § 67 defence would operate reduce the inchoate claim of $200,000 for that amount, the remaining $50,000 is owed to the other creditors for distribution.[207] Regarding the alternate statutory defence, the American Law Institute recognised a restitutionary change of position defence at common law before its codification in the Bankruptcy Code.[208]

New Zealand's common law, consensual transaction focused law of restitution also specifically deals with one's funds coming into the hands of another. The common law recognises a claim for money had and received against a recipient who has received property from a third party that belongs to the plaintiff.[209] Glover considers a claim between a fraud victim and third party recipient is distributive justice in operation.[210] Such a claim is typically personal, and requires proof of receipt.[211] A proprietary claim can be made but recovery is barred if the property is not identifiable.[212] The plaintiff's money cannot be traced at common law if it ceases to be identifiable by being mixed with other money derived from elsewhere.[213] Even in the situation where money is identifiable, a recipient who provided value takes this free.[214] This value defence is echoed in the CA.[215] Additionally, the CA change of position defence is reminiscent of the restitutionary defence set out in statute: "has so *altered his position* in *reliance on the validity*

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[206] Kull, above n 199, at 947.

[207] For example, see *Eby v Ashley* 1 F 2d 971 (4th Cir 1924). The court imposed liability in restitution for distributions received from a net-winner to the extent they exceeded that net-winner's investment.

[208] American Law Institute *Restatement of the Law of Restitution: Quasi Contracts and Constructive Trusts* (St Paul, Minnesota, 1936). The Bankruptcy Code was enacted in 1978 by § 101 of the Bankruptcy Reform Act 1978.

[209] *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218 (HC).

[210] John Glover *Equity, Restitution & Fraud* (LexisNexis Butterworths, Sydney, 2004) at 7.16.

[211] Peter Twist *Laws of New Zealand* Restitution (online ed) at [2].

[212] See Marcus Pawson *Laws of New Zealand* Restitution (online ed) at [69].

[213] Pawson, above n 212, at [70].

[214] The nemo dat principle is replaced in favour of a rule that the recipient's title to money is not dependent on the title of the transferor. See Ross Grantham and Charles Rickett *Enrichment and Restitution in New Zealand* (Hart Publishing, Oxford, 2000) at 321.

[215] Section 296(3)(c).

of the payment that in the opinion of the Court … it is inequitable to grant relief."[216] Both require reliance on the "validity of the transfer."[217] Further, the CA defence does not mention inequity,[218] or balancing relative equities or responsibility.[219] This is likely given the objective, effects-based nature of the CA. On this basis, we can say the CA has modified the restitutionary defence to fit the statutory scheme.

III Same, But Different

As illustrated, common-law consensual transaction focused restitution generally produces the same result as application of the net-loss method to avoidance legislation. This is because Ponzi property will seldom be identifiable. Even where it is, value defences ensure that so long as the recipient is also a victim of the fraud (and not a third party, such as the recipient of a gift), the result remains the same because restitution measures the claim against the promotor by the extent of the promotor's enrichment at the expense of the victim. In the US this is achieved via § 67, and in New Zealand through antecedent debt operating as value at common law. While the statutory scheme generates the same outcome, it fails to consider who has been enriched and at whose expense – yet, that is the very question that Ponzi clawbacks ask. Given the relevant claims are at their core restitutionary, it is important to consider the Ponzi situation through a restitutionary lens. Taking a restitutionary approach provides two findings. First, that the transfer into a Ponzi is defective. Secondly, that the investor is best characterised as beneficiary, and not debtor.

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[216] PLA, s 74B. Compare Judicature Act 1908 s 94B.

[217] *McIntosh* (SC), above n 9, at [137].

[218] Compare PLA, s 74 B: "… that in the opinion of the court, having regard to all possible implications in respect of other persons, it is inequitable to grant relief."

[219] *Thomas v Houston Corbett & Co* [1969] NZLR 151 (CA) placed this gloss on s 94B at 165 per North P. Relative fault and inequities was also accepted as being part of the common law defence set out in *Lipkin Gorman (a firm) v Karpnale Ltd* [1991] 2 AC 548 (HL) at 479 and approved in *National Bank of New Zealand v Waitaki International Processing (NI) Ltd* [1999] 2 NZLR 211 (CA) at 228.

IV Restitutionary Theory

A Nature of the Transaction

There are various sources of unjust enrichment in New Zealand. A failure in consideration[220] has long been recognised as one.[221] It operates as a claim for money had and received based on the concept of unjust enrichment, to say that the plaintiff's consent to the transaction is defective because the thing expected in return did not materialise.[222] A classic example is provided by *Rowland v Divall*.[223] A purchaser of a car discovered after four months of use that the seller had no title to it, and the true owner reclaimed it.[224] It was found the transfer was conditional on good title being received. Viewing an investor's deposit into the hands of a Ponzi entity through the lens of restitutionary theory proves that transaction to be defective on a similar basis. It could be framed in the following way: it would be unjust for the money to be retained by the Ponzi promotor because the transfer was conditional on the money being invested, or perhaps that it would *not* be misappropriated. This condition could never be met. The investment would never materialise as the promotor could never carry out the promise of investment. Of course, the money has been misappropriated at this point and is quite frankly, long gone.

1 Basis of the transfer

For consideration to fail, the basis or condition of a transfer of money must be jointly understood by both parties.[225] This is assessed objectively. The uncommunicated intentions and thoughts of the promotor (such as fraudulent intent) are irrelevant. Where there is a written agreement between promotor and investor there will be no trouble assessing the basis,

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[220] In the unjust enrichment context, 'consideration' is not referring to the promises exchanged in a contract but rather the *performance* of those promises. Thus, it is not the failed quid pro quo that is the unjust factor but the failure of the contract, which is the very basis for the transaction. *See* P Twist, J Palmer and Marcus Pawson *Laws of New Zealand* Restitution (online ed) at [45], citing *Fibrosa Spolka Akcyjina v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 at 48: "'Consideration' here refers to the performance expected by the claimant and does not bear its technical contractual meaning."

[221] P Twist, J Palmer and Marcus Pawson *Laws of New Zealand* Restitution (online ed) at [44], citing *Moses v Macferlan* (1760) 97 ER 676. Also see Grantham and Rickett, above n 214, at 148.

[222] Grantham and Rickett, above n 214, at 152.

[223] *Rowland v Divall* [1923] 2 KB 500.

[224] Above n 223.

[225] Lord Goff and Gareth Jones *The Law of Restitution* (3rd ed, Sweet & Maxwell, London, 1986) at [13-02].

which will generally be to stipulate an investment management agreement whereby the promotor invests on behalf of the investor. In fact, the objective approach to assess basis is noted as being very similar to construing a contract.[226]

The basis for a transfer to a promotor will generally be the provision of legitimate investment services and nothing else. The essence of investment services is a joint understanding between promotor and investor that money will be invested on behalf of the investor.[227] In other words, the consent of the investor can be explained as qualified, on the basis that legitimate investment services be provided. Indeed, this was the case with the contract between McIntosh and RAM, yet the qualification need not be express. Returning to *Rowland v Divall,* there was nothing to suggest the buyer had indicated the sale was conditional on receiving good title. It was found the basis for the payment was the receipt of good title because it was such a fundamental feature of the sale of goods.[228] It is an equally fundamental feature of investment services that funds are actually invested.

2 *Total failure of consideration*

A valid contract does not preclude a total failure of consideration.[229] From the moment an investment scheme becomes a Ponzi, its demise is imminent. The promotor cannot perform the legitimate investment services that were the basis for the transfer, given that any new funds are used to pay earlier investors cashing out. A total failure of consideration can explain cases where performance of what was bargained for becomes inevitably impossible. *Neste Oy v Lloyds Bank* involved five payments made in advance under contract, but the services were not performed.[230] In between the fourth and fifth payments, the parent company resolved to cease trading. It was found that at the time the last payment was made consideration was bound to

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[226] Goff and Jones, above n 225, at [13-04].
[227] At [13-06].
[228] Above n 227.
[229] Peter Birks *Unjust Enrichment* (2nd ed, Oxford University Press, New York, 2005) at 123. Contracts between an investor and Ponzi promotor cannot be illegal contracts for they merely stipulate a legal investment management relationship. Performance of the contract is accordingly legal. While the fraudulent acts of a Ponzi promotor are illegal, the fraud does not render the actual governing contract illegal. See Contract and Commercial Law Act 2017 (CCLA), s 71(1).
[230] *Neste Oy v Lloyds Bank* [1983] 2 Lloyd's Rep 658.

have failed –it was inevitable that the defendant company would too cease trading. It was impossible for the agent to perform its side of the bargain. This talk of inevitability lends itself to the Ponzi context and the undeniable reality that the promotor cannot perform the investment services bargained for. As such, from the point an investment scheme is a Ponzi, every transfer for the purposes of investment is bound to be defective.

All transfers of funds into Ponzis for investment purposes must be defective. A potential response to this is that consideration must fail totally.[231] The plaintiff must be able to show that she received none of the benefits stipulated as the basis for the transfer of the enrichment.[232] Yet, if the benefit received does not form part of what was understood to be given for the payment, the claim for total failure of basis remains intact.[233] Enjoyment and use of the car was immaterial in *Rowland v Divall* because legal title was not received. The sale contract was construed as only stipulating for the provision of good, non-defective title. The Ponzi situation provides the consummate application of this principle. On the face of it, the investors who receive some of, all of, or even more than their initial investment from the promotor have received a clear benefit in return for the payment. Yet, these benefits are not from legitimate investment; rather from the misappropriation of others' funds. It was the agreement for legitimate investment services that was the basis of the transfer. Wilmot-Smith observes the value of the total failure rule as being to ensure restitution is only granted where truly justified. The closer the claimant's position is to the one that she anticipated, the weaker the reasons for restitution.[234] On this view, the Ponzi situation justifies restitution: the claimant has become a creditor – something never anticipated.

B Implication

A total failure of consideration, or defective transaction, confers a right to restoration. A right to restore is essentially used to express the reason for the law's imposition of the restitutionary

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231 Birks, above n 229 at 125; and Grantham and Rickett, above n 214, at 157.

232 Grantham and Rickett, above n 214, at 157.

233 Charles Mitchell, Paul Mitchell and Stephen Waterson (eds) *Goff and Jones: The Law of Unjust Enrichment* (9th ed, Sweet & Maxwell, London, 2016) at [12-24].

234 Frederick Wilmot-Smith "Reconsidering 'Total' Failure" (2013) 72(2) CLJ 414 at 430.

obligation.[235] In respect of claims based on the principle of unjust enrichment, the presumptive remedy is a personal monetary remedy.[236] This is no different to the remedy that *McIntosh v Fisk* noted investors were entitled to as beneficiaries for breach of trust. A personal remedy will not survive insolvency,[237] an inevitable outcome of all Ponzis. The investor would only be able to prove in the insolvency for the amount initially invested with other unsecured creditors for pari passu distribution. Perhaps more importantly, it means that distributions already made to investors up to the value of their principal investments are safe in their hands.

V Conclusion

Liquidators have emphasised the value of rules that are clear in application.[238] If the essence of disputes between Ponzi investors is enrichment at another's expense, it is equally important that the law of restitution, as the area of law that best explains these relationships, is utilised. This chapter has employed common law, consensual transaction focused restitutionary theory to suggest the initial payment into a Ponzi scheme should be properly regarded as a defective transaction. The following chapter sets out the theoretical and practical implications of such a finding, ultimately concluding that a purely statutory approach is inadequate in the Ponzi context.

[235] Grantham and Rickett, above n 214, at 58.
[236] Grantham and Rickett, above n 214, at 397.
[237] The investor would only be able to prove in the insolvency with other unsecured creditors.
[238] Fisk, above n 191, at [95c].

CHAPTER FOUR: EXPLORING AN ALTERNATIVE APPROACH

I The Evolution of Restitutionary Theory

So far, we have seen that restitutionary theory underpins clawback claims. Despite noting the claims accrued against RAM were restitutionary, restitutionary theory was not employed further in *McIntosh*. Closer analysis of restitutionary theory reveals that the initial transfer into a Ponzi is a defective transaction. The implication of this will become apparent later in this chapter. We can take this restitutionary analysis further to show that the true characterisation of a Ponzi investor is as a beneficiary, and not as a creditor. This is because restitution, as the underlying principle, has evolved.

In New Zealand's commercial context in particular, the historical distinction between common law and equity is becoming increasingly eroded. In 1993, Maxton considered the fusion of various equitable and common law actions to be underway.[239] Extrajudicially, Andrew Tipping later echoed this sentiment.[240] The range of actions available in restitution are animated by an underpinning concept of unjust enrichment, affecting and even merging a range of formerly individual actions, with an increasingly equitable approach to remedies. Common law restitutionary bases of claim are matched with equitable defences such as change of position,[241] and remedies such as a remedial constructive trust,[242] whereby courts have the capacity to utilise their discretion. There is increasing coalescence between the two sources of law, and in turn, judicial willingness to use principles of unjust enrichment and common law restitution in deciding equitable matters. For example, when considering the imposition of a constructive trust, Cooke P noted that it "normally makes no difference in the result whether one talks of constructive trust or unjust enrichment, imputed common intention or estoppel."[243] Tappenden summarises how aspects of New Zealand's common law restitution are equity

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[239] Julie Maxton "Some Effects of the Intermingling of Common Law and Equity" (1993) 5 Canter LR 299 at 299.

[240] Andrew Tipping "Causation at Law and in Equity- Do we have fusion?" (2000) 7 Canter L R 443.

[241] For example, see *National Bank of New Zealand v Waitaki International Processing*, above n 219.

[242] For example, see *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 (HC)..

[243] *Gillies v Keogh* (1989) 2 NZLR 327 (CA).

sourced, speaking of the use of "broad equitable principles that are being developed under the banner of the law of restitution, those of unjust enrichment" in applying equitable remedies.[244]

Developments in this equity sourced law of restitution have considered unjust enrichment, while not a cause of action, the unifying legal concept "at the heart" of equitable remedies.[245] Unjust enrichment helps mark out the defences to claims in restitution and can explain the imposition of various remedies. As such, while claims between parties in a Ponzi are at their core restitutionary, this restitution has evolved to incorporate equitable principles.

This chapter uses this modern restitutionary theory to suggest that even if an express trust does not exist from the outset, a remedial constructive trust ought to be imposed to remedy the defective transaction. In practice, this would grant the investor an equitable proprietary interest in their initial investment. Second, the more orthodox situation where the funds are held on trust initially for the purposes of investment will be considered. In this case, a resulting trust arises to result the beneficial interest in the misappropriated trust property back to the investor. Either way, the inescapable conclusion remains that the investor is most accurately characterised as a beneficiary. This will have implications on recovery and distribution of funds. Most crucially, that distribution ought to be done on an equitable rather than statutory basis. To claim that Ponzi investors are truly described as beneficiaries holding a proprietary interest in their investments, it must be shown that this interest arises regardless of the position they are in from the outset. Henceforth is an explanation of two potential situations that a Ponzi investor could find themselves in.

II Starting Point

A Investor Places Money in Express Trust

Often Ponzi investors are beneficiaries of an express trust. This was the case in *McIntosh v Fisk*. Recall that the RAM investment agreement stated that funds would be held on an express

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[244] Sue Tappenden "The Emergence of the Concept of Unjust Enrichment in New Zealand, Its Relationship to the Remedial Constructive Trust and the Development of the Status of Joint Ventures in Equity" (2008) 1(3) Journal of Politics and Law 32 at 39.

[245] *Equiticorp Industries v The Crown* (No 47) [1998] 2 NZLR 481 at 710 citing *Woolwich Equitable Building Society v Inland Revenue Comrs* [1993] AC 70, CA at 196-197 per Lord Browne-Wilkinson.

trust, with RAM as legal owner and McIntosh as beneficiary. The Court accepted the investors had accrued claims in restitution for breach of that trust, and that these claims were debts owed by RAM. This led the Court to ardently focus on the status of investors as creditors, and RAM as debtor. Given the Court accepted the breach of trust meant investors accrued a personal restitutionary claim, RAM investors occupied a dual position as both creditor and beneficiary. The fact the liquidator's claim was framed under the CA meant it was simple for the Court to treat the claim as creditor as the primary claim the investor held. This comfortably lent itself to the operation of the CA insolvency provisions. It indicates that the claim as debtor was treated as the most important claim the investor had.

B No Existing Proprietary Interest

In less sophisticated situations, the investment management agreement may not stipulate that the funds for investment be held on trust for the benefit of the investor. Nevertheless, an express trust could be deemed to exist if it is possible to assess that the parties' intention was that the funds would not be at the free disposal of the promotor.[246] However, the objective assessment of this intention will turn on what was agreed by the parties.[247] The situation where an investor does not hold a beneficial interest in their principal investment from the point of investment will also be evaluated.

III Ponzi Investor as Beneficiary

A Remedial Constructive Trust

Unjust enrichment is accepted as the rationale for a number of restitutionary claims, both at common law and at equity.[248] For example, a claim in money had and received, as to remedy a defective transaction, is founded on principles of unjust enrichment.[249] While personal restitutionary remedies for such a claim are by far the most common, certain circumstances demand proprietary restitution responds. Instead of revesting rights in property retained by defendant (such as through rescission or rectification), the rights in property retained by the

[246] Graham Virgo *The Principles of Equity and Trusts* (Oxford University Press, Oxford, 2012) at 271.
[247] Virgo, above n 246, at 81.
[248] Twist, above n 211, at [4].
[249] Grantham and Rickett, above n 214, at 146-157.

defendant may sometimes be made the subject-matter of a trust.[250] Burrows considers that the imposition of that trust "is restitutionary and, on the best analysis, reverses the unjust enrichment of the defendant."[251]

A remedial constructive trust (RCT) could arise in response to the defective transaction in situations where the investment funds are not held on trust from the outset. Operation of the RCT would be to say that instead of validating the transaction to remedy its defect, the Ponzi context demands a proprietary remedy instead. Investors would thus be the beneficiaries of many distinct but identical RCTs. The RCT is a remarkable development in trust law that can respond to a personal claim.[252] It is considered a "restitutionary remedy in equity."[253] Like other remedies in equity, its use is discretionary,[254] and its application is flexible and diverse. Burrows' *Restatement of the English Law of Unjust Enrichment* considers that if the benefit obtained is a right in property retained by the defendant, the claimant has a right (as a remedy) to be a beneficiary of that right in property under a trust imposed by law.[255] The RCT requires judicial discretion to first establish that right in property. This is a departure from institutional constructive trusts as envisaged in that *Restatement*, whereby existing property rights are conceived as being retrospectively recognised or declared.[256]

1 *Availability*

While the RCT initially arose in property disputes between de facto couples,[257] this dissertation is concerned with the extension of its use to commercial transactions. In *Chase Manhattan NA v Israel-British Bank (London) Ltd* Goulding J held that a mistaken double payment generated

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250 Andrew Burrows *A Restatement of the English Law of Unjust Enrichment* (Oxford University Press, Oxford, 2012).
251 Burrows, above n 250, at 162.
252 Grantham and Rickett, above n 214, at 405. Note that such equitable discretion is not recognised at English law. See Goff and Jones, above n 225, at [38-17].
253 Twist, above n 211 at [4].
254 Grantham and Rickett, above n 214, at 405.
255 Burrows, above n 250, at s 35(1)(d).
256 Extrajudicially, Lord Neuberger noted "the notion of a remedial constructive trust displays equity at its flexible flabby worst": Lord Neuberger "The Remedial Constructive Trust – Fact or Fiction" (speech to the Banking Services and Finance Law Association Conference New Zealand, 10 August 2014).
257 David Wright "The Remedial Constructive Trust" (Butterworths, Australia, 1998) notes that some view the remedial constructive trust as only appropriate in the familial setting, at [1.14].

equitable proprietary rights (which could be realised if the money was identifiable).[258] Although the Court attempted to justify this on the basis of a fiduciary relationship, it is widely accepted that the true basis for the RCT was the mistaken payment.[259] As such, it represented a development in English law that the constructive trust could respond as a proprietary remedy to a personal claim founded in unjust enrichment – the mistaken payment is widely heralded as the classic case of enrichment.[260] This lead to Chase Manhattan standing in priority over other creditors. On a better view, *Chase Manhattan* is a case where an RCT responded to remedy a defective transaction. Claims on the basis of a mistaken payment and on the basis of failed consideration are both based on intention being conditional.[261] In *Chase Manhattan*, the condition that money was still owed was accepted as true, even though it turned out not to be. This is the essence of a mistaken payment. Yet, consideration could have failed for this payment. On this view, the payment was conditional on a joint intention that only what was due would be paid. Once this was paid, consideration was bound to fail for anything above this.

RCTs are available in a commercial context in New Zealand[262] and courts have indicated a preparedness to impose the remedy as a response to a personal claim based upon unjust enrichment within this commercial context. To illustrate, *Neste Oy v Lloyds Bank* was approved in *Elders Pastoral Ltd v Bank of New Zealand* in a commercial context.[263] *Neste Oy* can be rightly understood as confirming that an RCT can respond to a defective transaction. As noted, the payee became a trustee because at the time of payment it was already certain that the service bargained for would not be rendered. There was an equitable flavour throughout the judgment, with the Court noting that the money could not be retained "in good conscience."[264] The

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258 *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch. 105.

259 Wright, above n 257, at 52.

260 Grantham and Rickett, above n 214, at 5.

261 Duncan Sheehan "Mistake, Failure of Consideration and the Planning Theory of Intention" (2015) 28(1) Canadian Journal of Jurisprudence (2015) 155 at 156. Sheehan notes the difference is that while mistaken claims are based on conditional individual intention, failure of consideration claims are based on conditions affecting collective intention.

262 *Regal Castings Limited v Lightbody* [2008] NZSC 87, [2009] 2 NZLR 433 at [162]. Also see *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180 (CA); *Liggett v Kensington* [1993] 1 NZLR 257 (CA) where Gault and McKay JJ considered the remedy available) and this was not doubted on appeal: *Re Goldcorp Exchange Ltd (in rec)* [1994] NZLR 358 (PC).

263 *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180 at 186.

264 Above n 230, at 666 per Bingham J.

Court did not purport to be relying on a fiduciary relationship, but rather the total failure of consideration.[265] The essence of the imposition of the RCT can be best explained as remedying the defective transaction, as Neste Oy's consent to the transaction was qualified to exist only on the basis that the services would be rendered. More recently, *Commonwealth Reserves I v Chodar*, which dealt with a scheme that could comfortably be described as a Ponzi,[266] granted an RCT on the basis of unjust enrichment.[267] In imposing the trust, Glazebrook J noted there must be a principled basis for such a trust; it can be triggered either by unjust enrichment or unconscionability. [268]

2 *Application to Ponzi context*

The Court of Appeal has emphasised caution is required with the RCT to ensure that it does not subvert other recognised principles or priorities.[269] There must be a reason for displacing the presumptive personal monetary remedy in favour of a remedy with proprietary effect.[270] It is not enough to say that the personal remedy is worthless to the Ponzi victim.[271] Scott notes that sometimes the requisite policy arguments will be provided by restitutionary theory.[272] For example; as illustrated above in *Chodar* where unjust enrichment was the justification,[273] *Chase Manhattan* on the basis of a mistaken payment or defective transaction, and *Neste Oy* on the basis of a defective transaction. In the Ponzi context, the central rationale behind the

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265 The fiduciary relationship has long been regarded a prerequisite to the imposition of a constructive trust. See *Re Diplock* [1948] Ch 45 (CA).

266 The defendants had misappropriated money provided by plaintiffs which they had represented would be invested in shares in US oil and gas companies.

267 *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 (HC).

268 Unconscionability has been criticised as a basis for the imposition of a remedial constructive trust, see Jessica Palmer "Attempting Clarification of Constructive Trusts" (2010) 24 NZULR 113.

269 *Fortex Group Ltd (in receivership and liq) v MacIntosh* [1998] 3 NZLR 171 (CA) at 172-173.

270 Grantham and Rickett, above n 214, note that establishing a cause of action goes no further than justifying a personal remedy, and that something else must be shown at 415-416.

271 Grantham and Rickett, above n 214, point to the exact example of becoming an unsecured creditor in insolvency being insufficient, at 416.

272 S R Scott "The Constructive Trust and the Recovery of Advance Payments: *Neste Oy v Lloyds Bank Plc*" (1991) 14 NZULR 375 at 402.

273 This case has received criticism on the basis that Glazebrook J did not suggest which unjust factor justified liability. While it would have been preferable if Glazebrook J had elaborated on this, it is submitted that this is not an argument the present paper can engage with, given this paper is more concerned with the finding that in principle unjust enrichment can justify a remedial constructive trust. See Jessica Palmer "Attempting Clarification of Constructive Trusts" (2010) 24 NZULR 113 at 127.

imposition of an RCT is the defective transaction. There are other justifications lurking beyond the failure of consideration. Grantham and Rickett consider factors from the "wider factual matrix" of the case to be relevant, beyond matters directly relevant to establishing the cause of action.[274]

The first relevant factor is the interest of third parties.[275] This factor was relevant to the courts in both *Fortex Group* and *Chodar*.[276] There are many third parties, but almost all would be in the identical position as the claimant in having invested unknowingly in a Ponzi. Crucially, this is distinct from *Neste Oy* whereby one creditor received a windfall at the expense of the rest,[277] thus presenting a stronger case for an RCT in the Ponzi context. Granting a Ponzi victim a proprietary interest in trust property will elevate their priority in liquidation and potentially impact the few non-'investor' creditors of the promotor. Yet uniquely, in a Ponzi, by far the largest group within the creditors will be the investors. These investors form a distinct class and ought to have their own distinct proprietary claim over their initial investment. Returning to *Chodar*, Glazebrook J commented that proprietary relief may not be appropriate where (amongst others) "the interests of third parties [creditors] would be prejudiced by a proprietary remedy, particularly if those third parties are in a *substantially similar position* to the plaintiff."[278] A proprietary remedy may actually result in the inverse: where third parties, all in a substantially similar position, land in equal positions. For many, this position would be better than without the imposition of a RCT.

Denial of an RCT would be contrary to the presumed intention of this distinct class of investors as to the recovery of funds. *Barlow Clowes* also concerned a fraudulent investment scheme.[279] It was found it would be nonsensical if those who invested the earliest had the least prospect of recovery, given that all creditors were common victims of the same fraud.[280] This would amount to giving effect to a quirk of timing. It was presumed the investors would not

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[274] Grantham and Rickett, above n 214, at 415.
[275] Above n 274, at 415.
[276] *Fortex*, above n 269, at 181; *Chodar*, above n 267, at [47]-[48].
[277] See *Scott*, above n 272, at 399.
[278] Above n 267, at [47]-[48] (emphasis added).
[279] *Barlow Clowes International Ltd (in Liquidation) v Vaughan* [1992] 4 All ER 22, CA.
[280] *Barlow Clowes,* above n 279, at 45f-45g.

have intended that recovery turn on timing.[281] The net-loss approach to Ponzi clawbacks turns on a similar quirk of timing, whereby those out the earliest have the greatest prospect of recovery. The *Barlow Clowes* investors did not intend that their funds be held on trust, yet it was accepted that "the assets and moneys in question are trust moneys held on trust for all or some of the would-be investors who paid moneys … for investment."[282] This included those funds had not yet been invested.[283] On this basis it is possible to presume the intention of Ponzi investors, as victims of a common fraud, would be that timing would not impact recovery.

Second, is there a presence of some common intention that the plaintiff would have an interest in the property? It is difficult to imagine a situation more pertinent than the Ponzi context. *Fortex Group Ltd v MacIntosh*, in accepting the existence of the RCT in an insolvency context, stressed the importance of context. In a Ponzi, while legal title often passes to the promotor, the joint expectation remains that the funds are held on behalf of the investor. Tied closely to common intention in the present context is the notion of an acceptance of risk.[284] Crucially, Scott notes that if the plaintiff paid money to the defendant for a specific purpose, it cannot be said that she voluntarily assumed the position of general creditor.[285] Ponzi victims pay the promotor specifically for the purpose of investment. Whilst they take on the risk that their investments will generate either winnings or losses, they do not accept the risk that their funds would not be invested at all. Investors do not voluntarily assume the position of creditor as against the promotor.[286] The Supreme Court accepted that the parties in *McIntosh* did not intend a debtor-creditor relationship.[287] This is to be contrasted with *Neste Oy* whereby the claimant took no precaution against the debtor becoming insolvent. This has been a

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[281] At 45h.
[282] At 25g.
[283] At 45j.
[284] Such as that advanced by Goff and Jones, above n 225; also noted by Glazebrook J in *Chodar*, above n 267, at [47]-[48].
[285] Scott, above n 272, at 389.
[286] Underlying some courts' reluctance to impose an RCT is that the law should not afford a proprietary remedy to a claimant who voluntarily ran the risk of the defendant's insolvency. For example, in *Liggett v Kensington* (HC) M 1450/88, 17/10/1990 these concerns were expressed by Thorp J. These concerns are particularly prevalent in England & Wales.
[287] At [16].

fundamental critique of the Court's rationale in imposing the RCT.[288] On the constructive trust approach, the funds are not debtor property but trust property. To grant an RCT in this context is not akin to reordering priorities between creditors, nor giving one creditor a windfall. Rather, it levels the playing field between claimants who truly ought to be categorised as beneficiaries.

Neste Oy has recently been overruled in England.[289] This is without surprise after much academic and judicial hostility towards the remedy in the context of a commercial party paying funds in advance to obtain certain benefits.[290] This should not however dampen New Zealand's efforts where context and policy not only justify but demand such a remedy. Moreover, Virgo considers that in New Zealand "the principled approach to the operation of the remedial constructive trust is most apparent."[291]

B Resulting Trust

In the situation where investment funds are held on an express trust from the outset, such as in RAM, there is no need for a proprietary remedy to respond to the defective transaction. The beneficial interest already exists. It must be returned to the investor, as settlor of the express trust. The resulting trust is a restitutionary remedy in equity. Birks considered the resulting trust "a concealed synonym of restitutionary",[292] where restitution is recovery of a defendant's gain (an enrichment) received or its value in money.[293] It has the effect of requiring one party give up an enrichment at another's expense. A resulting trust can arise on the basis that the purpose for which the trust was constituted failed.[294] Where money is paid for a particular purpose, and that purpose does not eventuate, that money is held on a resulting

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[288] See Scott, above n 272.

[289] *Re D&D Wines International Ltd (in liquidation): Bailey v Angove's Pty Ltd* [2017] 1 All ER 773.

[290] Burrows notes in England it is clear there is no proprietary restitution for a failure of consideration. See *Restatement of Restitution,* at s 35(1)-(2). Rather, it is favourable that all constructive trusts be institutional (although *Neste Oy and Chase Manhattan* may be understood in a way that means this is not always the case).

[291] Graham Virgo "Judicial Discretion in Private Law" (2016) 14 Otago LR 257 at 271.

[292] Peter Birks *Unjust Enrichment* (2nd ed, Oxford University Press, New York, 2005) at 304.

[293] For a discussion of Birks' change in view of the definition, see Robert Chambers "Resulting Trusts" in Andrew Burrows and Alan Rodger (eds) *Mapping the Law: Essays in Memory of Peter Birks* (Oxford Scholarship Online, 2009).

[294] Chris Kelly, Greg Kelly and James Garrow *Garrow and Kelly Law of Trust and Trustees* (7th ed, Lexis Nexis, Wellington, 2013) at [14.54].

trust.[295] Virgo considers this is only possible where money is intended to be used for an exclusive purpose and the recipient was obliged to keep the money separate from his or her own assets.[296] This was clear from the outset in RAM. In *Re Ames' Settlement*, funds settled on express trust by relatives of the bride and groom were recovered on annulment of the marriage.[297] The funds were deemed to be held on a resulting trust for the settlor when the marriage was declared void.[298] The marriage was found to have been void from early on. From the moment RAM was a Ponzi scheme and being at all material times helplessly insolvent, it could never provide the investment services.

A resulting trust is widely regarded as giving effect to the presumed intention of the parties.[299] In *McIntosh* for example, its operation would have given effect to the proposition accepted by the Court that neither party intended a debtor-creditor relationship. The resulting trust vindicates the original beneficial interest the investor has in the funds transferred, by resulting beneficial ownership of the trust property to the person who owned the property (the investor) before it reached the promotor.[300] Accordingly, the investor acquires an equitable proprietary interest in the trust assets immediately.

C Implication of Trust

Whether resulting or constructive, the conclusion remains that application of restitutionary theory illustrates a principal investment is properly regarded as being held on trust for the benefit of the investor. This necessarily takes us out of the statutory scheme, for if funds are trust property they are no longer company assets. It also means that the true characterisation of the Ponzi victim is not as a creditor, but as a beneficiary of an equitable proprietary interest. The existence of the trust does not alter the finding that the condition that the transfer was based upon has failed. The principal investment remains a defective transfer. If there was no

[295] Virgo, above n 246 at 284.
[296] Above n 295.
[297] *Re Ames' Settlement* [1946] Ch 217. At 223 it was considered "a simple case of money paid on a condition that failed."
[298] Lord Goff, Gareth Jones and others *The Law of Unjust Enrichment* (9th ed, Sweet & Maxwell, London, 2016) at 37-22.
[299] Kelly and Garrow, above n 294, at [14.6].
[300] Goff and Jones above n 298, at 38-06.

beneficial interest from the outset, the trust remedies the defective transaction to provide one. Where there is an express trust from the outset, the resulting trust operates to result the beneficial interest back to the investor. Moreover, where all investors hold the same proprietary remedy, pari passu is effectively in action.

IV Dealing With a Mixed Fund

The commingling of funds is the distinctive characteristic of a Ponzi scheme. If these funds are held on trusts for the investors, their commingling is a mixing of trust funds. The question then becomes; how should this fund be distributed? The difficulty of distribution is exacerbated by the fact that some investors have already been repaid from this fund. This section will first address distribution of the mixed pool held by the liquidators, and second the trust funds already distributed in the form of pay-outs during the course of the scheme's operation.[301] Finally, it will suggest that these prior distributions ought to be treated as part of the mixed pool.

A Mixed Fund

Equity allows tracing through a mixed fund in New Zealand.[302] The High Court has noted that the essence of tracing through a mixed fund is the ability to re-divide the fund pari passu (or pro rata).[303] The Ponzi context demands that this be the case, in favour of the rule in *Clayton's Case* which now appears to be regarded as the exception and not the rule.[304] As victims of a common misfortune, it would be contrary to Ponzi investors' presumed intention that timing would impact recovery. This rings true in the distribution process, and places us in the same context as where *Barlow Clowes* discussed the issue.[305] Pari passu was deemed to apply in that case as any other method would mean those invested in the scheme the longest would have the least prospect of recovering their money. As equal victims of the same misfortune, this must have been contrary to their presumed intention. Similarly, the case of *Commerzbank*

[301] Subject to limitation periods.
[302] Marcus Pawson *Laws of New Zealand* Restitution (online ed) at [70].
[303] *Gibson and Stiassny v Stockco Ltd* [2011] NZCCLR 29 (HC), citing *Foskett v McKeown* [2001] 1 AC 102.
[304] Burrows above n 250, at 137.
[305] *Barlow Clowes*, above n 279.

Aktiengesellschaft v IMB Morgan plc employed pari passu. With insufficient money to satisfy all the claims, broad justice was deemed to be best served if no claimant was paid in full, but no claimant received nothing.[306] It was "the only fair way."[307] Closer to home, *Re Waipawa Finance* concerned an application for direction on how to distribute funds recovered from an investment fund whereby funds had been commingled, with some misappropriated.[308] Similarly to *Barlow Clowes*, it was found it could not have been the investors' intention that the last investors be paid in full. Clifford J expressed that pari passu was a pragmatic and fair way to share common misfortune: "It is the misfortune being common that gives rise to the pari passu distribution."[309]

B Distributions Made Prior to Liquidation

To determine if the mixed pool contains distributions made prior to liquidation, it must first be established that these distributions are in fact distributions of trust money. In *Re Waipawa Finance* Ronald Young J considered Ponzi funds already withdrawn prior to liquidation must be capital, stating that if this was not the case, it "would be allowing one investor's trust money to be used to pay another investor's profit and tantamount to confirming [the] fraud."[310] This conclusion makes intuitive sense in the Ponzi context. After all, 'profits' generally do not exist. Logically, distributions must have come from other investors' capital. If this reasoning is transposed to the same situation outside of the statutory scheme, Ronald Young J's finding that early withdrawals are assumed to be payments of initial investments means those funds are trust funds. Accordingly, those funds are the victim of misappropriation. Ponzi distributions paid prior to insolvency are wrongful transfers of trust property. This property can theoretically be followed and recovered so long and so far as it is capable of being identified in its current position.[311]

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306 *Commerzbank Aktiengesellschaft v IMB Morgan plc* [2004] EWHC 2771 (Ch), [2005] 2 All ER (Comm) 564.
307 At [49]-[50].
308 *Re Waipawa Finance Co Ltd (in liq)* [2011] NZCCLR 14 (HC). For more information on the Waipawa investment fraud, see Doug Laing and Lawrence Gullery "Notorious Hawkes Bay fraudster freed" *Hawkes Bay Today* (online ed, Auckland, 29 August 2012).
309 *Priest v Ross Asset Management* (in liq) [2016] NZHC 1803. This case was a victim of RAM claiming that their shares were held on a bare trust and thus not part of the pool of funds available for the liquidators to distribute.
310 At [33].
311 G Fuller *Laws of New Zealand* Trusts (online ed) at [73]. It need not be identified in terms of whose trust it came from; it is sufficient that it be identifiable as from the mixed fund. Consider a simpler example. The trustee

Second, does the operation of an equitable defence preclude recovery of the misappropriated trust funds? Recovery is permitted unless the money has come into the hands of a bona fide purchaser for value without notice of the equitable interest, in which case the recipient takes free.[312] This includes the discharge of a debt.[313] On first thought, the operation of the equitable value defence lands us in the same position that *Allied Concrete*'s application to *McIntosh* provides. However, this conclusion was based upon the Court's acceptance that the promotor became indebted to the investor upon misappropriation of the principal investment, for that amount. That was the outcome of viewing the victim as debtor and not beneficiary. Chapter Three established that the transfer of value is defective; value cannot pass. Accordingly, as a general rule, the provision of value will not be able to operate as a defence to a distribution. The reason an investor would retain their pro rata share is not because of a value defence, but rather because it is owned equitably. Of course, the equitable change of position defence would remain available. Yet, this has been far less salient than the value defence in New Zealand Ponzi litigation.

C Effecting Distribution

As a response to perceived injustices caused by the orthodox net-loss approach, some courts in the US have implemented what they have called the 'Rising Tide' method of distribution.[314] This method does not require that an earlier victim repay all of their withdrawals in cash.[315] Rather, the withdrawals are considered to be part of the total mixed pool of funds available for distribution and are measured against that victim's ratable share of that fund. All funds paid out by the promotor are treated as distributions, including funds paid out prior to formal liquidation. Investors can retain previously received funds, but those funds are credited against

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takes $500 of trust A's assets and $1000 of trust B's assets and mixes them into an empty bank account. $500 is spent on a painting which is resold. While the painting is identifiable and thus its profits traceable, it is unclear whose funds paid for it. This is why tracing fictions are employed.

[312] Wright, above n 257, at 134. See *Re Diplock* [1948] Ch 465; *Foskett v McKeown,* above n 303.

[313] Virgo, above n 246, at 668. Also note that the value can be provided before or after the property was transferred to the recipient.

[314] For example, see *SEC v Elliot* 953 F 2d 1560 (11th Cir 1992).

[315] Bazoian Phelps and Rhodes, above n 8 at § 20.04[3][e].

the investors' pro rata shares calculated from full amounts invested.[316] The investors must repay the liquidators to the extent they received more than their pro rata share. As such, the method seeks to give effect to the view that all investors are victims and should thus receive an equal percentage proportionate to their investments.[317]

A similar method could be implemented in New Zealand to claw back misappropriated trust funds from those who received more than their pro rata share. To consider funds already paid out as part of the pool available for distribution illuminates the fluid relationship between clawbacks and distributions upon liquidation. The orthodox net-loss method assumes that these are discrete steps by considering investors who have been paid to be 'winners' and labelling funds received above their principal investment as 'profit'. This label numbs us to the reality that these funds belong to another investor. Yet, this does not have to be the case. In New Zealand, the liquidator's principal duty is to "take possession of, protect, realise and distribute the assets, or the proceeds of the realisation of the assets."[318] There is no requirement that realisation necessarily comes first in time. Distribution is already a flexible exercise, whereby interim distributions are made to some creditors while claw-back litigation is ongoing with others.[319]

A model similar to Rising Tide was rejected at the High Court. Consideration of pre-liquidation payments was deemed to "run roughshod" over the defences under the CA and PLA.[320] Outside of the statutory confines this is not at issue. I have not advocated for the recategorisation of ownership through denying tracing or a value defence. Rather, I have suggested that investors are joint beneficial owners of a mixed fund, where ownership is proportionate to contribution. Moreover, alteration of position remains a defence in equity. It is impractical to require liquidators clawback funds that no longer exist. This defence gives effect to the practical concept that where funds no longer exist, they cannot be clawed back.

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[316] Above n 8.

[317] Above n 8.

[318] KC Francis *Morison's Company Law (NZ)* (online ed, LexisNexis) at [55.2]. See CA, s 253.

[319] Mike Colson "Submissions for John Howard Ross Fisk and David John Bridgeman in the matter of Ross Asset Management (in Liquidation) and related entities, John Howard Ross Fisk and David John Bridgeman as liquidators" (Submissions for the Applicants, CIV 2012-485-2591, 18 June 2018) at [94b].

[320] Colson, above n 319. See *Graham & Jackson v Arena Capital (in liq)* [2017] NZHC 973 at [38].

To implement Rising Tide is to consider that the distribution process began prior to liquidation.[321] It effectively shifts the 'bite' of pari passu to the moment the scheme became a Ponzi. This gives effect to the inevitably unsustainable nature of Ponzis. The moment a scheme is a Ponzi, its insolvency is inevitable, and from that point investors ought to share pro rata (subject to limitation periods).[322]

D The Identifiability Exception

Although not the case in *McIntosh*, in some situations funds will be untouched and clearly identifiable. For example, in *SEC v Elliot* some existing securities were registered in the names of victims.[323] Most often this will be relevant to only the very last investor. This paper is not looking to remove the tracing ability of those who can identify their money or its product. If such an inherent property right exists, investors must not be denied of it.[324] This would mean that if there are funds identifiable as belonging to a particular investor and thus not part of the mixed fund, that investor would take up to the value of what they are entitled to as beneficiary of the trust. If funds were already distributed to that investor, but short of their entitlement, the Rising Tide-type method would allow the investor to take the rest, if identifiable. If not, they would share pro rata with the other investors for the outstanding amount. It is noted that in the Ponzi context, identifiability of funds is the exception and not the rule.

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[321] Based on the six-year limitation period set out in the Limitation Act 2010, s 11.

[322] Whether six years per the Limitation Act is appropriate is an issue for Parliament. Perhaps the 2-year limit as set out in the CA could be retained given that this paper's recommendations would lead to many more claims being able to be made out during that time.

[323] Above n 314. Note that the Court denied tracing for those investors. As such, this paper suggests a 'soft' Rising Tide, where tracing remains available to those who can identify their funds.

[324] To restrict this right would be a large deviation from the existing law and is outside the scope of this paper. See *McKenzie v Alexander Associates Ltd (No 2)* (1991) 5 NZCLC 67,046 (HC); *Re International Investment Unit Trust* [2005] 1 NZLR 270 (HC).

V Bringing it Together: The Case for Equality

A Returning to Scenarios

To illustrate the operation of this alternative approach, reconsider the scenarios from Introduction. Recall that Investor A invested $500,000. Upon liquidation. 10 cents in the dollar is available for distribution. Assume that Investor A cannot identify specific funds in their name, nor advance a change of position defence. If there were three investors in the scheme, each representing Investor A in all three scenarios, the following would occur:

In Scenario 1, Investor A would retain the $50,000.
In Scenario 2, Investor A would return $450,000, retaining $50,000.
In Scenario 3, Investor A would return $850,000, retaining $50,000.

All three investors receive $50,000 as it represents 10% of their initial $500,000 contribution. There would then be an extra $1.3M clawed back for pro rata distribution between all three. Given that in all scenarios the initial investment was the same, this would be shared equally. All would receive approximately $433,000 plus the $50,000 already received. This would mean each receive $483,000 of their initial $500,000 investment.[325]

B Returning to RAM (and future Ponzis)

On the face of it, the conclusion of *McIntosh v Fisk* is robust. It was not disputed whether the CA or PLA applied to the Ponzi context. Once the court found that a debt was owed upon misappropriation, *Allied Concrete* was applied to its logical conclusion; that the repayment reduced the debt and thus constituted value. Yet, its application had the effect of adopting the US net-loss approach to Ponzi clawbacks. This paper has set out how this approach is problematic. It has attempted to justify an alternative approach outside the confines of insolvency legislation on the basis that the relationships that clawback claims deal with are restitutionary in nature, in terms of common-law, consensual transaction focused restitution.

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[325] Of course, many Ponzis will be larger than this example and operation of the alternate approach would accordingly be on a more complex scale. The ultimate recovery rate will depend on the combination of trust funds paid out that are available for recovery, and the assets held by the company upon liquidation.

It is suggested there is scope for the court to reconsider its approach in future Ponzis. First, all courts in the *McIntosh* trilogy proceeded on the basis that the misappropriation of funds gave rise to a personal claim to the amount of principal investment.[326] In the High Court it was accepted this claim was restitutionary in nature and this was not disputed in the later courts. The Supreme Court accepted there were restitutionary principles underlying the issues being dealt with. For example, it was accepted that the CA change of position defence largely equates to the general restitutionary change of position defence.[327] The Court thus at least recognised that there were restitutionary principles lurking within the relevant claims and defences. It is submitted there is scope for the court to consider that claims between two victims, rather than victim and promotor, may too be restitutionary. Second, the Court comfortable noted that the Ponzi victim-promotor relationship was not an "orthodox" debtor-creditor relationship.[328] This could be taken as alluding to the fact this was not a regular transaction. Tellingly, the Supreme Court went further to note there was no intention that this debtor-creditor relationship arise at all. Consequently, there is scope to further explore the nature of the transaction between the parties.[329] Third, the Court resorted to arguments of general fairness. For example, it was considered that fairness suggested McIntosh ought not to be barred from a value defence.[330] Finally, the conclusion in *McIntosh* did not turn on the existence of an express trust.[331] Subsequently, we can say that future Ponzi clawback cases have the capacity to reconsider the Supreme Court's conclusion, regardless of whether an express trust is involved.

In sum, the implication of this restitutionary approach is that in RAM and future Ponzis a greater amount of principal investments would be available for recovery by liquidators. Victims would receive pro rata distribution regardless of withdrawal timing, to vindicate their equal status as victims of a common misfortune. While some see this as taking from the few to give

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326 See *McIntosh* (HC), above n 88, at [45]; (CA), above n 101, at [38]; (SC), above n 9, at [18].
327 *McIntosh* (SC), above n 9, at [138].
328 *McIntosh* (SC), above n 9, at [16].
329 At [16].
330 Above n 125.
331 See discussion above, at page 18.

to many,[332] or "robbing Peter to pay Paul",[333] this chapter has illustrated that each victim's ownership of Ponzi funds is truly characterised as a proportion of a mixed fund.

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332 Nina Opacic "Minimising Winners to Give More to Losers: An Analysis of New Zealand's Voidable Transaction Regime in Light of *Fisk v Mcintosh*" (LLB (Hons) Dissertation, Victoria University of Wellington, 2017).

333 John Farrar "The Bankruptcy of the Law of Fraudulent Preference" (1983) JBL 390 at 390.

CONCLUSION

In 2017, one journalist remarked that "the only winners from the Ross [RAM] saga are the legal profession."[334] Of course, he was alluding to litigation costs. Yet, the Supreme Court decision in *McIntosh v Fisk* leaves much to be desired from a legal perspective. Use of voidable transaction provisions to resolve Ponzi clawbacks is akin to jamming a square peg into a round hole. The statutory claim advanced by the liquidators meant that the Court was bound to apply its *Allied Concrete* precedent on value. This had the effect of adopting the US net-loss approach to clawbacks, an approach that is undesirable for the way it generates inconsistent results between equal victims of a common fraud, who cannot have intended that recovery would turn on timing.

At times, the law will be required to deal with situations it has not envisaged; a square peg *will* fit eventually. It ought not to be forced where there is an alternative that fits better. At first glance, clawbacks occupy a peculiar space in law, resting at the intersection of insolvency law and the law of trusts. However, the law of restitution lies beneath this labyrinth, and as such must be utilised to explain the Ponzi context. Its use reveals that the initial investment into a scheme is a defective transaction. Crucially, this means that value cannot have been provided to a promotor through that transaction. In cases where there has been no express trust from the outset, the defective transaction is remedied with a remedial constructive trust using modern restitutionary theory. Similarly, where a trust exists from the outset, an equitable proprietary interest in the funds results back to the investor. This reveals that Ponzi victims are properly characterised as beneficiaries of a mixed trust fund and not creditors. On this approach, liquidators can clawback funds for pro rata distribution amongst all. The Court laid enough bare in *McIntosh* that there is scope to reconsider the decision outside of the statutory confines, should this issue be before the courts again. With an increasing amount of Ponzi schemes revealing themselves in New Zealand, it seems this may be likely. Until then, potential investors are left with only the most disconcerting rule in the book: "The best advice, of course, is that if it sounds too good to be true, it usually is."[335]

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[334] Brian Gaynor "Ponzi scheme fallout still being untangled" *New Zealand Herald* (online ed, Auckland, 4 June 2017).

[335] Bazoian Phelps and Rhodes, above n 8, at § 1.05.

APPENDIX

Companies Act 1993, s 296 Additional provisions related to setting aside transactions and charges

(3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (A) proves that when A received the property—

(a) A acted in good faith; and

(b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and

(c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

Property Law Act 2007, s 349 Protection of persons receiving property under disposition

(1) A court must not make an order under section 348 against a person who acquired property in respect of which a court could otherwise make the order and who proves that—

(a) the person acquired the property for valuable consideration and in good faith without knowledge of the fact that it had been the subject of a disposition to which this subpart applies; or

(b) the person acquired the property through a person who acquired it in the circumstances specified in paragraph (a).

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