**IN THE HIGH COURT OF NEW ZEALAND**
**WELLINGTON REGISTRY**

**CIV-2014-485-11448**
**[2016] NZHC 1803**

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| UNDER | Part 18 of the High Court Rules |
| BETWEEN | MAURICE DUNCAN PRIEST AND NORA BEATRIX PRIEST<br>Plaintiffs |
| AND | ROSS ASSET MANAGEMENT LIMITED (IN LIQUIDATION)<br>First Defendant |
| | DAGGER NOMINEES LIMITED (IN LIQUIDATION)<br>Second Defendant |
| | NESSOCK CUSTODIANS LIMITED<br>Third Defendant |

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| Hearing: | 19-23 October 2015<br>(Further written submissions 6, 13, 26 November and 21 December 2015) |
| Counsel: | D J Chisholm QC and M H L Morrison for Plaintiffs<br>M G Colson, F J Tregonning and L Brazier for Defendants |
| Judgment: | 5 August 2016 |

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**JUDGMENT OF CLIFFORD J**

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## Introduction

[1] The first defendant, Ross Asset Management Ltd (in liquidation) (RAM), through its owner and director, Mr Ross, provided discretionary investment management services. Mr Ross also owned the second defendant, Dagger Nominees Limited (Dagger). Dagger's intended role was to act as a nominee/custodian to hold client investments. For many years, those services appeared to produce outstandingly successful results for investors. As is now well known, however, for a considerable period of time Mr Ross had been defrauding investors and producing falsified returns (concealed losses and fictitious profits) to hide that fraud. In late-2012 the fraud, a Ponzi-type scheme, unravelled. RAM and Mr Ross ran out of cash to meet requests from investors to withdraw their funds. The Financial Markets Authority (FMA) became involved.

[2] The High Court appointed Messrs John Fisk and David Bridgman (the Liquidators) as receivers (6 November 2012) and liquidators (17 December 2012).

[3] This is an application by Maurice and Nora Priest (the Priests) for declarations that various shares (the Priest Holdings) held by RAM, Dagger and the third defendant, Nessock Custodians Limited (Nessock) are held on a bare trust for them. The consequence of those declarations would be that the Priest Holdings are not part of the pool of assets that the Liquidators anticipate will be available for distribution to the other investors who are the victims of this fraud (the Other Investors). They apply for orders for the transfer of the Priest Holdings into the names of the Priests.

[4] The Liquidators oppose the Court making those declarations. They say the Other Investors are entitled to share the value represented by the Priest Holdings amongst themselves, in proportion to the losses Mr Ross' fraud has caused the Other Investors individually. In taking that position, the Liquidators are not acting on behalf of all creditors to preserve for their benefit assets of a company in liquidation. It is accepted that all the assets held by RAM and Dagger at the point of their liquidation are trust assets, held for the benefit of RAM and Dagger's, that is

Mr Ross', customers. The Liquidators are, in effect, acting on behalf of the Other Investors, in resisting the Priests' claim to the Priest Holdings. That is not the normal position liquidators put themselves in. Normally they would, where appropriate on behalf of the general creditors, resist a claim from beneficiaries to what are asserted to be trust assets. Because here there are no assets other than trust assets, the issue is how those trust assets are to be distributed amongst the Priests and the Other Investors. The Priests have expressed reservations, if not about the Liquidators representing the Other Investors in the way they do, then about the way they have gone about it. Although mentioned, nothing more was made of that matter before me, and I do not discuss it further.

[5] The Liquidators accept that if they succeed in this claim then the Other Investors and the Priests would share, pro rata, the Priest Holdings as they would share all the other assets held by RAM or Dagger when the Liquidators were appointed. To avoid confusion, however, in this judgment I avoid that complication, and simply refer to the competing claims of the Priests and the Other Investors to the Priest Holdings.

[6] The facts are complex but largely not in dispute. The law is both complex and in dispute. An overview of the parties' positions follows.

***The Priests' claim***

[7] The Priests advance a relatively orthodox, in property law terms, argument as follows.

[8] Each of RAM and Dagger were custodians for the Priests, that is, bare trustees. The Priests were at all times the equitable owners of the Priest Holdings. The Priests acquired that title when RAM or Dagger acquired the shares comprising the Priest Holdings. They did so without notice of any claim the Other Investors may – by reference to the fraud of RAM and Mr Ross and its consequences – have to those shares (the existence of which they deny). And, in any event, the Priests had priority to any such claim. The Priests provided valuable consideration for all shares which Mr Priest directed the purchase of and, to the extent that the Priests withdrew funds, there were no fictitious profits involved. Accordingly, the Priests obtained

equitable title to all the shares involved. As such, the Other Investors cannot have a better claim to the Priest Holdings than the Priests have.

[9] Moreover, when in late October 2012 Mr Priest instructed Mr Ross, on behalf of Dagger and RAM as bare trustees, to transfer the bulk of the Priest Holdings to Nessock, as between the Priests and the Other Investors any interests that the Other Investors might have had in that part of the Priest Holdings necessarily came to an end. The only thing the Priests have in common with the Other Investors is that, when they provided and/or withdrew funds, they did so, as did the Other Investors, through RAM's current, 00, account with ANZ or the equivalent thereof operated by another bank.

[10] The Liquidators' assertion that the Priests must be able to establish what the Liquidators call individual tracing to establish a better claim than the Other Investors is simply wrong. In effect, the Priests say they were not part of the Ponzi scheme operated by RAM and Mr Ross.

[11] Therefore, and with one exception (the unauthorised sale by Mr Ross between July 2011 and May 2012 of some 179,925 shares in Diligent Board Member Services Inc (Diligent) belonging (beneficially) at that time to the Priests (the Diligent Fraud)) the Priests were not the victims of the RAM/Mr Ross fraud. On orthodox principles of property law the Priests are the beneficial owners of the Priest Holdings. The other investors have no prior or better claim, and the Priest Holdings should be transferred to them accordingly.

[12] The Priests emphasise that this is not a situation where, following a major fraud, liquidators seek pragmatic directions from the court to deal with the generality of cases. The Priests acknowledge that, in those situations, the courts may approve a pragmatic solution whereby, subject to specific claims, investors share pro rata in the remaining assets of the defrauded pool, and hence in the losses that represent the fraud. They accept that such an approach is appropriate for the Other Investors. It is not, however, one that is appropriate for them.

*The Liquidators' response*

[13] The Liquidators advance what they say is also an orthodox argument for pro rata sharing by all investors. Pro rata sharing, based on proprietary rights, is, they say, a well recognised response of the courts in liquidations where fraud, mismanagement or other circumstances cause the collapse of investment entities.

[14] In their opening submissions the Liquidators summarised that argument in the following terms:[1]

> RAM and Dagger say that the shares in issue (referred to as the Priest Holdings to adopt the plaintiffs' label and without in any way conceding the Priests have any rights to them) were in the majority of instances in fact paid for by investors' funds i.e. not the Priests' funds. They therefore became part of a pool of assets held on trust for all investors.
>
> The legal authorities in relation to this are clear:
>
> (a) Where trust funds belonging to two or more innocent contributors are mixed then the starting point is the first in, first out rule in *Clayton's Case*. But this approach to tracing and identification of assets is frequently considered to be arbitrary and problematic. The more modern approach is to treat the mixed asset pool as subject to a rolling charge in favour of all innocent contributors. Assets acquired from that pool are likewise subject to the charge.
>
> (b) The most frequent instance of the application of these principles is in cases where the company is placed into liquidation and issues arise as to the distribution of a mixed pool(s) of trust assets. New Zealand courts have generally held that they should be distributed on a pari passu basis in order to avoid an unfair, expensive and inaccurate tracing exercise.
>
> (c) The legal basis for the Priests' claim ("bare trust") does not appear to have received any consideration in insolvency situations where there are competing claims to assets which were to be held on trust. Those authorities that do uphold individual claims to assets in an insolvency situation have all done so on the ability of the claimant to trace. This is hardly surprising. Otherwise, as the Priests urge here, a bizarre situation would arise in that assets purchased with trust moneys in breach of trust would be awarded (solely) to a party who had not provided those trust moneys.
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> The Priest Holdings, having been acquired with the pool of investor trust assets as a matter of fact, become part of that pool of trust assets held for all investors as a matter of law. They fall to be allocated between all investors on a pro rata basis.

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1 Footnotes omitted.

[15] In their closing submissions the Liquidators identified eight core propositions upon which they relied. Those propositions were:

(a) RAM had legal title at all relevant times to a mixed pool of assets including funds held in bank accounts, and various shares. The funds comprised contributions from investors and the proceeds of share sales which had previously been purchased with investors' monies.

(b) The Priest Holdings had (except where the Liquidators recognise a proprietary claim) been paid for by the Other Investors. As stated in the Liquidators' submissions, when tracked on a flow of funds tracing basis[2] the "assets which were used, or realised, to purchase the Priest Holdings were actually provided by other investors".

(c) The Other Investors had a proprietary right to the funds in any of RAM's bank accounts and to the shares purchased with those funds and still on hand. They were trust funds which had been misapplied in breach of a fiduciary duty.

(d) The correct approach, in applying tracing rules, was that the pool of assets should be shared pro rata amongst investors unless an individual investor could trace, on a flow of funds basis, "their funds to particular assets which had been allocated to them".

(e) The Priests had not been able to establish "flow of funds" tracing (except to the limited extent the Liquidators had already recognised).

(f) Alternatively, RAM was holding legal title to a number of fungible assets: those fungible assets should be held as a pool pro rata for all those who contributed to their purchase.

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2 The Liquidators refer to two types of tracing: (a) "flow of funds tracing", described by them as "the traditional *Clayton's Case*/FIFO (first in, first out) tracing rule"; and (b) "collective tracing", described by them as the tracing rule established in cases "such as *Re Registered Securities Limited* and *Barlow Clowes* to give effect to the proprietary right that contributors to a mixed fund have in that fund and any assets to which it has been applied". The Priests challenge the validity of that concept of collective tracing.

(g) The Priests have not been able to demonstrate an interest in the Priest Holdings because they had not been able to establish the three certainties required for a bare trust.

(h) Even if the Priests did have such an interest, the rights of other investors took priority.

[16] As I understand it, the argument the Liquidators advance is that at each point when the shares which now comprise the Priest Holdings were acquired, the clients of RAM , including the Priests, acquired in some collective way a proprietary claim to those shares which ranks ahead of the claim the Priests have as beneficiaries of the bare trusts on which they say RAM and Dagger hold those shares for them.

**Facts**

[17] Extensive affidavits were filed by both the Priests and the Liquidators. Those affidavits reflected the complex details of the work the Liquidators have undertaken in attempting to resolve the affairs of RAM, including the exercises in tracing they have undertaken.

[18] The Priests and the Other Investors principally used a RAM current account (the RAM 00 account) when doing business with RAM. That was the account into which the Other Investors deposited funds for management by RAM. That was the account into which Mr Priest deposited money to pay for the Priest Holdings and into which proceeds of his dealings in the Priest Holdings were paid and held from time to time.

[19] The tracing exercise the Liquidators carried out sought, to the extent possible, to unravel the movement of funds through the RAM 00 account so as to identify, on the basis of the first in, first out principle, whose monies were represented by credit balances in the 00 account over time. It is on the basis of that tracing exercise that the Liquidators say, with some very limited exceptions, it was not the Priests' money, but money belonging to Other Investors, that was used to acquire the Priest Holdings. That analytical result is central to the legal position the Liquidators take in these proceedings.

[20] Mr Priest provided similarly detailed evidence, regarding the background to his involvement with RAM and Mr Ross, and the way in which he bought and sold the shares using RAM and Dagger as custodians and the RAM 00 account to settle those transactions, which now constitute the Priest Holdings. Expert accounting evidence was also provided on behalf of Mr Priest (from Mr Petterson), proposing an alternative tracing exercise which produced a more favourable outcome for the Priests. That more favourable outcome is part of the Priests' response to the position taken by the Liquidators.

[21] It is not necessary to go into that evidence in great detail for most purposes of this judgment. In particular, and as became apparent at the hearing, the resolution of this case does not require a minute examination and comparison of the tracing exercises undertaken by Messrs Fisk and Mr Petterson. There are two reasons for that. First, counsel have cooperated to produce a number of statements of agreed facts. Those statements, for which I thank counsel, identify the essential facts involved in this dispute. They are relatively straightforward.

[22] Second, I accept the orthodoxy and validity of the tracing exercise Mr Fisk carried out, on the basis of the first in, first out approach to the operation of a banking account. Moreover, as the case was argued, that was not an especially contentious issue. The issue was whether that analysis had the legal significance that the Liquidators said it did. The arguments on that point are central to this proceeding.

[23] Having said that, it is important, as ever, to understand the general context. Moreover, certain detailed factual matters are of relevance, especially when considering the Liquidators' "certainty of trust" argument in light of the intangible, fungible, property rights that shares represent.

***RAM, Mr Ross and investors generally***

*The usual course of dealing*

[24] The usual, albeit fraudulent, course of dealings between Mr Ross, RAM and the Other Investors has been described by this Court and the Court of Appeal in

earlier decisions in which the Liquidators were attempting to claw back funds paid out to Mr McIntosh before liquidiation (the *McIntosh* decisions).[3] In March 2007 a Mr Hamish McIntosh paid $500,000 into the RAM 00 account, for management by RAM (Mr Ross). In November 2011, after he had terminated that management contract, Mr McIntosh received payments totalling $954,047.62. The Liquidators are currently seeking the recovery of those monies. The Liquidators have succeeded in the High Court and the Court of Appeal, but only to the extent of the $454,047.62 which represented, in Mr McIntosh's case, "false" profits. The Supreme Court has recently given leave to Mr McIntosh and the Liquidators to appeal and cross-appeal that decision.

[25] In the High Court MacKenzie J explained:[4]

> **A Ponzi scheme**
>
> [1] David Ross operated an apparently successful investment business through Ross Asset Management Limited (RAM) and a number of related companies (which I refer to as the Ross Group).[5] The business purportedly involved investing clients' money in shares and other investments. Mr Ross was the sole director of all of the Ross Group companies with sole responsibility for all funds management and investment decisions on behalf of clients or by RAM. He was the person who liaised with investors to attract new contributions and to inform them of the investments purportedly made, and the returns on those investments. He was supported by two administrative assistants. Investors were given quarterly investment statements which reported healthy returns on their investments. The business grew to the extent that by late 2012 the investors' statements showed total funds held for all investors of over $450 million.
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> [2] But this was all a facade. The applicants (the Liquidators) were appointed receivers, then liquidators, of the Ross Group in November and December 2012. It became clear to them almost immediately that most of the assets supposedly held for investors did not exist. Investors' funds were not invested in the securities which were reported to them. They did not make the returns shown in their investor statements. Instead, Mr Ross was operating a Ponzi scheme under which investor funds were misappropriated and applied for other purposes. Those purposes included using funds paid in for investment by new investors to repay existing investors who requested repayment of their investments. Mr Ross admitted this to the Liquidators

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3 *Fisk v McIntosh* [2015] NZHC 1403, (2015) 11 NZCLC 98-033; *McIntosh v Fisk* [2016] NZCA 74.

4 *Fisk v McIntosh*, above n 3, at [1]–[2].

5 In addition to RAM itself, that group comprised Dagger, Bevis Marks Corporation Limited (Bevis Marks) and United Asset Management Limited (UAM). When I refer to RAM, I refer to RAM itself and other members of that group as relevant. I refer to those members individually where appropriate.

> soon after their appointment. He was subsequently convicted of criminal offending and is serving a prison sentence.

[26] In operating in this way, Mr Ross ignored the terms of his contracts with investors. Those contracts, in very general terms and as relevant here, provided that RAM, the "manager" was the agent of the client to manage and administer the client's portfolio.[6] As manager, RAM had full authority to invest the portfolio, subject to the instructions of clients. All investments were to be held in the name of Dagger as nominee, on a bare trust. All money in the portfolio, when not invested, was to be paid by the manager "at its discretion into an account to be opened by the Manager at a bank in the name of the Client and the Client agrees that the Manager shall have the sole signing authority over that account".[7]

[27] As MacKenzie J further explained:[8]

> [9] Mr Ross did not operate his business in accordance with that contract. Cash or shares transferred by investors for investment under the agreement were not immediately transferred to Dagger and held on trust for the individual investors. They became part of a pool of shares and cash held by Ross group companies: RAM, Dagger, Bevis Marks Corporation Ltd, and United Asset Management Ltd. RAM paid from that pool the operating expenses of RAM, personal drawings of Mr Ross, payments to investors, and payment for the few share purchases which were actually made. Funds obtained from investor deposits were used first to meet any Ross Group expenditure or withdrawals sought by other investors. If there was insufficient cash available to meet those requirements, shares were sold.
>
> [10] Mr Ross reported to the investor clients in terms which indicated to them that investments had been made in shares and other securities in accordance with the management agreement. The reports listed individual shareholdings of specific securities, at prices and returns which matched what was occurring in the market for the particular security. An investor who compared his portfolio statement to stock exchange reports would not have seen any price discrepancy. The fictitious investments were recorded in the RAM investor database records as being held through "Bevis Marks", a nonexistent dummy broker.

[28] The fictitious broker, Bevis Marks, was central to Mr Ross' fraud. Bevis Marks existed in RAM's books only. Mr Ross recorded fictitious transactions in RAM's books in the name of Bevis Marks.

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6 See *Fisk v McIntosh*, above n 3, at [3]–[8] for a more detailed description of these contractual arrangements.

7 Clause 7.6 of the Management Deed.

8 At [9]–[10].

[29] The role of Bevis Marks can be seen from the analysis in the receivers' report of one particular portfolio:

> A review of one investor portfolio indicated that contracts with Bevis Marks were referenced with "DRGR" or "David Ross" to denote the (original) largely hand-written instructions of Mr Ross to his administration staff to reflect transactions in the database that he directed, whereas contract notes from brokers were generally referenced with contract note numbers (as received from the counterparty broker and input to the database by the relevant staff member). On this particular portfolio, realised gains and losses for non-Bevis Marks trades averaged $11k in losses from 36 trades and $11k in gains from 44 trades for a net return of $83k for years 2000-2012. Realised gains and losses for Bevis Marks trades averaged $17k in losses from 44 trades and $31k in gains from 90 trades for a net return of $2.06m from 2001-12. Accordingly for this investor at least, the vast majority of the net returns were purportedly made through Bevis Marks.

[30] The shares said to be held for investors in Bevis Marks, which resulted from fictitious trading, came to be the largest part of the reported portfolios.

*The position at 6 November 2012*

[31] In late October 2012, the FMA began receiving complaints from Ross Group investors that their requests to withdraw funds were not being honoured. Some were also experiencing difficulty contacting Mr Ross. On 6 November 2012, on application by the FMA, Messrs Fisk and Bridgman were appointed receivers of RAM, Mr Ross and other (nominee) companies in the Ross group. As required by the orders appointing them, the receivers reported to the High Court on 13 November 2012 on RAM's state of affairs on 6 November. They described that position as follows:

(a) Cash on hand in RAM New Zealand based bank accounts was $59,141.98.

(b) $10.2 million worth of assets were able to be identified.

(c) The value attributed to investor portfolios in RAM's records was $449.6 million.

(d) The total value of the fictitious shares recorded as held by Bevis Marks was $437.6 million (ie some 97 per cent of the investors' portfolios).

(e) A further $5.6 million of shares were held by non-RAM entities, including Nessock.

[32] In an affidavit filed for these proceedings, Mr Fisk observed that:[9]

> … the vast majority of investors are likely to receive only a minor payment – around 3c in the dollar outside of litigation recoveries. Many of them are elderly and/or had all their retirement funds invested in the Ross Group. I am personally aware of the utter devastation this has caused for many of them.

***RAM, Mr Ross and the Priests***

*The usual course of dealing*

[33] The Priests are husband and wife. Mr Priest was, until December 2013, himself a sharebroker and financial adviser. Mr Priest had worked as a sharebroker at Forsyth Barr for 14 years. More recently, and at all material times as relevant here, he had been a director of McDouall Stuart Securities Limited, and subsequently a senior employee of MSL Capital Markets Limited, from which position he retired in December 2013.[10] In addition to advising clients and administering their transactions as a sharebroker, Mr Priest had also always managed investments for himself and his wife in various public and private companies.

[34] Mr Priest explained that he had had a long-standing relationship with Mr Ross. That relationship had largely arisen through their shared interests as professionals in investments, both in New Zealand and offshore. They would meet on a reasonably regular basis as friends, and discuss the markets in a general sense. Mr Priest said he never had any reason to doubt Mr Ross' integrity and high-standing in the Wellington business community. Mr Priest was not alone in that.

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9 At [4.5].

10 I refer to the McDonall Stuart entities together as MSL.

[35] Reflecting Mr Priest's long-standing relationship with Mr Ross, Mr Priest had, in February 1990, entered into a document called a Management Deed with Mr Ross, in the capacity of the manager, and Dagger, as the nominee. Mr Ross had sent that document to Mr Priest, at Forsythe Barr, under cover of a letter saying:

> Please find enclosed our standard Management Deed for signing. ... As discussed we will be happy to nominee (sic) holdings on your behalf.

[36] The schedule to that document provided for the fees basis to be recorded. In the case of the contract Mr Priest signed, the schedule shows:

> Fees Basis: ~~% of the Market value of the Portfolio~~.
>
> "$100.00 P.a. Nominee Fee." [Handwritten]

[37] It would appear that Mr Priest may have first used Mr Ross and RAM to trade in shares in overseas locations where Mr Priest did not himself, or through the firm he worked with, have brokering connections. Mr Priest said that from 2007 onwards he increasingly found it convenient to hold his and his wife's personal investments in RAM or Dagger, on the basis that those companies would hold such securities on their behalf and at their direction. The convenience Mr Priest saw in using Dagger as his nominee would appear to have been that of anonymity.

[38] Mr Priest would either trade the Priest Holdings as he saw fit, or give instructions to Mr Ross or one of his administrative assistants to do so. Much of the trading in the Priest Holdings was through MSL. MSL ran accounts for RAM and Dagger. Mr Priest would himself initiate the relevant transaction through MSL (with a buy or sell note) and report to Mr Ross or his administrative assistant after the event.

[39] The Priest Holdings were held separately in the name of Mr Priest (generally through RAM) and Mrs Priest (generally through Dagger). Tax considerations would appear to have been at play in the decision to allocate, somewhat arbitrarily Mr Priest accepted, shares in that way.

[40] Mr Priest summarised matters in his affidavit in the following way:

17. Nora and I never required or sought the assistance of Mr Ross or his companies in managing and advising in respect of the Priest Holdings. We never advanced funds to Mr Ross or RAM/Dagger as investments to be managed with other clients of Mr Ross or his companies in any managed fund or other such arrangement.

18. I simply did not need to engage Mr Ross to manage or advise us with regard to our personal investments. I was an experienced professional sharebroker in my own right and as such I made all relevant investment decisions with regard to Nora's and my personal investments, which I ran and managed for both of us.

19. The terms upon which our personal investments were held by RAM or Dagger were never recorded in writing. I believed that I knew Mr Ross well and I trusted him. From the commencement of the relationship there was no doubt that we both understood and agreed that the terms upon which RAM and Dagger held Priest Holdings were as follows:

    19.1 RAM or Dagger would hold our personal investments for the sole benefit of Nora and myself: RAM or Dagger were both under the sole directorship of Mr Ross and were administered by Mr Ross with the assistance of his personal assistant, Ms Y, who I understood to be an employee of RAM.

    19.2 I would convey instructions to Mr Ross or Ms Y who would act on those instructions, which I generally conveyed verbally or by email, fax or letter. In many cases I would simply trade the Priest Holdings as I saw fit and report to Mr Ross/Ms Y after the event. That included both sales and acquisitions. I was able to do this because I was a sharebroker at MSL, which ran accounts for RAM and Dagger.

    19.3 In the instances where I purchased Priest Holdings to be held by RAM/Dagger on behalf of Nora and me, I would effect those purchases as an MSL sharebroker. Ms Y would then need to settle the share purchase (which is usually required within three to five days). To enable her to do this I would ensure that sufficient funds were provided to RAM/Dagger by Nora and myself to finance such acquisition on our behalf. I used the RAM bank account (01-0505-0522437-00) when necessary, for example to deposit funds for acquisitions or to hold funds following sales of Priest Holdings. I would also use the RAM Australian dollars account (385369-AUD01) when convenient to do so. On some occasions proceeds from sales of Priest Holdings held by MSL were simply offset against purchases of further Priest Holdings (i.e. the funds did not pass through the RAM bank accounts at all).

    19.4 I was aware that the RAM bank accounts were current accounts through which I assumed numerous transactions were processed, including for "managed" clients of

> Mr Ross/RAM/Dagger. So I did not view the current account as being in the nature of a solicitors trust account for example, with our specific funds to be held and applied strictly to the particular acquisition. Until October 2012 I believed that Mr Ross and his companies were very successful and that there was no real risk in Nora and my holding credit balances with those companies from time to time when funds or proceeds were deposited with them. I believed that RAM/Dagger would be able to meet their obligation to acquire the specified securities that I had instructed them to acquire and to hold them on trust for Nora and me accordingly. Indeed to the best of my knowledge they always did meet their obligations in that regard. In fact, in earlier years, occasional acquisitions of Priest Holdings were initially financed out of the RAM current account and Nora and I would then have to reimburse RAM for those transactions. When that happened Mr Ross would require us to immediately deposit funds in the account so that our balance was put back into credit.
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> ...
>
> 33. In the vast majority of instances I would personally organise the sale and purchase of Priest Holdings to be held by RAM/Dagger through MSL. Where such transactions were processed through the market the transaction would be noted on the MSL Ledger for either RAM/Dagger. Where the transactions were done off market (i.e. privately) they would not be recorded on the MSL Ledger. As far as possible I have gathered the documentation evidencing the off market transactions (for example copies of the Off Market Transfer Forms sent to the relevant share registry) and exhibited those to this affidavit when I deal with particular Priest Holdings below.
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> ...
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> 37. In addition to the sales/purchases made through MSL and administered (i.e. brokered) by me personally, there were also some occasions when Mr Ross would organise a buy/sell for us through other brokers he dealt with – but only on my express instructions to do so. There are a variety of reasons why this would occur ...

[41] The Liquidators did not challenge that narrative in any material way. In one of his affidavits Mr Fisk acknowledges:

> By way of overview, and as explained fully below, there does not appear to be any material disagreement between Mr Peterson – and/or Mr Priest – and me concerning the following factual matters. (There are, of course, some exceptions to these statements, but the below is correct at a high level). The Liquidators accept:
>
> (a) Mr Priest and/or MSL generally placed orders or gave directions to purchase the Priest Holdings in the name of RAM/Dagger.

(b) The Priest Holdings were acquired on or around the dates and were not 'fictitious'.

(c) The Priests made payments to RAM/Dagger bank accounts on various dates.

(d) The Priest Holdings were generally recorded on the RAM investor Database in the name of the Priests and were not also allocated to other investors.

(e) The Priest Holdings now claimed were generally still in existence at the date of receivership.

[42] I am satisfied as a matter of fact that Mr Priest did not give Mr Ross any authority to deal in the Priest Holdings: rather the service Mr Ross provided through his companies was essentially that of a nominee or bare trustee. The way in which Mr Priest and Mr Ross referred to and signed the Management Deed in 1990 confirm that. In particular:

(a) the deletion of the reference to paying fees on a percentage of the market value of the portfolio (a common approach where management services are being provided); and

(b) the substitution of the reference to the $100 annual nominee fee (a common approach, where discretionary management services are being provided).

[43] The accepted narrative of the way Mr Priest and Mr Ross and other RAM staff dealt with each other is completely consistent with such an arrangement.

[44] Fundamentally, Mr Ross had no authority to manage the Priest Holdings: RAM and Dagger provided custodial services only to Mr Priest. RAM also provided Mr Priest the ability to transact through the 00 account.

*The Nessock transaction*

[45] In late October 2012 Mr Priest received two phonecalls from clients of Mr Ross. Mr Priest inferred they knew of his friendship with Mr Ross. Mr Priest said he was phoned to be asked whether he had any idea where Mr Ross was because they, and Other Investors, had experienced difficulty in getting hold of him.

Furthermore, various requests of Mr Ross to return investor monies had not been actioned. Mr Priest said he was not otherwise aware of any issues with Mr Ross.

[46] Later that day, Saturday 27 October 2012, Mr Priest met with Mr Ross. Mr Priest presented Mr Ross with nine transfer forms for signing. Those forms recorded the transfer to Nessock of what Mr Priest described as the "most valuable and readily transferrable of the Priest Holdings".[11] Nessock was chosen by Mr Priest as it was one of MSL's custodian companies. Mr Priest is a director of MSL. Subject to a small number of exceptions, where Mr Ross did not agree that certain shares were held on bare trust for the Priests, Mr Ross executed those transfers as directed by Mr Priest.

**The Priest Holdings – the agreed position**

[47] From a combination of sources, and based on a number of methodologies, at the commencement of the trial counsel provided the Court with a joint memorandum as to agreed facts relating to the Priest Holdings as represented by:

(a) shares currently held by RAM or Dagger or so held when Messrs Fisk and Bridgman were appointed receivers but which had subsequently been sold; and

(b) the Priest Holdings that were transferred to Nessock and which were held by Nessock at the date the receivers were appointed or which had subsequently been sold.

[48] That initial memorandum as to agreed facts was supplemented as evidence was clarified during the hearing. In addition, further memoranda were provided on an agreed basis after the hearing as to factual matters.

[49] Taken overall, those agreed facts and what the Priests and the Liquidators take from those facts (in terms of their competing legal theories) can be summarised in the following way:

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[11] Mr Priest's affidavit at [48].

(a) That all the shares that constituted the Priest Holdings were:

(i) acquired as a result of purchases which had been arranged or directed by Mr Priest;

(ii) in respect of which the Priests had prior to, at the time of, or subsequent to acquisition, provided valuable consideration;

(iii) which, for as long as Ms Lintern had maintained records in the RAM Investor Database (RID) of transactions in the Priest Holdings (until mid-2011), had been allocated exclusively to the Priests in the RID; and

(iv) which thereafter had not been allocated in the RID to any other investor.

(b) That, overall, the Priest Holdings comprised:

(i) a total of 1,237,831 shares in 11 companies held by RAM or Dagger; and

(ii) a total of 5,547,792 shares in four companies held by Nessock.

(c) Of the Priest Holdings, a total of 243,000 shares in five companies were acquired with funds which, on the basis of the Liquidators' tracing exercise, were funds belonging to the Priests.

[50] In other words, of the 6,785,623 shares which the Priests say are held on bare trust for them at the time of RAM's receivership, the Liquidators accept that the Priests have a valid proprietary claim to 243,000 of them.

[51] Since their appointment the Liquidators have, in consultation with the Priests as I understand it, sold various shares and retained the proceeds. Other shares have been affected by various forms of corporate activity. To the extent of such sales, the proceeds are being held on trust by the Liquidators' solicitors. To the extent of that

corporate activity, the effect of it on the Priest Holdings is understood and agreed as between the Liquidators and the Priests.

## The legal context

### *The contractual arrangements*

[52] The *McIntosh* decisions have also analysed the legal consequences of events as they transpired.[12]

[53] The Liquidators are bringing their claim against Mr McIntosh under the voidable transaction provisions of the Companies Act 1993. As a precondition to granting any such application the Court must be satisfied that RAM was insolvent at the time of the challenged payment.

[54] In the High Court MacKenzie J reasoned that the management agreements did not create debtor-creditor relationships.[13] The legal relationship under those agreements was, generally, that of trustee and beneficiary. Whilst, in terms of the documentation, once Mr McIntosh had given his notice to withdraw there was a relationship between him and RAM of creditor and debtor, that was not the case for other investors who had not, at that time, given a similar notice. But, MacKenzie J said, the contractual arrangements were not observed and therefore the position was to be examined as it actually was to determine whether debts to other investors existed, so as to render RAM insolvent at that time.[14]

[55] The Judge reasoned further that the relationship between investors and RAM was analogous to the solicitor-client relationship described by Lord Brown-Wilkinson in *Target Holdings*.[15] Thus:[16]

> RAM was to hold the funds as separate property of each investor. The management agreement gave decision making powers to RAM in relation to the investment of the funds. Those powers were to be exercised at the risk and for the benefit of the investor. The correct legal categorisation of the relationship is that there is a bare trust of the funds invested, with the related

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12 *Fisk v McIntosh* and *McIntosh v Fisk*, above n 3.
13 *Fisk v McIntosh*, above n 3.
14 At [40].
15 *Target Holdings Ltd v Redferns (No 1)* [1996] AC 421; [1995] 3 WLR 352; [1995] 3 All ER 785.
16 *Fisk v McIntosh*, above n 3 at [43].

> contractual arrangement for the management of those funds pursuant to that bare trust.

[56] The funds received from each investor were misapplied by RAM immediately on receipt. The funds were never held, and Mr Ross never intended to hold them, on the terms on which they had been received. The intended trustee thereby committed a breach of trust and came under an immediate duty to remedy that breach. The quantum of compensation payable for that breach would be fixed at the date of the judgment to enforce the remedy. Every investor in RAM had an accrued cause of action for breach of trust in November 2011, when Mr McIntosh was repaid. RAM was at that point unable to meet all of those claims.[17]

[57] Accordingly the question became whether those accrued causes of action constituted "debts" of RAM. MacKenzie J found that, in terms of the test for insolvency, they were. RAM was insolvent accordingly.[18]

[58] The Court of Appeal agreed.[19] The relationship between RAM and Mr McIntosh at the date of the payment was not in the orthodox nature of debtor and creditor. Initially it was that of trustee and beneficiary. The parties had created a bare trust of the deposited funds with a related contractual obligation of management. RAM had assumed legal ownership of the funds: Mr McIntosh retained beneficial ownership. RAM was not obliged to repay any or all of the monies, provided it performed its contractual duties, pending termination of the management agreement. The Court went on:

> [21] However, the nature of the legal relationship changed when RAM misappropriated the money for its own purposes. As MacKenzie J found, Mr McIntosh acquired a right of action for breach of trust against RAM. An equitable debt was created in Mr McIntosh's favour for the amount of the deposit together with equitable damages, being the amount necessary to restore Mr McIntosh to the position in which he would have been but for RAM's misappropriation. His measure of compensation is the same as for a restitutionary remedy. In short, by misappropriating the funds RAM breached the bare trust, reconstituting the relationship into one of debtor and creditor.

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17 At [45]–[46].
18 At [46].
19 *McIntosh v Fisk*, above n 3.

[59] Although not considered explicitly in these terms, the courts' recognition to date of the existence of a bare trust as regards Mr McIntosh's deposit, and a related contractual obligation as set out in the management deed, would – if those contractual terms had been observed – have resulted in a legal categorisation of the portfolios of the Other Investors as constituting a managed investment fund.[20] That is, the customer was to be the ultimate beneficial owner of the fund, the assets representing which from time to time were held by the nominee as bare trustee. But that ultimate beneficial ownership was subject to the manager's authority as agent on behalf of its principal to deal in the assets comprising the fund, including by way of lending them to third parties where appropriate security was provided.

[60] There is also no question that the remaining assets, including the Priest Holdings, are trust property. Neither Mr Ross, RAM, Dagger, any other RAM entity, nor any of their general creditors, assert any claim to those assets. There is also no question that RAM and Dagger acted in breach of their obligations: extensively in the case of the Other Investors (as represented by the estimated three per cent recovery), and in a more limited way in the case of the Priests (as represented by the Diligent Fraud). Moreover, there is no suggestion, at least as I understand the facts, that any of the Priest Holdings were shares which had previously been beneficially owned by any Other Investor.

### *Breach – consequences*

[61] In private law terms, the criminal fraud represented by Mr Ross' Ponzi-type scheme involved the following breaches of obligation:

(a) RAM, as trustee/fiduciary agent, breached its obligations when it misappropriated client monies and investments. RAM's fictitious reporting was also a breach of those obligations.

(b) Dagger, the bare trustee custodian/nominee, breached its trusts when, with knowledge (through Mr Ross' position as regards each of the RAM entities), it co-operated with RAM when RAM so acted.

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[20] E McKendrick (ed) *Goode on Commercial Law* (4th ed, LexisNexis, London, 2009) at 65.

[62] Both the principal of an agent and the beneficiary of a trust have rights to require the agent or trustee herself personally:[21]

(a) To restore to the principal/the trust fund the very property misappropriated; or

(b) To restore the value of the principal's/the trust fund's property; or

(c) To pay equitable damages to compensate the principal or the beneficiary.

[63] The principal and the beneficiary also have proprietary claims, that is claims in rem, to property, tangible or intangible, held by the agent/trustee, or a third party, where the application of the rules of tracing can result in legal or equitable proprietary rights to that property being identified.

***The Priest Holdings: intangible, fungible property – implications***

[64] The final element of the legal context, in my view, is the implication of the fact that the Priest Holdings constitute intangible property. Moreover, in the modern, electronic/de-certificated world, the shares comprising the Priest Holdings are fungible. That is, there is nothing to distinguish one share in a particular company from another share in that company. Share certificates are no longer issued, and possession is not a relevant concept.

[65] As one commentator has explained:[22]

> 3.25 Thus, while it is possible at any time to determine how many of the individual securities comprised in the client holding are attributable to a particular client, it is not possible to determine which ones. A corollary of fungible custody is that the redelivery obligation owed by the custodian to each client is not an obligation to return the assets originally delivered in specie, but merely an obligation to return assets equivalent to those originally delivered.

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21 Gerard Thomas and Alastair Hudson *The Law of Trusts* (2nd ed, Oxford University Press, Oxford, 2010).

22 Madeleine Yates and Gerald Montagu *The Law of Global Custody* (4th ed, Bloomsbury Professional, London, 2012) at [3.25].

[66] An essential element of a trust is the need for certainty of subject matter.[23] Part of the Liquidators' argument is that the Priest Holdings are not sufficiently identified so as to be able to be subject to a trust. They say for that reason, if no other, the proprietary claim the Priests assert fails. It will be necessary to consider that essentially factual claim.

[67] Fungibility can also have consequences in the insolvent liquidation of a custodian, questions of fraud and breach of trust aside. It will also be necessary to consider whether those consequences are relevant here.

## Analysis

### *Outline*

[68] The Priests advance an orthodox claim based on reasonably well-understood principles of legal and beneficial ownership, and the rights of a beneficial owner to require a bare trustee to act in accordance with her instructions.

[69] The Liquidators' proposition of the acquisition of a shared proprietary interest in the Priest Holdings which ranks in priority to any claim to that property of the Priests is, in my view, and although the Liquidators would have it otherwise, less orthodox.

[70] I will, therefore, consider the Liquidators' argument for a shared proprietary right first. If the Liquidators are correct on that point, they succeed.

[71] If I am not so persuaded I will need to consider whether the Priests' claim to all the shares comprising the Priest Holdings, including the Nessock Shares, correctly reflects the competing proprietary claims of the Priests and the Other Investors, including as affected by the implications of the fact that shares constitute intangible, fungible, property rights.

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23 Thomas and Hudson, above n 21, at [3.01].

***The Liquidators' shared proprietary right argument***

*Overview*

[72] The Liquidators conceptualise the Priest Holdings, together with the other shares held by RAM or Dagger, as a mixed pool of trust funds and assets. They then say that the rule in *Clayton's Case* (the first in, first out rule) is the starting point for how the assets in such a mixed pool are to be allocated amongst the Priests and the Other Investors.[24] But, they say, there is a range of well recognised circumstances where the courts have not followed the *Clayton's Case* approach.

[73] One example is the Court of Appeal's decision in *Re Registered Securities Ltd*.[25] There pro rata sharing was directed, based on a proprietary entitlement which existed because the investors funds had been held on trust. The Liquidators claim the Other Investors have a similar proprietary interest in this case. That is because the money used to pay for the Priest Holdings was money held on trust for the Other Investors. The Other Investors can, therefore, trace their money to the Priest Holdings which should be shared amongst the Other Investors (including the Priests) pro rata their loss. The Liquidators point to other, principally English, authority to the same effect. The Liquidators place particular reliance on the equitable doctrine of tracing, and its application in cases such as *Foskett v McKeown*.[26]

[74] In my view, and as the Priests argued, in doing so the Liquidators confuse or conflate two distinct matters. They are:

(a) pari passu sharing directed as a result of a pragmatic decision where tracing is not possible to allocate losses amongst those who have suffered a common misfortune; and

(b) pari passu sharing as recognised in the context of the equitable tracing rules.

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24 *Devaynes v Noble, Clayton's Case* [1814–23] All ER Rep 1.
25 *Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA).
26 *Foskett v McKeown* [2001] 1 AC 102 (HL).

[75] They would appear to have done so, at least in part, because of their recognition of *Clayton's Case* allocation as the starting point, to which proprietary pro rata sharing is a well recognised departure.

[76] The tracing of money into and out of bank accounts presents conceptual difficulties which reflect the nature of the property "money in a bank account" constitutes. As Lord Millett explained in *Foskett v McKeown*:[27]

> We speak of money at the bank, and of money passing into and out of a bank account. But of course the account holder has no money at the bank. Money paid into a bank account belongs legally and beneficially to the bank and not to the account holder. The bank gives value for it, and it is accordingly not usually possible to make the money itself the subject of an adverse claim. Instead a claimant normally sues the account holder rather than the bank and lays claim to the proceeds of the money in his hands. These consist of the debt or part of the debt due to him from the bank. We speak of tracing money into and out of the account, but there is no money in the account. There is merely a single debt of an amount equal to the final balance standing to the credit of the account holder. No money passes from paying bank to receiving bank or through the clearing system (where the money flows may be in the opposite direction). There is simply a series of debits and credits which are causally and transactionally linked.

[77] It would appear to have been because of those conceptual difficulties that *Clayton's Case* became part of the rules of tracing.

*Clayton's Case and its relevance to the rules of tracing*

[78] It has been recognised in many decisions that *Clayton's Case* involves neither a breach of trust nor any question of tracing. Rather, it establishes a presumption (often called a rule) as to how the balance of a current account at a bank is identified and allocated for certain purposes.

[79] Clayton, the creditor, operated a current account with a banking partnership. Whilst that partnership was solvent, one of its partners, Devaynes, died. The surviving partners subsequently went bankrupt. Clayton then claimed against Devaynes' (solvent) estate. He did so on the basis that Devaynes' estate was liable to him because the partnership had owed him money when Devaynes died, and still did. The Court found that withdrawals made by Clayton from that account after

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27 At 127–128.

Devaynes' death had extinguished any debt owed by the partnership to Clayton at the time of Devaynes' death. The first item on the debit side of an account was discharged or reduced by the first item on the credit side. *Clayton's Case* thus established the "first in, first out" principle, known as the "FIFO" rule (essentially of accounting) which is applied today to the operation of current accounts.

[80] The significance of *Clayton's Case* in the tracing context is reflected in the nineteenth century case of *Re Hallett's Estate*.[28]

[81] Hallett was a solicitor. After his death, various persons claimed against money in an account with his bankers. Hallett had misappropriated, in effect stolen, bearer bonds belonging to his marriage settlement trust and to a client, Mrs Cotterill. He deposited the proceeds of the sale of those bonds into his account with his bankers. Hallett's general creditors, the trustees of his marriage settlement trust, and Mrs Cotterill competed over the funds in that bank account. As relevant, two issues were involved:

(a) Hallett was not a trustee of his defrauded client Mrs Cotterill, but as her solicitor and agent he owed her fiduciary obligations. Did that fiduciary relationship allow Mrs Cotterill to trace in equity the proceeds of the sale of her stolen bonds into Hallett's bank account? In that way, Mrs Cotterill would gain priority over the general creditors.

(b) Did *Clayton's Case* apply as between the trustees and Mrs Clayton, given that Hallett's bank account contained a mixture of their trust monies and monies belonging to Hallett? If it did the trustees missed out. Applying *Clayton's Case*, their monies had gone. They would have to compete with the general creditors for any surplus.

[82] On the first issue, Fry J found for Mrs Cotterill, giving her priority over the general creditors. He said:[29]

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28 *Knatchbull v Hallett, Re Hallett's Estate* (1880) 13 Ch D 696; [1874-80] All ER Rep 793.

29 At 702 and 703.

> In that state of circumstances the question arises whether Mrs Cotterill is entitled to follow this money. It has been argued that Mr Hallett was a trustee for Mrs Cotterill. In that view I cannot concur; but it appears to me that he was solicitor for her, that he was agent for her, and that he was bailee for her. I think, therefore, that he stood in what has been called a fiduciary relation towards her. …
>
> I think that in this case – finding the fiduciary relationship, and finding the violation of that duty in the manner I have described – I am bound to give Mrs Cotterill the same relief as if Mr Hallett had been a trustee for her. That being so, the result is that she is entitled to follow the balance standing to his credit in his bankers' account, in the manner indicated when I gave judgment on the summons of the trustees.

[83] The Court of Appeal upheld that decision. Thus *Hallett's Estate* is, in the first instance, authority for the principle that not only will equity allow tracing where a trustee has misapplied funds, but will also do so where the wrongdoer is a fiduciary.

[84] On the second issue Fry J at first instance found that, unfettered by authority, he would not have applied the rule in *Clayton's Case*. He said:[30]

> The second question is whether *Clayton's Case* (6) applies. Now, if the matter were unfettered by authority, it would appear to me clear that where a man has a balance to his credit consisting in part of funds which are his own, and which he may lawfully draw out and apply for his own purposes, and in part of funds which he may not lawfully draw out and apply for his own purposes, his drawings for his own purposes ought to be attributed to his own funds, and not to the trust funds.

[85] If the flow of funds in *Hallett's Estate* was allocated in that way, the balance of trust funds left to Hallett's credit at his bank was sufficient for both the trustees of his marriage settlement and for Mrs Cotterill. Fry J felt bound, however, by the authority of *Pennell v Deffell* where Lord Justice Knight Bruce had said:[31]

> It may be, however, and, as I think, is true, that cheques drawn by the trustee in a general manner upon the bank would, for every purpose, be ascribed and affect the account in the mode explained and laid down by Sir W Grant in *Clayton's Case*. The principles there stated would, I conceive, be applicable, notwithstanding the different nature and character of the sums forming together the balance due from the bank to the trustee, whatever the purposes and objects of the cheques.

[86] The Court of Appeal did not disagree with the general proposition in *Pennell v Deffell*, namely that where trust monies of two or more beneficiaries had been

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30 At 699.

31 *Pennell v Deffell* 4 DE G M & G 371, 43 ER 551 at 384.

mixed in a bank account, the rule in *Clayton's Case* was to be applied to decide – where there was a shortfall – whose monies remained in the account and, therefore, whose claim to those monies succeeded. In terms of that authority, therefore, *Clayton's Case* becomes part of the rules of tracing. That is, if the application of the rule in *Clayton's Case* means the claimed balance no longer represents a particular beneficiary's monies, there is no property in the bank account they can trace into. However, the Court of Appeal held it could apply the principle that a trustee who blended trust money with her own money could not then say that she used the trust money in breach of trust when she had a right to use her own money. In that way, the rule in *Clayton's Case* was disapplied and, as Fry J would have done, the Court provided for both Mrs Cotterill and the trustees.

*The "exceptions" to Clayton's Case allocation*

[87] Since *Hallett's Estate* a series of English decisions are said by the Liquidators to have accepted *Clayton's Case* tracing as the starting point for settling claims in insolvent liquidations by beneficiaries to bank accounts in which trust monies have been mixed. The cases have, however, identified particular circumstances where that approach need not been taken.

[88] The Liquidators, relying on *Barlow Clowes International Ltd* submitted that there were, therefore, two categories of recognised departure from the rule in *Clayton's Case* where mixed funds were involved.[32] These were:

(a) Where it would be impractical to apply *Clayton's Case* on the facts of the case. The Liquidators place the circumstances relating to the Priest Holdings in that category. But, they do so not by reference to the way in which shares came and went from RAM and Dagger, but rather by reference to the RAM bank account, and the flow of funds through it.

32 *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22 (CA).

(b) Where to apply the rule would cause some sort of injustice to innocent contributors, usually, as the Liquidators put it, because there was a contrary intention evident on the facts of the case.

[89] I accept this as an accurate statement of English law as to the exceptions to *Clayton's Case*. By November 1991 the New Zealand courts had, as reflected by the Court of Appeal's decision in *Re Registered Securities Ltd*,[33] come to a very similar, but arguably broader circumstances where the *Clayton's Case* approach to tracing would not be followed.

[90] In cases where the *Clayton's Case* approach has not been followed, especially when this is due to the impracticality of applying the rule in *Clayton's Case* a form of pro rata sharing often described as "pari passu" has been applied. A further method of tracing when *Clayton's Case* tracing is not applied has been suggested. This is known as the "rolling charge" or "North American" method. It has been preferred in a number of the Canadian and United States courts. In a case such as this, where the number of investors is so great, this method is recognised as being too complex and costly.[34] No one argued for that approach here.

[91] The Liquidators at one point refer to the concept of a "rolling charge" in support of their proprietary pro rata sharing argument. As I understand it, that is a phrase only used in the context of the "North American" method. Accordingly, it being accepted here that the North American method was not appropriate, that reliance does not assist their argument.

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33 *Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA).

34 *Barlow Clowes*, above n 32, at 916: "This method goes on the basis that where funds of several depositors, or sources, have been blended in one account, each debit to the account, unless unequivocally attributable to the monies of one depositor or source (eg as if an investment was purchased for one), should be attributed to all the depositors so as to reduce all their deposits pro rata, instead of being attributed, as under *Clayton's Case*, to the earliest deposits in point of time. The reasoning is that if there is an account which has been fed only with trust moneys deposited by a number of individuals, and the account holder misapplies a sum from the account for his own purposes, and that sum is lost, it is fair that the loss should be borne by all the depositors pro rata rather than the whole loss should fall first on the depositor who made the earliest deposit in point of time."

***Pro rata sharing***

*Re Registered Securities Ltd*

[92] It is on those cases, establishing the exception to *Clayton's Case*, that the Liquidators base their argument for pro rata sharing. As will become apparent, the difficulty here is that the competition between the Priests and the Other Investors is not to monies in a bank account, but to shares.

[93] The Liquidators began their argument for pro rata sharing with *Re Registered Securities Ltd*.[35] That case concerned the insolvency of a contributory mortgage broking company, Registered Securities Ltd (RSL). In principle RSL received depositors' monies, placed them in one of two trust accounts (for first and second mortgage investments respectively) and applied those monies by way of mortgage advances, issuing "certificates" to evidence an individual depositor's investment in (ie contribution to) a particular mortgage. Unwittingly anticipating the consequences of the company's subsequent difficulties, RSL's brochure asked and answered the following question:[36]

> Q. Are my funds pooled?
>
> A. No, they are not. They are either in the trust account awaiting allocation, or they are advanced on mortgage and allocated to a specific security.

[94] As can be seen, RSL's arrangements necessarily involved the pooling, that is the mixing, of investors' funds, both in the two current accounts and in a particular, contributory, mortgage. A bank has, at most, only one debt per account to its customer.[37] Likewise, a mortgagor only has one debt to the (nominee) mortgagee.

[95] RSL failed. As the headnote describes:[38]

> At the time of the collapse of RSL and the appointment of provisional liquidators a substantial number of separate investments had not been allocated to any mortgage, parts of the principal of some mortgages and the whole of one large mortgage had not been expressly allocated, inward flow

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35 *Re Registered Securities Ltd*, above n 25.
36 At 548.
37 Consolidation of accounts may reduce that number further. Set-off could extinguish those debts.
38 At 545.

> of interest was far short of that which RSL had undertaken to pay its investors, many of the properties mortgaged were inadequate to secure sums advanced and huge losses had been sustained.

[96] The effects of the way in which RSL had dealt with investors' cash (that is, their deposits) was described by its liquidators in the following terms:[39]

> (a) In the vast majority of cases the trust cash cannot be traced to the mortgage to which that investor was at some time allocated. In the great majority of cases it is highly unlikely that the investor's cash went to the mortgage to which he or she was allocated. This is because of the timing differences described below and because we can trace the cash to any of a number of other destinations with a higher degree of probability.
>
> (b) In a number of cases, each of which is described below, we have been able to trace the investors' cash to one specific destination with certainty and in all of these cases that destination is other than the mortgage to which the investor has been allocated.[40]

[97] The primary question raised by the liquidators' application for directions was whether mortgages purported to have been allocated by RSL in whole or in part to individual investors, as represented by certificates RSL had issued to that effect, would be treated as beneficially owned by those investors or whether the proceeds of those mortgages would be distributed pro rata. In the High Court Barker J answered that question in the affirmative, on the basis "certificated" investors had a proprietary interest to the extent certified. He did so on the basis that, notwithstanding the mixing of funds in the current accounts, the separate record RSL maintained meant that it was possible to trace the movements of an investor's investment clearly from the date it was made until the date of liquidation.

[98] In reversing that decision the Court of Appeal reasoned:

(a) If RSL had run its business as had been intended, at any particular moment the allocation of investors to a mortgage would have been

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[39] At 552.

[40] A more recent example of the chaos that the collapse of a modern financial institution can give rise to is reflected in the various decisions of courts in the United Kingdom dealing with the collapse of Lehman Brothers International. The Supreme Court's decision in *Re Lehman Brothers International (Europe) (in admin)* [2012] UKSC 6, addressing the impact of the very complex rules promulgated by the Financial Services Authority to avoid the consequences of previous failures to properly segregate client monies, illustrates that chaos, but also the inability of those inordinately complex rules to deal with that chaos.

conclusive, irrespective of whether that allocation reflected the *Clayton's Case*, first in, first out rule on movements in a bank account.

(b) But, RSL had mixed the depositors' funds in the trust account, and used depositors' funds to pay interest. The Court continued:[41]

> Where a trustee mixes the funds of more than one beneficiary and there is a subsequent shortage it has been held that as between the beneficiaries the rule in *Clayton's Case* (1816) 1 Mer 572 applies, that is to say the money of the beneficiary first paid in is the first drawn out; see eg *Re Stenning* (1895) 2 Ch 433; Fry J in *Re Hallett's Estate* (1879) 13 Ch D 696; *Hancock v Smith* (1889) 41 Ch D 456, 461; and, between beneficiary and volunteer, *Re Diplock, Diplock v Wintle* [1948] Ch 465, 551-553.

(c) However, the automatic application of the rule, which in RSL would have negated the certificates, "would not stand scrutiny". It was a fiction, and could not be allowed to work an injustice. Being based on a presumed intent, it must give way to an express contrary intention, or circumstances which point to that intention:[42]

> It must follow in our view that where a trustee mixes the funds of different beneficiaries a withdrawal which is expressly or by implication intended to be to the account of one particular beneficiary must be so treated. In such a case there is no apparent equity in that beneficiary entitling him to impose part of the loss on the other.

(d) That consideration, therefore, gave the certificates prima facie validity. But, the Court reasoned further, no-one has a right to property which did not belong to her and, if money of the person to whom a certificate was given was never available to be applied to the mortgage in question, the expressed intentions of RSL would not convey any proprietary interest.[43]

(e) It was normally for a claimant to trace her money. But here the allocations represented by the certificates had sufficient apparent

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41 At 553.
42 At 553.
43 At 554.

validity to require the liquidators to disprove the title evidenced by those certificates.[44]

[99] The Court then considered the liquidators' evidence which sought to establish that proposition. The point of the liquidators' evidence was to show that the proprietary interests reflected by the certificates could not be validated by a traditional tracing exercise. The Court concluded:[45]

> The evidence indicates that in the great bulk of cases, perhaps in nearly every case, the money of the allotted contributors was not advanced to the mortgagors to whom it was credited. It must follow that a division of assets related to the contribution of each investor is the only rational mode of distribution at least in relation to sums allocated to mortgages.

[100] That is pro rata sharing was preferred both to sharing based on taking the certificates at face value and to sharing based on a *Clayton's Case* first in, first out basis.

[101] It is to be noted in *Re Registered Securities Ltd* that, although the investors' monies had initially been mixed in the trust accounts, the investors would not appear to have been competing over money in a bank account. Rather, they were competing over the property reflected by contributory mortgages which had been advanced from those trust accounts using, as was intended, depositors' funds. There was no particular requirement, therefore, to apply a *Clayton's Case* allocation out of the trust accounts to determine the allocation of the value of the mortgages. To that extent *Re Registered Securities Ltd* may be a source of what I see as the confusion in the Liquidators' argument.

[102] The Liquidators suggest that the conceptual basis for pro rata sharing in *Re Registered Securities Ltd* was that it reflected the beneficial interest the investors acquired when "their monies" were used to pay for the contributory mortgages. That gave them a collective right to the proceeds; this being what the Liquidators called collective tracing. The Liquidators apply the same reasoning to the present case: that the Other Investors money was used to pay for the Priest Holdings, therefore "collective tracing" should be available to them.

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44 At 554.
45 At 558.

[103] In my view, that was not the basis of the decision in *Re Registered Securities Ltd*. In that case, the Liquidators' argument was that the proprietary interests represented by the contributory mortgage certificates should *not* be recognised. In preferring pro rata distribution, the Court did not rely on a recognisable proprietary interest, let alone a collective one. It said tracing to identify proprietary interests, affected in equity by a charge on a particular asset or fund to which it can be shown the claimant's property had contributed, was simply not possible.[46] First, there was the significance of RSL's accounts from time to time going into overdraft. Second, the enormous effort involved was unlikely to produce a reliable result. Therefore it followed, "that a division of assets related to the contribution of each investor is the only rational mode of distribution at least in relation to sums allocated to mortgages".[47]

*Other New Zealand cases*

[104] The Liquidators also pointed to other New Zealand cases that had departed from the *Clayton's Case* approach.

[105] In each of *Donald v Investors in the Williams Guarantee Limited Participatory Scheme*,[48] *Waipawa Finance Company Limited*,[49] *Re International Investment Unit Trust*[50] and *McKenzie (No 2)*[51] pari passu distribution was directed on the basis of fairness to all investors and/or on the basis of presumed intention. For example in *Waipawa*, the Court found that it would not have been the investors' intention, in the case of an extensive fraud, that the latest investors would be paid in full, as a *Clayton's Case* application to mixed funds in a bank account would produce. In *Re International Investment Unit Trust*[52] (another Ponzi), pari passu distribution was seen as being fairest because all investors had paid into a mixed fund knowing their money would be blended with that of other investors. Therefore, their presumed intention was also for pari passu sharing.

46 At 554, 41-49.
47 At 558.
48 *Donald v Investors in the Williams Guarantee Ltd Participatory Scheme* HC Palmerston North M46/01, 17 June 2003.
49 *Re Waipawa Finance Company Ltd* [2011] NZCLC 14 (HC).
50 *Re International Investment Unit Trust* [2005] 1 NZLR 270 (HC).
51 *McKenzie v Alexander Associates Ltd (No 2)* (1991) 5 NZCLC 67,046 (HC).
52 *Re International Investment Unit Trust*, above n 50.

[106] In *Eaton v LDC Finance Ltd (in rec)* the Court emphasised the substantive principle involved:[53]

> It follows that to do equity the context and consequential nature of the fiduciary obligations enforced should dominate the selection of the mechanism used to ascertain the beneficiaries' rightful claims on any assets.

[107] Again, it is difficult to see much support for the Liquidators' argument that the decision in *Re Registered Securities Ltd*, and other like cases in New Zealand, adopt pari passu distribution because it reflects proprietary rights. Rather, in all those cases it would appear to have been seen as a pragmatic and fair way to share a common misfortune. It is the misfortune being common that gives rise to the pari passu distribution, rather than some pre-existing proprietary right held in common.

*The English cases*

[108] The Liquidators argue further that the English cases which give rise to the exceptions to the rule in *Clayton's Case*[54] recognised in *Barlow Clowes*,[55] also favour pro rata distribution. Hence those cases also are authority for the pro rata sharing they argue for. Of particular relevance are two cases followed by the English Court of Appeal in *Barlow Clowes*, namely *Sinclair v Brougham*[56] and *Re Diplock*,[57] and the decisions in *Barlow Clowes* itself and in *Foskett v McKeown*.[58]

[109] The relevance of these cases is in as far as they recognise some form of collective right to tracing akin to the rights the Liquidators say the Other Investors have to the Priest Holdings.

*Sinclair v Brougham*

[110] In *Sinclair v Brougham* an insolvent building society had, outside its powers, run a banking business. The case concerned the competing claims of the unadvanced shareholders of the building society's intra vires business (that is, members of the society who had not been granted mortgages) and the depositors of its ultra vires

53 *Eaton v LDC Finance Ltd (in rec)* [2012] NZHC 1105 at [62].
54 *Clayton's Case*, above n 24.
55 *Barlow Clowes*, above n 32.
56 *Sinclair v Brougham* [1914] AC 398 (HL).
57 *In Re Diplock: Diplock v Wintle* [1948] 1 Ch 465, [1948] 2 All ER 318.
58 *Foskett v McKeown*, above n 26.

banking business. The claims of all other creditors had, by agreement, been met. It was accepted that contracts entered into for the purposes of that ultra vires business, which by the time of bankruptcy had become the society's predominant business, were, so far as the society was concerned, void. The issue was the significance of that fact for the priority of claims of the shareholders and the depositors to the funds held by the Liquidators.

[111] In the High Court and the Court of Appeal the unadvanced shareholders prevailed: the depositors' contracts were void, and therefore would only be honoured to the extent that all prior valid claims had been met.

[112] In the House of Lords the competing claims for priority of both the unadvanced shareholders and the depositors were declined. The House of Lords held that the available funds should be shared pro rata, an outcome that had not been considered until raised by one of their Lordships[59] during argument.

[113] The bases upon which their Lordships reached that conclusion are not easy to express succinctly. In *Westdeutsche Landesbank v Islington London Borough Council* the House of Lords noted the difficulty of identifying any single legal rationale for the decision.[60] Four of the five Law Lords wrote separately. Whilst all agreed the depositors' claims for monies had and received failed, they arrived at the conclusion that the depositors would share pro rata with the unadvanced shareholders by different routes. *Re Diplock* helps to explain this.[61]

[114] The Court in *Re Diplock* characterised the decision in *Sinclair v Brougham* as an extension of the principle in *Re Hallett's Estate* that the equitable right of tracing into a mixed fund could be asserted against an original mixer who was in a fiduciary relationship to the claimant, albeit that she was not a trustee of the claimant. The Court of Appeal saw *Sinclair v Brougham* as explaining that *Re Hallett's Estate*:[62]

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59 Viscount Haldane, at 404.

60 *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 699, [1996] 2 All ER 961, [1996] 2 WLR 802 at 711 per Lord Browne-Wilkinson.

61 *Re Diplock*, above n 57.

62 At 467.

> … was an illustration of a much wider principle, viz.: that one whose money has been mixed with that of another or others may trace his money into the mixed fund (or assets acquired therewith) though such fund (or assets) be held, and even though the mixing has been done, by an innocent volunteer, provided that (a) there was originally such a fiduciary or quasi-fiduciary relationship between the claimant and the recipient of his money as to give rise to an equitable proprietary interest in the claimant; (b) the claimant's money is fairly identifiable; and (c) the equitable remedy available, i.e. a charge on the mixed fund (or assets), does not work an injustice.

[115] As those comments make clear, *Sinclair v Brougham* applied *Hallett's Estate* on the question of following or tracing: that is, it applied the reasoning by which Fry J and the majority in the Court of Appeal concluded that Mrs Cotterill could follow into the proceeds of the sale of her bonds, and thus have priority over the general creditors. Having done so, an equitable proprietary remedy may be available.

[116] Lord Parker, whose reasoning the Court in *Re Diplock* preferred, reasoned that at law the lender in an ultra vires loan transaction had the right to a tracing order. The lender could, so long as he could identify it, recover all her money. Such identification was not possible. Equity, however, approached the situation differently: it considered that the relationship between the directors or agents and the lender was a fiduciary relationship, and that the money coming into their hands was for all practical purposes trust money:[63]

> Starting from a personal equity, based on the consideration that it would be unconscionable for anyone who could not plead purchase for value without notice to retain an advantage derived from the misapplication of trust money, it ended, as was so often the case, in creating what were in effect rights of property, though not recognised as such by common law.

[117] On the facts, the equity lay in that it would be unconscionable for the society to retain the amount by which its assets had been increased by, and in fact still represented, the borrowed monies. The unadvanced shareholders had a similar equity, to the extent that their monies had been applied in the ultra vires business. The equities of the ultra vires lenders and of the society being equal, a pro rata sharing was the appropriate way of distribution. Starting from *Clayton's Case*, and then departing from it, does not feature in that analysis.

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63 *Sinclair v Brougham*, above n 56, at 441–442.

[118] Having said that, I note that Viscount Haldane did approach the question by assuming that specific tracing was not possible and, on that basis, concluding that pro rata sharing was the way to apportion the monies. He said:[64]

> ... The depositors can, in my opinion, only claim the depreciated assets which represent their money, and nothing more. It follows that the principle to be adopted in the distribution must be apportionment on the footing that depreciation and loss are to be borne pro rata. I am, of course, assuming in saying this that specific tracing is not now possible.
>
> What is there must be apportioned accordingly among those whose money it represents, and the question of how the apportionment should be made is one of fact. In the present case the working out of a proper apportionment based on the principle of tracing not only would involve immense labour but would be unlikely to end in any reliable result. The records necessary for tracing the dealings with the funds do not exist. We have therefore, treating the question as one of presumption of fact, to give such a direction to the liquidator as is calculated to bring about a result consistent with the principles already laid down.

[119] In reaching the conclusion that pro rata sharing should apply, the Court in *Sinclair v Brougham* would not appear to have considered *Clayton's Case* as the starting point, albeit one to be departed from. It should be noted that the House of Lords in *Westdeutsche* state that it is not always clear in *Sinclair v Brougham*:[65]

> ... whether this House was laying down a general proposition of law or merely giving directions as to the proper mode in which the assets of the liquidation should be distributed.

[120] The Court in *Sinclair v Brougham* does not characterise the interests of the depositors in the way the Liquidators characterise the interests of the Other Investors in the Priest Holdings, that is, as a beneficial interest which arose simultaneously with the acquisition by RAM or Dagger of those shares.

*Re Diplock*

[121] The Liquidators point to *Re Diplock*[66] as another example of the first category of exception to *Clayton's Case* and, as such, also supporting the pro rata distribution they argue for. In my view, it is wrong to characterise *Re Diplock* as

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64 *Sinclair v Brougham*, above n 56, at 424.
65 *Westdeutsche*, above n 40, at 710 per Lord Browne-Wilkinson.
66 *Re Diplock*, above n 57.

being such an example. It is, like *Foskett v McKeown* and as the Priests argued, a tracing case.

[122] *Re Diplock* involved challenges by the family of the deceased, Mr Diplock, to charitable bequests made from his estate. Mr Diplock had directed his executors to apply his residuary estate for charitable purposes. The executors purported to do so. There was no question that the distributions had been made and received in good faith. Their actions were subsequently challenged successfully by the next of kin of Mr Diplock, on the basis that the original bequest was invalid because of its disjunctive reference to "charitable or benevolent object or objects".

[123] The claims of the next of kin fell into two main categories:

(a) Claims in personam, based on the alleged right of an unpaid or underpaid beneficiary to recover money overpaid to a stranger to the estate.

(b) Claims in rem, based on the right of "tracing" assets, where they or their proceeds could be identified in the hands of those innocent parties who had wrongly received them, and thus mixed those assets with their own.

It is the second category of claim that is relevant here.

[124] The plaintiffs were largely unsuccessful in the High Court; wholly as regards their in personam claims, and mostly as regards their in rem claims.

[125] The next of kin appealed, except as regards their successful in rem claims. The Court of Appeal dealt first with the in personam claims.[67] After a lengthy consideration of numerous authorities, dating back to 1669, the Court concluded the next of kin did in equity have claims in personam against the recipient institutions. The Court's reasoning is not, thankfully, relevant here. Whilst therefore not strictly necessary, the Court went on to consider the claims in rem.

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67 Lords Greene MR, Wrottesley and Evershed LJJ.

[126] The problem was that, in general terms, those monetary bequests had – in good faith and without knowledge of the claims of the next of kin – been mixed by the recipients with monies of their own, or had been spent – for example on improvements to real property. The High Court found that such a claim was only available where the relevant trustee/fiduciary was herself responsible for the mixing of the fund. The Court of Appeal did not so agree. To reach that conclusion the Court went back to first principles. *Sinclair v Brougham* was of fundamental importance to that analysis, notwithstanding that the opinions in that case were "not only difficult to follow but difficult to reconcile with one another".[68] The Court identified the principle on which *Sinclair v Brougham* was based as being that:[69]

> … the principle clearly indicated by Lord Parker, that equity may operate on the conscience not merely of those who acquire a legal title in breach of some trust, express or constructive, or of some other fiduciary obligation, but of volunteers provided that as a result of what has gone before some equitable proprietary interest has been created and attaches to the property in the hands of the volunteer.

[127] That principle operated in different ways according to the circumstances. As the head note summarises:

> Thus:
>
> (a) Where the defendant is in a fiduciary relation to the claimant, and has mixed the claimant's money with his own, the claimant takes priority. The same result follows if the defendant had notice that the money was in equity the claimant's.
>
> (b) Where the contest is between two claimants to a mixed fund consisting of moneys belonging to both and therefore held on behalf of both, they share pari passu.
>
> (c) Where the claimant's moneys are handed by way of transfer to a person who takes for value without notice of the claimant's equity, the claim (like all equitable claims in like circumstances) is extinguished.
>
> (d) In the case of a volunteer who takes without notice (e.g., by way of gift from the fiduciary agent), if there is no question of mixing, he holds the money on behalf of the true owner, whose equitable right to the money still persists as against him.
>
> (e) But if the volunteer innocently mixes the money with money of his own, or receives it mixed with his own money from a fiduciary

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68 At 344.
69 At 351.

> agent, he must admit the claim of the true owner, but is not precluded from setting up his own claim in respect of the moneys which he has contributed to the mixed fund, the result being that they share pari passu, either being entitled to priority.

[128] Given no doubt the importance of the decision in *Sinclair v Brougham* for its decision, the Court in *Re Diplock* then explained the outcome in *Sinclair v Brougham* in the following terms:

(a) The fund to be distributed constituted a fund in the hands of the society.

(b) That fund comprised a mixture of the society's funds (from the shareholders) and funds to which the society had no equitable title (from the depositors).

(c) The directors had, in violation of the depositors' rights, mixed the depositors' funds with those of the society.

(d) The society was, as regards the depositors' funds, a volunteer holding legal title. As such it was compelled to recognise the equal equitable title of the depositors, as were the shareholders claiming through the society.

(e) Thus neither the society nor the depositors could claim priority. To allow either to claim priority would be unjust. If the depositors were to claim priority this would treat the society as being in a fiduciary relationship to the depositors (which it was not), and in as bad a position as the unfaithful agent in *Hallett's Estate*.

[129] Having explained the outcome in *Sinclair v Brougham*, the Court observed:[70]

> This explanation appears to us to accord with the fundamental conception which lies at the root of this equitable jurisdiction, i.e., that equity intervenes not to do what might be thought to be absolute justice to a claimant but to prevent a defendant from acting in an unconscionable manner. Equity will not restrain a defendant from asserting a claim save to the extent that it

[70] At 352.

> would be unconscionable for him to do so. If this limitation on the power of equity results in giving to a plaintiff less than what on some general idea of fairness he might be considered entitled to, that cannot be helped.

[130] No part of that analysis recognises a departure from *Clayton's Case* sharing. The Court on several occasions notes that *Clayton's Case* was neither a tracing nor a trust case, and that none of the cases referred to before the Court involved any argument that *Clayton's Case* had anything to do with the tracing arguments. The references to *Clayton's Case*, such as they are, would appear to have been made in response to the argument for the next of kin that the starting point of the analysis was that *Clayton's Case* should not be followed. But that was not the way the Court saw it.

[131] The Court of Appeal went on to apply those principles to the various situations in which bequests had been paid to charitable institutions. *Clayton's Case* had some relevance to the decisions that were finally made. But in doing so the Court expressly rejected the application of the rule in *Clayton's Case* to anything other than money bank accounts.[71] *Re Diplock* is an example of a traditional tracing case. It does not, however, support the Liquidators' argument for pro rata sharing.

*Barlow Clowes*

[132] The Liquidators see *Barlow Clowes*[72] as falling into the second category of exception to *Clayton's Case*. Namely, it was a situation where an injustice would result or a contrary intention can be identified. They point to the pari passu sharing which was directed in that case as further support for their argument for pro rata sharing.

[133] Barlow Clowes was a deposit taking company which promoted and managed certain investment plans and which collapsed. In the case of two of those plans, portfolios 28 and 68, at the time of the collapse the amount available for distribution to investors was far less than the amount of their claims. The receivers brought proceedings for directions. The investors who contributed later in time (the late investors) contended that the available assets should be distributed on the basis that

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[71] At 364.
[72] *Barlow Clowes*, above n 32.

withdrawals from the investment fund and its consequent depletion had been made on a first in, first out basis so that the late investors were those most likely to be repaid. Other investors (the early investors) contended that the first in, first out rule should not apply. At first instance, the Court found in favour of the late investors applying the first in, first out rule. The early investors appealed. That appeal was advanced on both a broad and a narrow basis. The broad basis was that *Clayton's Case* should not be applied because to do so would, as a matter of principle, be illogical and unfair. The narrower basis was that the available funds in question constituted common funds[73] and as such it would be contrary to the presumed intention of the investors to apply the first in, first out rule. On that basis, and by reference to authority, *Clayton's Case* should not be applied.

[134] The Court rejected the broader proposition, and accepted the narrower. It rejected the broader proposition because it saw *Re Hallett's Estate* and *Sinclair v Brougham* as not rejecting completely that the principle in *Clayton's Case* applied as between beneficiaries where there was a shortfall in a fund in a bank account comprising the account holder's own monies and monies held for different fiduciary purposes. The Court accepted the narrower proposition on the basis that where investors deposit into a common fund, they would expect to share losses rateably.

[135] Treating the Barlow Clowes investment arrangements as a common fund, all the investors had equitable charges, their equities were equal and they presumably intended their money to be dealt with collectively. Accordingly, rateable sharing, as in *Sinclair v Brougham*, was the appropriate outcome. This was described by Lord Woolf as the "pari passu ex post facto solution".[74]

[136] The Liquidators argue that the adoption of the pro rata outcome in *Barlow Clowes* supports their claim for pro rata sharing. Given Lord Woolf's description, that does not follow.

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73 As discussed in McKendrick, above n 20.
74 At 36.

*Foskett v McKeown*

[137] The Liquidators place considerable reliance on the more recent decision of the House of Lords in *Foskett v McKeown* as mentioned above.[75] That case involves claims by defrauded investors to the benefit of a life insurance policy. The investors had deposited monies on trust with a property developer to fund a development. The developer failed to develop the land. The investors' money was lost. It transpired, however, that the developer had used a small portion of the investors' monies to pay two of the five premiums on a life insurance policy he acquired for his own benefit. Before his death by suicide, the developer settled the policy on trust for his children.

[138] In effect, the High Court found for the investors; and the Court of Appeal for the children. There were appeals and cross-appeals to the House of Lords.

[139] A majority of the House of Lords concluded that, although the children "owned" the policy, its proceeds should be shared by the children with the defrauded investors to the extent (pro rata) that investor monies had paid for the policy. The Liquidators point to observations of Lord Browne-Wilkinson and Lord Millett in that case, when arguing that their approach to the Priests' claim is one based on orthodox principles of property law and recognises "hard-nosed property rights",[76] rather than being based on what might be seen to be a "fair, just and reasonable"[77] outcome.

[140] Four of the five Law Lords agreed that the investors were able to trace into the proceeds of the policy. The dissenter on that point was Lord Hope of Craighead. Of the four, Lord Steyn did not accept that tracing gave rise to a proprietary claim, and so joined the minority. Of the remaining three, Lords Browne-Wilkinson and Hoffman agreed with Lord Millett, who reasoned:[78]

> My Lords, this is a textbook example of tracing through mixed substitutions. At the beginning of the story the plaintiffs were beneficially entitled under an express trust to a sum standing in the name of Mr Murphy in a bank account. From there the money moved into and out of various bank accounts where in breach of trust it was inextricably mixed by Mr Murphy with his own money. After each transaction was completed the plaintiffs'

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75 *Foskett v McKeown*, above n 26.
76 At 109.
77 At 109.
78 At 126 G and H and 127 A, E and F.

money formed an indistinguishable part of the balance standing to Mr Murphy's credit in his bank account. The amount of that balance represented a debt due from the bank to Mr Murphy, that is to say a chose in action. At the penultimate stage the plaintiffs' money was represented by an indistinguishable part of a different chose in action, viz, the debt prospectively and contingently due from an insurance company to its policyholders, being the trustees of a settlement made by Mr Murphy for the benefit of his children. At the present and final stage it forms an indistinguishable part of the balance standing to the credit of the respondent trustees in their bank account. …

> Having completed this [the tracing] exercise, the plaintiffs claim a continuing beneficial interest in the insurance money. Since this represents the product of Mr Murphy's own money as well as theirs, which Mr Murphy mingled indistinguishably in a single chose in action, they claim a beneficial interest in a proportionate part of the money only. The transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment. There is no "unjust factor" to justify restitution (unless "want of title" be one, which makes the point). The claimant succeeds if at all by virtue of his own title, not to reverse unjust enrichment. Property rights are determined by fixed rules and settled principles. They are not discretionary. They do not depend upon ideas of what is "fair, just and reasonable". Such concepts, which in reality mask decisions of legal policy, have no place in the law of property.

[141] Lord Millett illustrates the proprietary nature of that claim of the investors in the following way:[79]

(a) Where a trustee wrongly misappropriates trust property, and uses it to acquire other property for his own benefit, the beneficiary is entitled at his option either to assert his beneficial ownership, ie to make a claim in rem to that other property, or to bring a personal claim against the trustee and enforce an equitable lien or charge on the proceeds to secure restoration of the trust property. Both remedies are proprietary, and depend on successfully tracing the trust property into its proceeds.

[79] *Foskett v McKeown*, above n 26.

(b) A more complicated case was one involving a mixed substitution.[80] That occurred where the trust money represented only part of the cost of acquiring the new asset. In that situation:[81]

> … the beneficiary is entitled *at his option* either to claim a proportionate share of the asset or to enforce a lien upon it to secure his personal claim against the trustee for the amount of the misapplied money. It does not matter whether the trustee mixed the trust money with his own in a single fund before using it to acquire the asset, or made separate payments (whether simultaneously or sequentially) out of the differently owned funds to acquire a single asset.

(c) The beneficiary's right to claim a lien or charge was available only against the wrongdoer, and those deriving title under him other than for value. It was not available against competing contributors who were innocent of wrongdoing.[82]

> Innocent contributors … must be treated equally inter se. Where the beneficiary's claim is in competition with the claims of other innocent contributors, there is no basis upon which any of the claims can be subordinated to any of the others. Where the fund is deficient, the beneficiary is not entitled to enforce a lien for his contributions; all must share rateably in the fund.
>
> The primary rule in regard to a mixed fund, therefore, is that gains and losses are borne by the contributors rateably.

[142] What Lord Millett would appear to be saying is that the proprietary claim, given effect to in equity by the equitable charge or lien, is not available as against another innocent contributor. It is only available against the wrongdoer or an innocent volunteer whose property has become mixed with trust property. But here the Liquidators argue for a proprietary claim against an innocent contributor, the Priests. Moreover, the proprietary claim is remedial. Tracing is a pre-condition to its existence. As explained by Lord Millet:[83]

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80 When Lord Millett refers in *Foskett v McKeown* to a "mixture" he is, therefore, referring to the mixture represented by the proceeds of the insurance policy, being in part derived from Mr Murphy's own monies and in part from the investors' monies. He is not referring to any mixing of Mr Murphy's monies with the beneficiaries' monies in Mr Murphy's bank accounts, or the mixing of the beneficiaries' monies inter se.

81 At 130.

82 At 132.

83 At 128.

> Tracing is thus neither a claim nor a remedy. It is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the person who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property. Tracing is also distinct from claiming. It identifies the traceable proceeds of the claimant's property. It enables the claimant to substitute the traceable proceeds for the original asset as the subject matter of his claim. *But it does not affect or establish his claim.* That will depend on a number of factors including the nature of his interest in the original asset. He will normally be able to maintain the same claim to the substituted asset as he could have maintained to the original asset. (emphasis added)

### *The arguments so far*

[143] Based on that analysis I am satisfied that the authorities properly understood do not support the Liquidators' argument that the Other Investors acquired proprietary rights to the Priest Holdings contemporaneously with their acquisition by RAM or Dagger. First, RAM and Dagger did not use the Other Investors' money to acquire property for their own benefit. Rather, they acquired bare title for the Priests as beneficial owners. There was no other intention at the time. There is no property of RAM or Dagger to which the Other Investors can claim beneficial ownership. Secondly, the Priests have paid for the Priest Holdings. They are therefore not innocent volunteers. The Liquidators' argument appears to involve the Other Investors making a proprietary claim not against the wrongdoer, or those deriving title under him other than for value, but from a bona fide purchase for value, and without notice of any competing claim.

[144] Thirdly, the pool of assets in question here is comprised of shares. The rule in *Clayton's Case* only applies to bank accounts. Therefore the rule and its exceptions do not apply. Fourthly, *Re Registered Securities Ltd* does not recognise a proprietary tracing claim. As expressed, pro rata sharing was a pragmatic response to a common misfortune. The Priests have not suffered any loss at the hands of RAM, Dagger or indeed Mr Ross, other than the Diligent Fraud. Subject to the resolution of this claim, they only share the Other Investors' common misfortune to that extent.

[145] Fifthly, the Liquidators' argument that the Priests cannot assert equitable title to the Priest Holdings, because they cannot prove that their monies were used when RAM/Dagger acquired its shares, is, with respect, without foundation. No case

suggests that acquiring equitable title by means of a bare trust, or indeed any title, requires the claimant to be able to trace in that way. Perhaps most importantly, *Re Diplock* and *Foskett v McKeown* held that a successful tracing exercise is a necessary pre-condition to the establishment of equitable proprietary rights. But tracing does not establish the claim. Although put somewhat differently, the following submission for the Priests captures my assessment of the Liquidators' arguments thus far:

> In particular, the Liquidators' submissions incorrectly assume that the displacement of the rule in *Clayton's Case* (FIFO) in favour of pari passu distribution is an example of collective tracing. That is wrong. Once again, the Liquidators are conflating references to pari passu sharing in the context of the equitable tracing rules on the one hand with pari passu distribution as a result of a pragmatic position when tracing is <u>not</u> possible.

[146] But that is not to say the Liquidators are wrong in arguing for pro rata sharing. The cases which discuss and apply the principles of tracing, in particular *Re Diplock* and *Foskett v McKeown* acknowledge that tracing may give rise to a proprietary interest: then again, it may not. If the Other Investors can establish a valid tracing claim, this may give rise to a proprietary interest. As the cases make very clear, the analysis of competing claims in these types of situation must be based firmly on the particulars of the transactions involved, and their proper categorisation in terms of the property interests they give rise to.

***The Priests' interests***

[147] Most fundamentally of all, and as noted, subject only to the outcome of these proceedings and the possible implications of issues of fungibility and shortfall, the loss the Priests have incurred from Mr Ross' fraud is limited to the Diligent Fraud. Interestingly, in closing, the Liquidators made the following submission:

> In relation to Mr Priest, it is accepted that his shares were all "real" and that he was not allocated fictitious shares through Bevis Marks. However, his shares were sold unlawfully and the funds used in the ponzi. There were over 99,000 Diligent shares sold in this way. On the current market value, that is 500,000. Mr Priest's "allocation" was therefore also subject to the arbitrariness evident in the fraud. Mr Ross selected shares allocated to Mr Priest to sell and place into the ponzi. No doubt he could have sold and applied more.

[148] That submission reflects the Priests' assertions of their limited involvement in Mr Ross' Ponzi. Indeed, putting aside the claims of the Other Investors, it is not clear to me that the Priests have a claim against RAM and Dagger other than to the extent of the Diligent Fraud.

[149] As the Liquidators recognise, in all other instances the Priest Holdings represent shares held and allocated to the Priests, or shares (those subject to the Nessock Transaction) which were so held and allocated or shares which were clearly purchased at the instigation of Mr Priest using RAM or Dagger as the Priests' bare trustee and, in all cases, for which as between RAM and Dagger and the Priests, the Priests have paid the purchase price.

[150] *Clayton's Case* tracing is not a requirement for the acquisition of legal or equitable title where, in the name of a bare trustee, a beneficiary acquires assets. Legal title vests in the bare trustee and beneficial title vests in the beneficiary at the time the assets are acquired. In my view, this is not a situation that requires the beneficiary to be able to show that their funds can be traced into the trust asset. It is also not a situation where the creation of the trust depends upon the intention of the bare trustee as notional settlor once the assets are purchased. Until the moment of acquisition the bare trustee has nothing to settle. At the moment of acquisition, that equitable title vests in the beneficiary, that is the person who nominated (the nominator) the bare trustee (the nominee) to acquire the property and to take legal title only. The legal (in a fused sense) effect of such a transaction is that at the time the assets are acquired the beneficiary acquires beneficial title. The bare trustee never has anything more than legal title. If a bare trustee is a settlor, as a matter of trust law she is one with a particular, and unusual, character.

[151] There can be no suggestion that when the Priest Holdings were initially acquired by RAM or Dagger, they were acquired on any basis other than that the legal title would vest in them, and beneficial title would vest in the Priests. Nor, by my assessment, can the Priest Holdings be seen as being part of a mixed fund of the type the courts have recognised, generally consisting of monies in a bank account.

[152] The shares acquired by Mr Priest in the name of RAM or Dagger were recorded accurately in the RID as allocated to the Priests. They were not allocated erroneously to any other investor. Even where the books of RAM and Dagger ceased to be correctly maintained, there was a de facto allocation to the Priests as the Priest Holdings were never erroneously allocated to any other investor. Moreover, as a result of the Nessock Transaction, the Nessock Shares were, prior to the liquidation of RAM and Dagger, transferred to a new bare custodian. This occurred in pursuance of the Priests absolute entitlement, as beneficiaries of a bare trust, to direct that transfer.

[153] It might be thought that those considerations alone were sufficient to conclude that the Liquidators could not establish that the Other Investors have "proprietary" claim to the Priest Holdings.

***Can the Other Investors nevertheless trace into the Priest Holdings?***

[154] The Priests have a propriety interest in the Priest Holdings as they are held on bare trust for their benefit. In order for the Other Investors to compete with the Priests' interests they must show that their money can be traced into the Priest Holdings.

[155] The process of tracing enables a principal/beneficiary to track the movement of any property misappropriated by an agent or dealt with by a trustee in breach of trust. A principal/beneficiary may then either seek to recover that specific property or to have the traceable proceeds of that property treated as though they had been previously part of the principal's property or of the trust fund. The term "traceable proceeds" includes any mixture of property into which that original property was passed, or any property which was substituted for that original property, or any property which was acquired with funds derived from the original property.

[156] The purpose of a claim based on tracing is to provide the claimant with some right in property, as opposed to merely a personal right against an agent, trustee or some other person. Tracing is itself merely the process of identifying the property

over which a proprietary claim can be brought.[84] Once the property which is to be the subject-matter of the claim has been identified by means of tracing, then a further question arises as to which form of remedy would be most appropriate in recognition of the value lost to the principal's property or the trust.

[157] Tracing can be effected at common law or in equity.[85] Tracing at common law is limited to the recovery of property taken from the claimant or to a substitute for that property which has been kept separate from all other property.

[158] By contrast, tracing in equity permits the claimant to establish propriety claims over any substitute for the claimant's property even if it has been mixed with other property. The practical effect of describing tracing as being merely the process of identifying the subject-matter of a further claim is to recognise that the remedy which will be imposed will be the remedy most appropriate in the circumstances. Typically, the choice of remedy will depend upon the manner in which the traced property is held.

***Collective tracing***

[159] There is no way of establishing which of the Other Investors' monies were represented in the bank account on the relevant days that the shares comprising the Priest Holdings were purchased. This means that the Other Investors cannot individually trace funds held on trust for them into the Priest Holdings. The Liquidators argue, however, that the Other Investors have a collective right to trace which competes with the Priests' interest. The Liquidators rest this argument on the fact that neither the Priests nor the Other Investors can demonstrate *Clayton's Case* tracing. That proposition sits awkwardly with the substantive approach that equity favours.

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84 *Foskett v McKeown*, above n 26, at 128.

85 There is recent authoritative judicial comment that it is no longer necessary or appropriate to speak of separate rules of tracing at law and in equity. See, for example, *Foskett v McKeown*, above n 26, at 128 per Lord Millett. The leading texts, at least those to which I was referred and to which, based on those referrals, I have subsequently gone, do not seem to regard that approach yet as orthodoxy. That may reflect the emphasis, proper in my view, that the authors of those texts give to the conceptual underpinnings of the different approaches of law and equity. Notwithstanding the fusion of law and equity, those different conceptual underpinnings remain important in understanding and applying, albeit in the one fused system, the different basic concepts, including particularly of relief, that are available.

[160] But, as I think is apparent, there are some similarities between the situation in which the Other Investors find themselves, vis-á-vis the Priest Holdings, and situations where a tracing claim has been recognised. Particularly *Foskett v McKeown* and *Re Diplock.* This requires the Liquidators propositions to be assessed further.

[161] In *Foskett v McKeown* a collective right to trace appears to have been recognised without any discussion in the House of Lords.[86]

[162] That can be explained by a procedural issue, dealt with at first instance and in the Court of Appeal, but not in the House of Lords. That was the application by Mr Foskett, one of the purchasers, to represent the other 220 purchasers.[87] As is the case here, not all individual investors could show that their money had been applied in payment of the premium. In deciding that Mr Foskett could represent the other purchasers the Court of Appeal stated:[88]

> It is not, in my opinion, to the point that one or other of the "class" may in the event be unable to show that his or her money was applied in payment of a premium. In that event the individual will be unable to share in the fruits of the action. The extent of the recovery achieved in the action will be dependent upon the amount of purchasers' money that can be shown to have been applied in payment of or towards one or more of the premiums. It is immaterial to the beneficiaries of the policy which purchaser or purchasers contributed the money that can be shown to have been so applied. It is, in my judgment, plainly expedient that the issue between the plot purchasers as a class and the beneficiaries should first be settled, and settled in a manner binding on each of the purchasers, leaving any factual issues between the purchasers inter se to be resolved subsequently without involvement or further expense of the beneficiaries.

[163] It was recognised in the Court of Appeal that sharing in the fruit of the action would depend upon establishing individual tracing, which was a factual matter. That is somewhat problematical. Only £20,440 of the purchasers' monies were used to pay for the premiums in question. Given that there were 220 purchasers, and that a total sum of £2.645 million had been invested by them, it seems highly likely that the extent to which individual purchasers could, in fact, trace would be limited. Perhaps what is more important here, however, is the recognition that individual tracing

86 *Foskett v McKeown*, above n 26.
87 Based on a procedural rule: RSC Ord 15 r 13.
88 *Foskett v McKeown* [1998] Ch 265, [1997] 3 All ER 392, [1998] 2 WLR 298 at 272 per Sir Richard Scott VC.

would be required to share the fruit of the action. In this case *no* Other Investor can so trace into the Priest Holdings.

[164] *Re Diplock* is also a case in which tracing is used to establish a proprietary interest. However, it does not offer any support for the Liquidators' concept of "collective" tracing.

[165] The Liquidators argue that the displacement of the rule in *Clayton's Case* in favour of pari passu distribution is an example of collective tracing. The Liquidators rely on *Re Registered Securities Ltd* (and other contributory mortgage cases) and *Barlow Clowes* for that argument. Neither of those cases support a collective right to trace. As discussed, the pari passu approach is not based on a proprietary right identified by tracing. *Re International Investment Unit Trust* is the strongest authority against recognising a collective right to trace.[89] Williams J, in the High Court, describes the availability of group tracing as "dubious".[90]

[166] In my view, therefore, the authorities do not establish the concept of a "collective" right to trace. It follows the Other Investors cannot establish a proprietary right in the Priest Holdings in this manner.

***Tracing the inherent value***

[167] The modern cases recognise that equity responds to the substance of what has occurred rather than – to adopt the characterisation from *Re Diplock* – its more "materialistic" appearance. It is substantive value, not notional or apparent value based on *Clayton's Case* tracing, that equity responds to. That criticism does not, in my view, give rise to any problem of uncertainty.

[168] In the recent case of *The Federal Republic of Brazil v Durant International Corporation*,[91] the Privy Council, in a single opinion given by Lord Toulson, referred favourably to observations in *Foskett v McKeown* of Sir Richard Scott VC in the Court of Appeal that "the availability of equitable remedies ought, in my view,

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[89] *Re International Investment Unit Trust*, above n 50.

[90] At [47].

[91] *The Federal Republic of Brazil v Durant International Corporation* [2015] UKPC 35.

to depend upon the substance of the transaction in question and not upon the strict order in which associated events happened".[92] In that context, the Board also referred favourably to Lord Millett's observations in the House of Lords, that what is traced is not the physical asset itself, but the value inherent in it.[93] By reference to that approach, academic commentary and the decision of the Saskatchewan Court of Appeal in *Agricultural Credit Corporation of Saskatchewan v Pettyjohn*,[94] their Lordships rejected the argument that there could never be backward tracing or that the Court could never trace the value of an assets whose proceeds were paid into an overdrawn account.

[169] In identifying her substantive value in an asset, the tracing claimant must establish a coordination between the depletion of the trust fund and the acquisition of the asset that is subject to the tracing claim. She must do so, looking at the transaction as a whole, so as to warrant the Court attributing the value of the interest acquired to the misuse of the trust fund. This, the Privy Council advised, meant that tracing through an overdrawn account would be possible.

[170] Applying that approach here, the value of the Priest Holdings is to be seen as properly representing the value provided by the Priests. In terms of the arrangement that existed between the Priests and Mr Ross, the Priests paid the full purchase price of the Priest Holdings. To the extent that it might be argued the Other Investors temporarily funded the purchase of the Priest Holdings, the value of that contribution was restored to the trust funds of the Other Investors when the Priests discharged their debt to RAM/Dagger. Thus, the Other Investors cannot establish coordination between the depletion of their trust monies and the acquisition of shares in the Priest Holdings. Their money was used by Mr Ross as part of the Ponzi scheme, it was not coordinated with the purchases of the Priest Holdings in the same manner in which the Priests funds were.

[171] The Other Investors will, quite fairly, say they provided value to Mr Ross when they established their accounts with him. That is, of course, why Mr Ross'

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92 *Foskett v McKeown*, above n 88.
93 *Foskett v McKeown*, above n 26.
94 *Agricultural Credit Corporation of Saskatchewan v Pettyjohn* (1991) 79 DLR (4th) 22 (Sask CA).

Ponzi scheme represents for many of them such a significant loss. But their relationship, through Mr Ross, with RAM and Dagger was essentially a different one. Mr Ross had a power, at his discretion, albeit in some cases within investment guidelines or ratios, to use cash they had deposited with him to buy shares on their behalf and/or to sell shares and purchase new ones. It was that authority that Mr Ross abused in the context of the Ponzi scheme. That is not the case for the Priests. Mr Ross had no prima facie entitlement whatsoever to deal in the Priest Holdings. Nor, other than as regards the Diligent Fraud, did he do so.

[172] It is my conclusion, therefore, that the Other Investors cannot establish an ability to trace. This is neither supported by the authorities on which they rely, nor justified by an application of the fundamental principles involved.

***If tracing was possible***

[173] If tracing was possible, applying the reasoning in *Foskett v McKeown*, the Priests (the beneficiaries of the bare trust) would be innocent contributors: compared to the beneficiaries in *Foskett v McKeown* who were innocent volunteers. This is because the Priests paid for all of the shares in the Priest Holdings, and RAM/Dagger were merely acting as custodians. The beneficiaries in *Foskett v McKeown* simply inherited the life insurance monies from their father, who was the wrongdoer, they never paid anything for the benefit they received.

[174] Lord Millet considered that whether the beneficiary was an innocent volunteer or innocent contributor affected the type of remedy available:[95]

> … the wrongdoer who was responsible for the mixing and those who derive title under him otherwise than for value are subordinated to those of innocent contributors. As against the wrongdoer and his successors, the beneficiary is entitled to locate his contribution in any part of the mixture and to subordinate their claims to share in the mixture until his own contribution has been satisfied. This has the effect of giving the beneficiary a lien for his contribution if the mixture is deficient.
>
> Innocent contributors, however, must be treated equally inter se. Where the beneficiary's claim is in competition with the claims of other innocent contributors, there is no basis upon which the any of the claims can be subordinated to any of the others. Where the fund is deficient, the

[95] *Foskett v McKeown*, above n 26, at 132.

> beneficiary is not entitled to enforce a lien for his contributions; all must share rateably in the fund.

[175] This means that if the Other Investors had been able to trace into the Priest Holdings, they would be entitled to share rateably with the Priests in the fund comprising the Priest Holdings. On that basis, the Other Investors and the Priests would share the Priest Holdings in equal proportions. This relies on the assumption that on each occasion when the shares comprising the Priest Holdings were acquired there were funds available of the Other Investors to pay the whole purchase price. That would mean the Priests and the Other Investors had each contributed half the value of the Priest Holdings. Were that not the case, then necessarily the funds used by RAM/Dagger to acquire Priest Holdings would have come, in effect, from their bank or perhaps their sharebroker, so that the proportion of value contributed by the Other Investors would reduce accordingly.

[176] However, as the Other Investors are not able to bring a successful tracing claim they are not entitled to share equally in the Priest Holdings.

[177] It therefore follows that, subject to the questions of fungibility and shortfall, the Priests are entitled to the declarations they seek. I therefore turn to those two issues.

***Fungibility and shortfall***

*Certainty of subject of trust*

[178] Shares in one company are, amongst themselves, fungible. This means that there is no way to distinguish one share in a particular company from other shares in that company.[96] A conceptual difficulty arises.

[179] Assume that, at the date of the acquisition by RAM/Dagger of shares comprising the Priest Holdings – say shares in Company X – RAM or Dagger already owned (for Other Investors) shares in Company X. In that circumstance, a question of the certainty of the subject matter of the trust would arise. That is, for a trust to come into existence the property which is the subject matter of the trust must

96 Discussed further above at [64]–[67].

be able to be identified with certainty.[97] If RAM or Dagger already held shares in Company X for Other Investors, given that shares in a particular company are amongst themselves fungible, it could be argued it would not be possible to identify which of the pool of fungible shares was subject to the trust in favour of the Priests, and which were subject to the trust in favour of the Other Investors. I am not attracted to that argument. Given the ubiquity of decertificated shares, in my view it should be enough for a given number of those shares to be identified as having been earmarked for an investor for the trusts, bare or otherwise, recognised in managed funds to come into existence.

[180] I recognise that difficulties may arise if, subsequently, there is a shortfall amongst the fungible shares that had been allocated, or earmarked, as belonging to particular investors. In such a situation the obvious response would be to divide the remaining shares pro rata the original allocation or earmarking. As I understand the evidence that is not an issue here. It would only be an issue as regards that part of the Priest Holdings which had not been transferred to Nessock in the Nessock Transaction. It is to the significance of that transaction that I now turn.

***The Nessock Transaction***

[181] The Liquidators argued that, whatever might have been the position when Mr Priest directed Mr Ross to give effect to the Nessock Transaction, the subsequent acknowledgement of the solicitors as to the position Nessock took given the proceedings that were at large in the following terms:

> Neither MSL nor Nessock has any interest in, or entitlement to, the relevant securities other than as legal holder and trustee on behalf of the party lawfully entitled to those securities.
>
> I am instructed by MSL and Nessock to inform you that Nessock will not transfer or otherwise deal with any of the above securities or any rights or entitlements which Nessock may receive by virtue of the holder of these securities except:
>
> (a) in accordance with a direction signed by both of you as receivers of Ross Asset Management Limited or Dagger Nominees Limited, as applicable and Mr Priest;
>
> (b) in accordance with an order of the High Court;

97 Thomas and Hudson, above n 21, at [3.01].

> (c) after giving you no less than three business days prior written notice of its intention to do so.
>
> I trust that this clarifies for you the basis on which Nessock currently holds the relevant securities.

[182] The Liquidators also point to a letter written the same day to similar effect.

[183] They therefore argue that, whatever the position may have been on 29 October 2012, by early December 2012 the position was that Nessock has been a stakeholder pending the outcome of this proceeding.

[184] I cannot accept that proposition. The respective interests of the Other Investors and the Priests must, as a matter of general principle, be determined as at the date of the receivership/liquidation. Whether or not Nessock gave and/or honoured any undertaking to the Liquidators is, in my view, irrelevant. The outcome will be what the situation as at the date of the liquidation gives rise to, not what may subsequently have been agreed between the solicitors. The proposition the Liquidators advance is, in effect, that Nessock itself effected a change to the basis upon which it, as a matter of law, held the Priest Holdings on the date of the liquidation. Nessock did not, in my view, have the ability to effect such a change. Nor, as a matter of law, was it a stakeholder as between the Priests and the Other Investors. A bare trustee cannot, by their own act and in the face of competing claims, bootstrap themselves into the position of a stakeholder. The position of stakeholder arises from the agreement of the competing parties.

[185] The Other Investors cannot rely on post-liquidation conduct by Nessock, as the Liquidators' arguments claim. Both the Liquidators and the Priests will, in these circumstances, stand or fall on the basis of the legal situation existing as at the point of liquidation.

**Conclusion**

[186] I have concluded that the legal situation existing as at the liquidation of RAM/Dagger was that, as regards the Priest Holdings, Mr Priest had, as was his entitlement, directed the transfer of those shares to a new bare trustee, Nessock, and the Other Investors have no proprietary claim to those shares. As regards the balance

of Priest Holdings, Mr and Mrs Priest were the equitable owners, RAM/Dagger were bare trustees and, again, the Other Investors have no claim to those shares.

**Outcome**

[187] I therefore make the declarations and orders sought by the Priests at clauses 30(A) to (D) and 31(A) to (D) of their amended statement of claim, namely that:

(a) The Priest Holdings are held by RAM and Dagger on bare trusts for the sole benefit of the Priests and at the sole direction of Mr Priest.

(b) RAM and Dagger are to transfer to the Priests the Priest Holdings held by each of them.

(c) RAM and Dagger are to transfer to the Priests all dividends, shares, proceeds, interest and other returns earned in respect of the Priest Holdings held by each of them.

(d) Priest Holdings now held by Nessock previously held by either of RAM or Dagger:

   (i) were until transferred to Nessock held by RAM and Dagger on bare trusts for the sole benefit of the Priests and at the sole direction of Mr Priest; and

   (ii) are held by Nessock as nominee for the Priests on the Nessock Nominee Terms as set out in the amended statement of claim.

**Interest and Costs**

[188] The questions of interest and costs are reserved.

Clifford J

Solicitors:
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