IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2012-485-2591
[2015] NZHC 1403

BETWEEN	JOHN HOWARD FISK and DAVID JOHN BRIDGMAN Applicants
AND	HAMISH McINTOSH Respondent

Hearing: 23 March 2015

Counsel: M G Colson and R L Pinny for Applicants
J B M Smith QC and J L W Wass for Respondent

Judgment: 22 June 2015

RESERVED JUDGMENT OF MACKENZIE J

I direct that the delivery time of this judgment is
12.30 pm on the 22nd day of June 2015

Solicitors: Bell Gully, Wellington, for Applicants
Gibson Sheat, Wellington, for Respondent

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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). 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.

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

[3] The legal structure of the arrangements with investors was that each investor entered into a management deed with RAM as manager and another Ross group company, Dagger Nominees Ltd (Dagger), as nominee. Clause 3 of the agreement provided:

> **3 APPOINTMENT**
>
> The Client hereby appoints the Manager to be the agent of the Client for the purpose of managing and administering the Portfolio in accordance with the terms, conditions and covenants of this Deed and, (subject to clause 10), any instructions given to the Manager by the Client in accordance with this Deed and the Manager is hereby authorised to act as agent of the Client in the management and administration of the Portfolio in accordance with such terms, conditions, covenants and instructions and to incur any liabilities which result from the proper conduct of the Business of the Portfolio

[4] By cl 4 the manager agreed to manage and administer the portfolio in a proper manner. Clause 5 provided that either party could terminate the agreement on 30 working days notice, on the expiry of which the manager was to account to the client for all money received by the manager payable to the client. The management and administration procedure was prescribed in cl 7 as follows:

7 MANAGEMENT AND ADMINISTRATION PROCEDURE

The management and administration of the Portfolio shall be carried out in accordance with the following procedure:

7.1 The Client will provide the Manager with a schedule showing details of all Business in the Portfolio as at the date of this Deed and any securities or contracts relating to investments in the Portfolio;

7.2 The Manager may retain such existing investments or any of them;

7.3 The Manager shall have full authority to invest the money and securities of the Portfolio subject to the instructions of the Client (subject to clause 10);

7.4 All investments shall be held in the name of the Nominee Company as nominee for the Client or such other nominee as approved by the Manager in accordance with clause 17;

7.5 When the realisation of any investment or investments is required the Manager shall select the investment or investments to be so realised;

7.6 All money in the Portfolio shall be handled by the Manager on behalf of the Client and when not invested shall 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;

7.7 Where any securities in the Portfolio carry rights to attend and vote at meetings on any company, unless the Client instructs otherwise, the Nominee Company may appoint the Manager or any person nominated by the Manager as its proxy or representative and the Manager or such person may use its discretion to exercise those rights. The manager is under no obligation to inform the Client of any such rights attached to the securities nor to advise the Client of the Manager's exercise of those rights.

[5] Clause 11 provided:

11 LOAN OF ASSETS

Except where prohibited by the Client, the Manager may lend any securities which are part of the Business comprising the Portfolio to brokers or dealers in securities where such broker or dealer provides adequate security for the performance of its obligations.

[6] Under cl 14, management fees were payable by the client to the manager, to be calculated in accordance with a fee basis prescribed in a schedule to the agreement but subject to amendment by the manager.

[7] Clause 26 contained a limitation of liability (to three times the year's fees) for any act, omission or error of judgment in the performance of the manager's obligations. That limitation did not apply to liability arising from malicious, fraudulent or dishonest acts or omissions.

[8] Dagger's responsibility was to hold securities as nominee. Clause 28 provided:

> **28 NOMINEE COMPANY'S UNDERTAKING**
>
> The Nominee Company undertakes that it shall not carry on business or do any act matter or thing except in accordance with or incidental to the following objects:
>
> 28.1 to act as a nominee company holding any assets and undertaking any obligations or liabilities of any Business comprised in the Portfolio or otherwise under the management of the Manager or any other manager associated with the Manager (each being referred to as a "Nominee's Principal"), upon a bare trust for the legal or beneficial owners thereof;
>
> …

[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.

[11] The scale of the difference between what was reported to investors and what actually happened is very vividly demonstrated by the liquidators' summary of investor related receipts and payments from 2006 to the date of liquidation in 2012. Taking the year ending 31 March 2012 as an example, the investor statements reported total assets held for all investors of $387 million. Those assets were made up of $114 million of investor contributions, and the reported but fictitious returns on investments. The actual assets available to investors were $15 million. The cash flow analysis shows that $27.9 million of investor related receipts were actually received. This included investor deposits of $12 million. $27.8 million of investor related payments were made. This included $27 million of investor withdrawals.

The respondent's investment, and repayment

[12] The respondent invested in RAM following a meeting with Mr Ross in March 2007. His investment objectives were summarised in a letter from RAM dated 26 March 2007 as being to establish an international equity portfolio managed under a formal contract with RAM, with the investment goal of achieving consistent medium to long term capital growth from a diversified share portfolio. The respondent paid $500,000 in cash to RAM in April 2007. He borrowed from Westpac to fund that payment. He received a letter from RAM dated 19 April 2007 which acknowledged receipt and said that the money had been used to commence his global share portfolio.

[13] The investment was, according to the reports which the respondent received, profitable. It continued for about four years. The respondent decided to cash up his investment in 2011. On 5 July 2011, he emailed Mr Ross and said:

> As discussed previously, I would like to start selling off my RAM portfolio, this year, to pay for a new dwelling in Queenstown.
>
> In your hands as to how and when best to do that so as to maximise the return, but, with the global stock markets picking up in the next week or so, would now be a good time to begin that sell-down please?

> I would prefer the proceeds of each stock to be paid as you go, but happy to discuss.

[14] On 19 July 2011, the respondent sent a follow up to check that his email had been received. Mr Ross acknowledged it that day. The respondent emailed again on 19 August 2011 and said:

> I know everything got hammered in the last two weeks, but would be grateful for an update on things/plans when you have a minute.

[15] There was a further exchange of emails leading to a request from the respondent for a meeting, which took place on 9 September 2011. The respondent followed up with an email on 11 September saying:

> As I said, I'm really pleased with how well you have done with the portfolio, particularly given the tough market conditions in the last few years.
>
> Having thought about the situation since and discussed the options with Wes[t]pac later on Friday, I have decided that we should call it quits and take the gains made so far – they are excellent, and while we might do even better by year end, we can't be sure of that, and I need funds to reduce debt now anyway. Also, a thirty working day notice period from now allows time for close-out until around the end of October anyway.
>
> So, could I please now give 30 working days notice to close the portfolio as per the contract.

[16] Arrangements were subsequently made for a repayment to be made on 3 November 2011 to the respondent's Westpac account. That had not been received by 4 November 2011 so the respondent followed that up by an email enquiry. A payment of $150,000 was made to the respondent's Westpac account on 4 November 2011. On 8 November 2011, a second payment of $109,000 was made. A third payment of $185,750 was made on 10 November 2014. A fourth payment of $180,000 was made on 14 November 2011. A fifth payment of $134,000 was made on 15 November 2011. A final payment of $195,297.62 was made on 23 November 2011. Those payments totalled $954,047.62.

[17] RAM sent the respondent an investment report as at 23 November 2011, which purported to show how his supposed share portfolio had been sold to realise the cash paid to him. That report said eight share sales were made in the period from 26 October 2011 to 3 November 2011 to realise the amounts paid to the respondent

from 4 November to 23 November 2011. The liquidators have prepared an analysis of RAM's bank account which compares what was reported to the respondent, with the probable actual source of funds. That analysis shows that no proceeds from the purported share sales were paid into RAM's bank account. All of the shares purportedly held were shown in the RAM database as being owned by the non-existent broker, Bevis Marks. Mr Fisk's evidence is that it is highly likely that none of the shares existed. I find, on the balance of probabilities, that none of the shares existed and that none of the monies paid to the respondent were derived from the sale of shares held on his behalf pursuant to the management agreement.

[18] The liquidators' analysis of the payments into the RAM bank account which made up the credit balance in that account from which the payments to the respondent were paid shows that most of the payments into RAM's bank account in the relevant period, to provide sufficient funds to make the payments to the respondent, were derived from the sale of other shares and securities, not those reported as held on behalf of the respondent. Also, some of the funds were sourced from inter-company transfers from bank accounts of companies within the Ross group. In addition, Mr Fisk's evidence is that just under $250,000 of deposits by other investors were paid into the bank account over that period.

The Liquidators' claims

[19] The liquidators seek to recover part or all of the amounts paid to the respondent. They rely on:

(a) sections 345 to 348 of the Property Law Act 2007 (the PLA), as payments made with intent to prejudice creditors and without a receipt of reasonably equivalent value in exchange;

(b) sections 292 and 294 of the Companies Act 1993 (the CA), as payments made when RAM was unable to pay its due debts and enabling the Respondent to receive more than he would in a liquidation;

(c) section 297 of the CA, as payments made at an undervalue when RAM was unable to pay its due debts.

[20] Before turning to address the specifics of those claims, I venture some general comments. Ordinarily, recovery claims by a liquidator under those provisions have the purpose of recovering, for the benefit of all creditors, money which belonged to the company but which was paid or transferred to one creditor. This case is different in that what the liquidators seek to recover is not money which ever belonged to RAM. The intended arrangement under the management agreement was that the funds invested would be beneficially owned by the investor, and held by RAM on trust for the investor. That did not happen. RAM misappropriated the funds entrusted to it. In doing so, it did not acquire the beneficial interest. At no stage did RAM have other than bare legal title to the money it received. Because it completely failed to observe the terms on the trust pursuant to which it was to obtain that bare legal title, it may be questionable whether it obtained any title at all. For this reason, the liquidators' claim to recover is quite fundamentally different from the usual case.

[21] Similar considerations also apply to any money which the liquidators may recover through these proceedings. Generally, any sums recovered under the provisions relied on will add to the pool of the company's assets available for the general creditors of the company. Here, it seems likely that any funds recovered will be the property of the investors, not the company. That may affect the rights and duties of the liquidators in respect of any such recovered money, and the entitlement of creditors to share in any recoveries.

[22] Further, because funds which were to be held on trust were misapplied, the liquidators may not be the only persons with claims to funds paid out by RAM to investors. Other investors may have their own remedies, in equity, in respect of the funds, at least to the extent that they can be followed or traced.

[23] The issues which I have raised were not the subject of argument before me, and it is not appropriate to venture into them. I mention them only to recognise the unusual circumstances of this liquidation. I apply the provisions which the

liquidators seek to invoke on their terms. To the extent that the general points that I have made are relevant to the application of those provisions, I deal with them during the course of this judgment. Any further implications of the points I have raised are beyond its scope.

RAM's insolvency

[24] The liquidators formed the view that RAM was insolvent when they were appointed as receivers, and had been so for a long period of time. Their first report to this Court, dated 13 November 2012, signalled that possibility. It was subsequently confirmed. Their investigations have revealed that RAM was repeatedly and seriously in breach of its obligations to investors since at least 2006. It had misapplied the investors' funds by not holding those in accordance with the management agreement and inter-mingling the funds. It was reporting to investors a series of fictitious transactions which in no way represented the true value of their portfolio.

[25] The liquidators have prepared a solvency analysis for each year from 2006 to 2012. That analysis examines the solvency of RAM in several different ways. One is to consider the solvency with regard to the position of investors. For each year, the liquidators have calculated the value of each investor's account, by reference to money paid in less money withdrawn. That information is based upon RAM's quarterly reports to investors, but ignores the fictitious trading profits shown in those reports. For each year from and including 2008, the actual assets available for investors would have been insufficient to repay those net contributions. The deficit at 31 March 2008, calculated on that basis, was about $18 million. It rose steadily each year to about $99 million by 31 March 2012, and to $109 million by 6 November 2012.

[26] The solvency analysis also separately considers RAM's own position, without regard to the investor funds which ought to have been held on trust. RAM had no income of its own. It was entitled to charge management fees under the management agreements but these were rarely if ever paid. The deductions shown on investors' quarterly reports for management fees were largely fictitious. In the

year ending 31 March 2012 RAM received actual management fees of $2,000. The solvency analysis does not include those actual fees. Instead it assumes that RAM was entitled to management fees of $300,000, based on a fee of one per cent of assets under management (using the actual assets, not the reported assets) and a transaction fee per withdrawal of 0.25 per cent. Against the notional income entitlement, RAM's actual operating expenses were $1.3 million.

[27] I address the implications of that analysis of RAM's insolvency when I consider the requirements of the statutory provisions on which the liquidators rely.

The statutory provisions

[28] The liquidators seek to set aside the payments to the respondent under part 6 subpart 6 of the PLA. Under ss 345 to 348, on an application by a liquidator, the court may make an order requiring the recipient to pay reasonable compensation to the applicant, if it is satisfied that the applicant has been prejudiced by a payment made by a debtor who was insolvent at the time, and made with intent to hinder, delay, or defeat a creditor in the exercise of any right of recourse of the creditor in respect of the property, or without receiving reasonably equivalent value in exchange. The debtor must be treated as insolvent if it is unable to pay all its debts as they fall due, from other assets. Under s 349, the court must not, or may, decline to make an order in certain circumstances, as I later discuss.

[29] The liquidators also seek to recover all or part of the payments under ss 292 to 295 of the CA. Under those provisions, an insolvent transaction entered into by a company in liquidation within two years before the liquidation commenced is voidable by the liquidator. A transaction (including paying money) is an insolvent transaction if it is entered into when the company is unable to pay its due debts and enables another person to receive more towards the satisfaction of a debt owed by the company than the person would receive, or be likely to receive, in the company's liquidation. Under s 296 the court must not make an order in certain circumstances, which I again later discuss.

[30] The liquidators rely, in the alternative to those CA provisions, on s 297 of the CA. Under that section, the liquidator may recover any undervalue suffered by the company on an insolvent transaction.

The preconditions to an order

[31] The requirements of the PLA and the CA provisions are essentially similar, but with some differences of wording. I address each of the preconditions to the making of an order, having regard to those differences.

(a) Disposition of property, or transaction

[32] Under s 346 of the PLA, there must be a disposition of property. Under s 292 of the CA, there must be a transaction. Under the respective definitions, a disposition includes a payment and a transaction includes paying money. Each of the payments to the respondent was a disposition for the purposes of the PLA and a transaction for the purposes of the CA.

[33] As I have noted above, the money paid did not belong to RAM. The Court of Appeal *in Anzani Investments Ltd v The Official Assignee* held that it is not a requirement under s 292 that the payment has been made out of the company's own property.[1] The payment must be made by the company, but it is not a requirement that the payment be made out of the company's own property.[2] I consider that this is also the case under the PLA section. There must be a payment by the debtor, but the payment need not be made out of the debtor's own money.

[34] This requirement of both the PLA and CA provisions is met.

(b) By a debtor, or a company

[35] Under s 346(1)(a) of the PLA, the disposition must be by a debtor. That does not mean that there must be a debtor/creditor relationship between the disposer and the recipient. The focus is on the status of the disposer as a debtor in relation to the insolvency requirement, not on its status with regard to the challenged disposition. I

[1] *Anzani Investments Ltd v The Official Assignee* [2008] NZCA 144.
[2] At [23]-[24].

consider RAM’s status in relation to the insolvency requirement under the next heading. For present purposes, it is sufficient to note that RAM is a debtor for the purposes of the PLA requirement. It is undoubtedly a company for the CA provisions.

(c) Insolvent at the time of payment

[36] The next requirement of both provisions relates to the solvency of RAM. The PLA will apply if RAM was insolvent at the time of the payment. Under s 345(1)(d), RAM must be treated as insolvent if it is unable to pay all its debts as they fall due from its assets remaining after the payment. Under the CA provision, RAM must be unable to pay its due debts at the time of the payment.

[37] Those two requirements are essentially identical and can be examined together. The focus is on whether RAM was able to pay its debts as they fell due in November 2011. This raises the question, on the facts here, of the nature of RAM’s obligation to its investors. Do the rights which the investors had against RAM create a debtor/creditor relationship between RAM and the investors concerned?

[38] The management agreement for each investor did not create a debtor/creditor relationship between RAM and the investor in relation to the funds invested. The legal relationship, in respect of those funds, was that of trustee and beneficiary.

[39] The only express obligation to repay the funds invested arises on the termination of the management agreement. RAM was required by cl 6 to deliver to the investor any of the business of the Portfolio held in the name of Dagger or any other nominee, and any cash held by the manager at the date of termination, after satisfaction of any obligations to the manager. At the dates of the several payments to the respondent his notice of termination had expired. Accordingly, in terms of the legal arrangements in place between them, RAM was under an obligation under cl 6 to transfer any securities held, and to pay any cash balance to the respondent. RAM reported to the respondent that it had realised his portfolio by selling shares so that its contractual obligation under the management agreement was to pay the cash to the respondent. Accordingly, in terms of the document, there was a debtor/creditor relationship between RAM and the respondent in respect of the funds which should

have been held for him. There is no evidence that, in November 2011, any of the other investors had given notice of termination. In those circumstances, it cannot be said that in terms of the contractual arrangements between RAM and its investors, there was at November 2011 any debt owed to the continuing investors.

[40] But that of course is all rather academic. The contractual arrangements were not observed. The position of both the respondent and the continuing investors must be examined according to the position as it actually was, to determine whether that gave rise to debts to the investors as at November 2011.

[41] The nature of the claim by a person whose funds are held in a fiduciary capacity by another and are misapplied is addressed by the House of Lords in *Target Holdings Ltd v Redferns (a firm)*.[3] Lord Browne-Wilkinson drew a distinction, in relation to the equitable rules for compensation for breach of trust, between what he described as a traditional trust where the fund is held in trust for a number of beneficiaries who have different, usually successive, equitable interests, and a trust in which the beneficiary is absolutely entitled to the trust fund. He noted that the equitable rules of compensation for breach of trust have been largely developed in relation to the traditional trust, where the only way in which all the beneficiaries' rights can be protected is to restore to the trust fund what ought to be there. In such a case the basic rule is that a trustee who is in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach, or compensation for such loss. In the second type of trust, if the trustees commit a breach of trust, there is no reason to compensate for the breach of trust by restitution and compensation to the trust fund, rather than to the beneficiary himself. The beneficiary's right is not simply to have the trust duly administered: he is, in equity, the sole owner of the trust estate. In such a case, where the beneficiary is absolutely entitled to the trust fund, the Court ordinarily orders not restitution to the trust estate but payment of compensation directly to the beneficiary. The measure of that compensation is the same as in a restitutionary remedy, namely the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust.

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[3] *Target Holdings Ltd v Redferns (a firm)* [1996] AC 421, [1995] 3 All ER 785 (HL).

[42] Lord Browne-Wilkinson went on to observe:[4]

> This case is concerned with a trust which has at all times been a bare trust. Bare trusts arise in a number of different contexts: eg by the ultimate vesting of the property under a traditional trust, nominee shareholdings, and, as in the present case, as but one incident of a wider commercial transaction involving agency. In the case of moneys paid to a solicitor by a client as part of a conveyancing transaction, the purpose of that transaction is to achieve the commercial objective of the client, be it the acquisition of property or the lending of money on security. The depositing of money with the solicitor is but one aspect of the arrangements between the parties, such arrangements being for the most part contractual. Thus, the circumstances under which the solicitor can part with money from client account are regulated by the instructions given by the client: they are not part of the trusts on which the property is held. I do not intend to cast any doubt on the fact that moneys held by solicitors on client account are trust moneys or that the basic equitable principles apply to any breach of such trust by solicitors. But the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach. I have no doubt that, until the underlying commercial transaction has been completed, the solicitor can be required to restore to client account moneys wrongly paid away. …

[43] The relationship in this case is analogous to the solicitor/client relationship there described. RAM was to hold the funds as the 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 a related contractual arrangement for the management of those funds pursuant to that bare trust.

[44] His lordship went on to discuss the quantum of the beneficiary's claim, in both the traditional trust and the trust to which the beneficiary is absolutely entitled, in these terms:[5]

> A trustee who wrongly pays away trust money, like a trustee who makes an unauthorised investment, commits a breach of trust and comes under an immediate duty to remedy such breach. If immediate proceedings are brought, the court will make an immediate order requiring restoration to the trust fund of the assets wrongly distributed or, in the case of an unauthorised investment, will order the sale of the unauthorised investment and the payment of compensation for any loss suffered. But the fact that there is an

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4 At 437.

5 At 438.

> accrued cause of action as soon as the breach is committed does not in my judgment mean that the quantum of the compensation payable is ultimately fixed as at the date when the breach occurred. The quantum is fixed at the date of judgment, at which date, according to the circumstances then pertaining, the compensation is assessed at the figure then necessary to put the trust estate or the beneficiary back into the position it would have been in had there been no breach. I can see no justification for 'stopping the clock' immediately in some cases but not in others: to do so may, as in this case, lead to compensating the trust estate or the beneficiary for a loss which, on the facts known at trial, it has never suffered.

[45] The trust for each investor was a trust to which the investor was at all times beneficially entitled; that is to say, it was of the second category discussed by Lord Browne-Wilkinson. 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 the compensation payable for that breach would be fixed at the date of a judgment to enforce that remedy. That would be the amount then necessary to put the investor back in the position it would have been in had there been no breach.

[46] Every investor in RAM had an accrued cause of action for breach of trust in November 2011, when the respondent was repaid. RAM was, at that point, unable to meet all of those claims. The critical question then, is whether those accrued causes of action of the investors at that point constituted "debts" of RAM.

[47] Mr Colson submits that, in United States cases involving Ponzi schemes, the fact that a Ponzi scheme will at some point inevitably collapse has lead the United States to adopt a legal presumption of insolvency from the moment the nature of the business became a Ponzi scheme. That legal presumption is based on the premise that where a business is running a Ponzi scheme and conducting little or no legitimate business, the business cannot pay the debts owed to all investors. He refers in particular to *Warfield v Byron*[6] and *Re Universal Clearing House Co*[7] and *Burton Wiand v Vernon Lee*.[8]

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6 *Warfield v Byron* 436 F 3d 551 (5th Cir 2006)

7 *In Re Universal Clearing House Co* 62 BR 118 (D Utah 1986).

8 *Burton Wiand v Vernon Lee* 13-10448 (11th Cir 2014)

[48] The nature of the relationship between the operator of the Ponzi scheme and the investor is a relevant consideration in determining whether or not the obligation to the investor is a "debt" for the purpose of determining whether the operator is able to pay its debts as they fall due. It appears from the judgments in the United States cases that the intended relationship between the Ponzi scheme operator and the investor was that of debtor and creditor: that is, the Ponzi scheme operator received the money pursuant to a contractual obligation to repay the investment, with a specified rate of return. That is different from the situation here, as I have described. I accordingly place little reliance on the United States authorities on this point.

[49] The relevant Oxford English Dictionary definition of 'debt' is "that which is owed or due; anything (as money, goods, or service) which one person is under obligation to pay or render to another". A claim in restitution has been held to be a debt.[9]

[50] I consider that the right of each investor to bring immediate proceedings as soon as the investors' funds were misapplied constitutes a debt, in terms of the test for insolvency in both the PLA and the CA. The investor had the right to bring immediate proceedings, for damages which would be at least equal to the sum invested. While proceedings would have been necessary to enforce that claim, the obligation existed so that it constituted a debt. The theoretical possibility that subsequent events might reduce the amount of the loss before judgment does not require consideration, on the facts here. This is not a case, like *Target Holdings Ltd v Redferns (a firm)*, in which the subsequent application of the funds by the trustee might have the effect of reducing the beneficiary's loss.[10]

[51] I hold that the accrued cause of each investor, which arose immediately upon the misappropriation of the funds as I have described, constitutes a debt for the purposes of the solvency tests in both the PLA and the CA. I therefore find that RAM was, in November 2011, unable to pay all its debts as they fell due, or all its due debts. It was then insolvent for the purposes of both the PLA and the CA.

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9 *Woolwich Building Society v Inland Revenue Commissioner (No 2)* [1993] AC 70; *R (on the application of Kemp) v Denbighshire Local Health Board* [2006] EWHC 181, 3 All ER 141 at [80]-[86].

10 *Target Holdings Ltd v Redferns (a firm)*, above n 3.

(d) Intention to prejudice a creditor

[52] The next requirement of the PLA cause of action is that the payment to the respondent was made with intent to prejudice a creditor, or without receiving reasonably equivalent value in exchange. I address first the question whether RAM intended, when it made the payments to the respondent, to prejudice its other creditors. Under s 345(1)(a), a disposition of property prejudices a creditor if it hinders, delays, or defeats the creditor in the exercise of any right of recourse of the creditor in respect of the property. It is not necessary that the creditor have a specific right of recourse against the property disposed of. It is sufficient that the property would be available for the enforcement of creditors' claims generally.

[53] This requirement was discussed by the Supreme Court in *Regal Castings Ltd v Lightbody*.[11] It is necessary to distinguish between the debtor's purpose and the debtor's intention. It is not necessary to show that the debtor wanted creditors to suffer a loss, or that it was his purpose to cause loss. It is necessary to show the existence of an intention to hinder, delay or defeat them and that the debtor has accordingly acted dishonestly. Whenever the circumstances are such that the debtor must have known that in alienating property, and thereby hindering, delaying or defeating creditors' recourse to that property, he or she was exposing them to a significantly enhanced risk of not recovering the amounts owing to them, then the debtor must be taken to have intended this consequence, even if it was not actually the debtor's wish to cause them loss.[12]

[54] Mr Colson also refers to the United States approach and submits that the United States Courts have consistently held that where a Ponzi scheme is established and a payment is made, in connection with or furtherance of the Ponzi scheme, the operator's actual intent to hinder, delay or defraud is inferred, as a matter of law, simply from the operation of the scheme itself.[13] He submits that this approach is sound in principle and should be adopted in New Zealand. I do not consider that, under New Zealand law, an inference of law will arise. What is required is the

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11 *Regal Castings Ltd v Lightbody* [2008] NZSC 87, [2009] 2 NZLR 433.
12 At [54].
13 *In Re Bayou Group LLC* 362 BR 624 (Banker SDNY 2007).

application of the law to the facts of the case. That leads me in this case to the same conclusion as in the United States cases.

[55] I consider that Mr Ross's intent to hinder, delay or defeat RAM's creditors can readily be inferred. In receiving the funds for investment, Mr Ross immediately misapplied those funds in circumstances where repayment could only be made from the misapplication of other investors' funds. He must have known that whenever he made a payment to an investor he was exposing other investors to a significantly enhanced risk of not recovering their funds.

(e) Enabling the respondent to receive more than in a liquidation

[56] The analogous requirement, under the CA, is that the payment to the respondent enabled him to receive more towards the satisfaction of his debt than he would receive or be likely to receive in the liquidation of RAM. Under this requirement, it is not the intention of the payer, but the effect for the payee, which is relevant.

[57] When the respondent was repaid in November 2011, every investor then had the right to prove in a liquidation of RAM for the amount owing under the accrued cause of action referred to by Lord Browne-Wilkinson in *Target Holdings Ltd v Redferns (a firm)*.[14] The amount the respondent would have been likely to receive in a liquidation, if he had not been repaid, would have been very small, amounting to single cents in the dollar. This requirement is clearly satisfied.

(f) Reasonably equivalent value

[58] An alternative precondition in the PLA to intent to prejudice a creditor is that the payment was made without receiving reasonably equivalent value in exchange. As I have held that the intent to prejudice a creditor limb of s 346(1)(b) is made out, it is not necessary to examine this limb. It is more convenient to address the issue of value for the transaction in dealing with the respondent's defences The relevant defences are in s 349(1)(a) of the PLA, that the respondent received the payment for

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[14] *Target Holdings Ltd v Redferns (a firm)*, above n 3.

valuable consideration, and in s 296(3) of the CA, that the respondent gave value for the payment.

(g) Conclusion on the preconditions

[59] For these reasons, I find that the statutory preconditions to the Court's power to make orders under both the PLA and the CA are met. I must therefore consider the prohibitions in s 349 of the PLA and s 296(3) of the CA.

The defences

(a) The statutory provisions

[60] Section 349 of the PLA provides:

> **Protection of persons receiving property under disposition**
>
> (1) A court must not make an order under section 348 against a person who acquired property in respect of which a court could otherwise make the order and who proves that—
>
> > (a) the person acquired the property for valuable consideration and in good faith without knowledge of the fact that it had been the subject of a disposition to which this subpart applies; or
> >
> > (b) the person acquired the property through a person who acquired it in the circumstances specified in paragraph (a).
>
> (2) A court may decline to make an order under section 348, or may make an order under section 348 with limited effect or subject to any conditions it thinks fit, against a person who received property in respect of which a court could otherwise make the order and who proves that—
>
> > (a) the person received the property in good faith and without knowledge of the fact that it had been the subject of a disposition to which this subpart applies; and
> >
> > (b) the person's circumstances have so changed since the receipt of the property that it is unjust to order that the property be restored, or reasonable compensation be paid, in either case in part or in full.

[61] Section 296(3) of the CA provides:

> (3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other

> enactment, or in law or in equity, if the person from whom recovery is sought (A) proves that when A received the property—
>
> (a) A acted in good faith; and
>
> (b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
>
> (c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

(b) In good faith and without knowledge or suspicion

[62] It is a requirement of s 349 of the PLA that the respondent received the payments from RAM in good faith without knowledge of the fact that it had been the subject of a disposition liable to be set aside. Under s 296 of the CA, he must have acted in good faith, and not have suspected, or had reasonable grounds to suspect, that RAM was insolvent.

[63] It is common ground that the respondent meets these requirements. There is no suggestion that the respondent was other than a good faith recipient of the payments. There is no suggestion that he was then aware, or had any reason to suspect, that Mr Ross was operating a Ponzi scheme. Nor is there any suggestion that he had any foreknowledge or warning of, or reason to suspect, RAM's insolvent position. He is in all respects an innocent investor.

(c) Value, or valuable consideration

[64] It is a requirement of s 349(1) that the respondent received the payments for valuable consideration. One of the alternative requirements of s 296(3)(c) of the CA is that the respondent gave value for the payments. It is convenient to address those together.

[65] Mr Smith QC for the respondent relies upon four matters in support of the proposition that the respondent gave value for the payments, or acquired them for valuable consideration. These are:

(a) the respondent's original investment of $500,000;

(b) the benefit to RAM of the use of the money for four years (and the corresponding detriment to the respondent of his deprivation of it);

(c) his promise to pay management fees (albeit that, unbeknownst to him, they were not in fact deducted); and

(d) the discharge of RAM's debt to the respondent on repayment.

(i) The original investment

[66] In considering whether the original $500,000 investment constituted value, or valuable consideration, it is once again necessary to draw a distinction between what should have happened and what did happen. Under the transaction the respondent had intended, and for which the documentation provided, the respondent paid his initial investment on terms by which it was to be held on trust for him, and invested in accordance with the management agreement. In those circumstances, the respondent would not have given value, or valuable consideration, to the extent of the amount of his investment, to RAM. There would have been no transfer of value (the beneficial interest in the sum invested) from the respondent.

[67] However, in terms of what actually happened, the funds were applied by RAM for its own purposes, contrary to the agreed terms. Value was taken by RAM, without the knowledge or concurrence of the respondent. The respondent was deprived of the amount of the original investment, and RAM was able to use that amount for its own purposes. The issue is whether that constitutes valuable consideration for the subsequent repayment of the amount of the initial investment of $500,000, in terms of s 349(1)(a), or the giving of value in terms of s 296(3).

[68] The Supreme Court's decision in *Allied Concrete v Meltzer* makes it clear that payment of an existing debt may be valuable consideration, and value.[15] While all members of the Court were agreed on that outcome, they differed as to the reason why that is so. The reasoning of the majority is based on the antecedent transaction.

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15 *Allied Concrete v Meltzer* [2015] NZSC 7.

On that hypothesis, the giving of value need not be contemporaneous with the payment in issue, so that, where that payment is in satisfaction for a debt arising from value given earlier, that earlier value will meet the requirement. Elias CJ and William Young J base their reasoning on discharge. On that hypothesis the relevant value is not the value given earlier, it is the discharge, at the time of payment, of the debt arising from the transaction under which that earlier value was provided.

[69] That difference of view is likely to make little practical difference in the usual case. In this case, it is potentially significant.

[70] There is a difficulty in applying the reasoning of the discharge hypothesis to my analysis of the facts. The repayment of the amount originally invested did not discharge a debt arising from an antecedent transaction. Rather, as I have earlier discussed, there was a claim for damages arising from the earlier misapplication of funds. It is unrealistic to regard the repayment of the amount originally invested as a settlement of that cause of action. The respondent was not aware of the existence of that cause of action. The payment cannot properly be categorised as the payment of a debt, or an accord and satisfaction, as the discharge hypothesis envisages.

[71] The antecedent transaction hypothesis is also not without difficulty. It is not easy to identify an earlier transaction in which value was given. Because the money was paid with the intention that it be held in trust, its payment to RAM did not add equivalent value to RAM's assets. When it was misapplied, it was used by RAM for its own purposes, but it is not a natural use of the word "gave" to say that the respondent gave value to RAM when that happened. It is more natural to say that value was taken from him, rather than given by him.

[72] These points reflect the reality that this case is far removed from the situation in *Allied Concrete v Meltzer*, as described by William Young J.[16] The cases in that appeal involved a very simple and common situation: goods or services are supplied on credit to a company and the company, while insolvent, pays the debt.

16 At [176].

[73] Accordingly, I do not regard the decision in *Allied Concrete v Meltzer* as directly on point so as to provide the answer to the unusual circumstances of this case. What is required is that I must endeavour to apply the law as determined by the Supreme Court to the quite different facts here, by adopting an approach which applies what I take to be the essence of the decision. That essence, as I discern it, is that where a payment discharges an obligation arising from a situation in which value has been provided to the company, the need for value can be met, even though there is not a contemporaneous exchange of moneys worth at the time the challenged payment is made.

[74] Applying that approach, I conclude that the requirement of value, or valuable consideration, was met when RAM appropriated to itself the respondent's investment, so that the requirement of valuable consideration in s 349, and the requirement to give value in s 296(3)(c), were met, in respect of the $500,000 original investment.

(ii) The use of money

[75] The second matter relied on is the benefit to RAM of the use of the money for four years, and the corresponding detriment to the respondent of his deprivation of it.

[76] The respondent incurred use of money costs. He borrowed the sum invested from Westpac, and incurred interest on that borrowing. Those costs are not relevant to the assessment of the value, or valuable consideration, provided by him. What is required is value to RAM, not a cost to the respondent.

[77] Under the intended investment arrangements, RAM would have received no benefit from the use of the respondent's money during the period it was invested. The way in which the respondent's investment funds were actually dealt with meant that the funds were not used in a way which added value to RAM. Therefore, any allocation of value for use of money would be entirely arbitrary and not reflective of any benefit to other creditors. It would not be in accord with the purposes of the legislation to attempt to ascribe a notional value to RAM for the use which it appropriated to itself of the respondent's money.

[78] Further, the quantum of damages able to be claimed by the respondent under the cause of action which accrued to him when the principal sum invested by him was misapplied would have included compensation for his being deprived of the use of the money between the date of misapplication and the date of judgment. That element of damages, would, but for RAM's liquidation, have remained available to the respondent. It was not given up by the respondent when he was repaid and it remains theoretically available to him. He has not given valuable consideration by releasing a claim for compensation for the use of his money. Rather, events have occurred which make his theoretical right to claim worthless.

[79] I therefore find that the use of the money over the period it was wrongly held does not constitute an additional item of value provided by the respondent.

(iii) The promise to pay management fees

[80] The third item relied upon as value or valuable consideration is the promise to pay management fees, although those were not paid. As I have noted, if the terms of the management agreement had been complied with, the provision of the $500,000 investment amount would not have constituted value, or valuable consideration, given by the respondent. In those circumstances, it may be that the promise to pay management fees, and the payment of those fees if they had been deducted in accordance with the agreement, might be regarded as providing some limited value, or valuable consideration. But that is not what happened. I have had regard to what actually happened, rather than to what should have happened, with respect to the principal sum invested. It would be inconsistent to have regard to what should have happened, rather than what in fact happened, with regard to management fees. Nothing was taken for management fees from the respondent's money. Because the agreement which provided for the payment of fees was never given effect, the promise to pay management fees did not constitute valuable consideration or value given by the respondent.

(iv) The discharge of the debt on repayment

[81] I have held that the respondent did give value to the extent of the $500,000 original investment. The repayment of that amount is thereby taken into account, and need not be further addressed under this heading.

[82] For the fictitious profits component, there has been no discharge of a debt. The profits were fictitious, and so were never due to the respondent. He had, as I have discussed, an accrued cause of action against RAM for the misappropriation of his investment. That cause of action has not been discharged. No part of the additional $454,000 was received in terms which involved the giving of valuable consideration or value by the discharge of any rights against RAM.

[83] I therefore conclude that the only item to be considered as potentially meeting the requirement, under s 349(1)(a), for valuable consideration, or under s 296(3) for value given, is the amount of the sum originally invested, $500,000.

(v) Equivalence of value

[84] The next issue is whether the value, or valuable consideration, provided must equate to the amount of the payments which are challenged. Mr Colson for the liquidators submits that the value provided must be "reasonably equivalent". He submits that much of the case law assumes, without discussion, that valuable consideration is akin to, or substantially similar to reasonably equivalent value. Mr Smith submits that taking into account the respondent's investment, the use of money by the company, and the promise to pay management fees, the respondent clearly "gave real and substantial value" in terms of the Supreme Court's decision in *Allied Concrete v Meltzer*. In his submissions, he tabulated a spectrum of concepts ranging from full consideration to nominal consideration. He submits that there is no mandate for undertaking a mathematical comparison of the quantum of value provided by the creditor with the size of the payments in question. He submits that it is sufficient that the respondent provided value that was more than nominal or trivial. He says that the submission that valuable consideration in s 349(1) of the PLA should be interpreted to mean the same as reasonably equivalent value is untenable because it is inconsistent with the judgments of the Supreme Court in *Allied*

Concrete v Meltzer, which regarded value and valuable consideration as synonymous. Mr Smith further submits that there is authority about the meaning of valuable consideration in other contexts. He refers to *Welch v The Official Assignee*.[17] In the context of voidable gifts under s 54 of the Insolvency Act 1967 the Court held that valuable consideration means more than nominal consideration which would be sufficient to support a contract, but falls short of a consideration which equates with the value of the property under consideration. By contrast, "adequate consideration" must differ in meaning from "valuable consideration" and must bear some reasonable relationship to the true value of the property although it may very well be less than that.

[85] Mr Smith submits that the payments were, in substance, one transaction and one payment, in that they were paid out in response to a single, full closure instruction by the respondent. That is so, but the reality is that while there was a single instruction, that was not effected by a single payment. The wrongful steps taken to find the funds to make the payments resulted in there being six separate payments, not a single payment.

[86] If the function of the Court in considering the extent of value is simply to decide whether there is some value to support the payment, without an analysis of the adequacy of the consideration, then it seems more appropriate to conduct that exercise with regard to each of the payments, rather than to aggregate them. But I consider that it is necessary to focus on the nature of the payment by RAM. In the way that the payments were reported by RAM in the investor statement, and in reality, there were two clearly identified components in the total sum of $954,000 paid to the respondent. The first was the repayment of his initial investment, and the second was the payment of fictitious reported profits. I do not consider that the authorities require the Court to ignore that substance and to focus globally on the total sum paid.

[87] For these reasons I do not consider that an "all or nothing" approach is appropriate in this case. That is, I do not consider that it is correct to simply contrast the consideration or value which I have held was provided, namely the principal

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17 *Welch v The Official Assignee* [1998] 2 NZLR 8 (CA).

amount of the investment of $500,000, with the total amount repaid, $954,000, and to consider whether the one is valuable consideration, or value, for the other.

[88] When the substance is viewed in that way, it is clear that there was valuable consideration or value to the full extent of the repayment of the sum invested. There was no value or valuable consideration for the fictitious profits.

[89] Counsel for the liquidators refers to *Re Waipawa Finance Co Ltd (in Liquidation)*.[18] That case concerned interest which had been reported to investors but not earned. Ronald Young J said:

> [30] The exclusion of fictitious interest from valid investors' claims has been the subject of several United States' authorities. The reasoning applied there applies here. What must be stressed and understood is that the interest portion of the investment was fictitious. It was, as Mr Chan observed, part of Mr Pickett's long elaborate fraud. I agree with Mr Chan when he said:
>
>> If the trust money held by the liquidators were used to pay interest it would be tantamount to furthering the fraud committed by Mr Pickett.
>
> [31] I conclude therefore that the investors' claims should not include any accrued unpaid interest.

[90] Mr Smith seeks to distinguish that case. I find it sufficiently relevant to provide a helpful indication of the approach of this Court to a situation which is fortunately rare. It supports the conclusion I have reached that value was not given for the fictitious profits.

[91] If I am wrong in that approach, and it is necessary to approach the matter by deciding whether consideration of $500,000 is value, or valuable consideration, for a payment of $954,000, then I conclude that it is not. An important objective of the legislation is to achieve a fair balance between the general body of creditors and the individual creditor. The requirement for value reflects that objective. It recognises that the assets of the company have been increased to the extent of the value given. To uphold a transaction which represents one side of an exchange of value from which the company has benefited is less unfair to the general body of creditors than is a payment which reduces the assets of the company without a corresponding

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18 *Re Waipawa Finance Co Ltd (in Liquidation)* [2011] NZCCLR 14 (HC).

increase (whether contemporaneous or previous). That balance between fairness to the individual creditor and fairness to the general body of creditors is not achieved if the exchange of value is substantially one-sided.

[92] The defence in s 296(3) is intended to promote certainty for debtors and creditors alike.[19] That objective of certainty would not be achieved by a test which required an exact mathematical equivalence of value, and that is not required. But the objective of fairness would not be achieved if the discrepancy in value is significant. I consider that a value provided which is little more than half of the payment received fails to meet the objective of fairness. It is not sufficient value for the total received, if the matter must be viewed in an "all or nothing" way, so that the s 296(3) defence must fail on that basis.

(vi) Conclusions on valuable consideration and value

[93] For these reasons, I conclude that the respondent has given value, or provided valuable consideration, to the extent of $500,000, his initial investment. In respect of the remaining $454,000, he has not.

[94] Mr Colson refers to the United States cases, and to the statement in *Re Bayou Group LLC* that:[20]

> … virtually every court to address the question has held unflinchingly that 'to the extent that investors have received payments in excess of the amounts they have invested, those payments are voidable as fraudulent transfers.'

[95] The conclusion I have reached on this point is congruent with that position. In reaching it, I have not relied on the United States cases, in the light of the slightly different statutory provisions there.

[96] The consequence of that finding is that the respondent acquired $500,000 of the payments for valuable consideration under s 349(1)(a) of the PLA, and gave value for that amount under s 296(3)(c) of the CA. Those defences therefore

[19] *Allied Concrete v Meltzer*, above n 15, at [50].
[20] *In Re Bayou Group LLC*, above n 13.

succeed, for that amount. For the balance of $454,000, I must consider s 349(2) and the second limb of s 296(3)(c).

(d) Alteration of position

[97] As I have held, the requirement in s 349(2)(a) of the PLA, that the respondent received the payment in good faith and without knowledge, is not in question, and is met. I must consider, under s 349(2)(b), whether the respondent's circumstances have so changed that it would be unjust to order repayment. Under the second limb of s 296(3)(c) of the CA, the question is whether he has altered his position in the reasonably held belief that the payment of $454,000 was valid and would not be set aside.

[98] These two defences, namely a change of circumstances or an alteration of position, can be considered together. The same facts are relevant to both. I address particularly the alteration of position defence, since the change of circumstances relied upon is the change resulting from the alteration of position claimed.

[99] Mr Smith refers to the statement of the elements of this defence by the Court of Appeal in *Madsen-Ries v Rapid Construction Ltd*.[21] He accepts that the respondent has the onus of proving the elements of the defence. He acknowledges that the alteration of position must be a conscious one, and that some detriment to the respondent must be shown. Contemporaneity of the alteration of position and receipt of the payment is not required. He submits that there are no restrictions as to what may or may not constitute a change of position, except that a mere debt reduction is not usually seen as an alteration of position. The alteration of position can be by way of action or inaction. There is no requirement, beyond the necessity to establish a detriment, as to the degree of change of position. The more proximate the action or inaction to the time of the payment, the more visible the reliance is likely to be, and the inquiry is fact specific.

[100] The respondent's contention is that he altered his position by consciously deciding, in specific reliance on the return of funds and having retired the equivalent

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[21] *Madsen-Ries v Rapid Construction Ltd* [2013] NZCA 489.

amount of his existing debt, to then incur much greater debt, and also commercial risk, by proceeding to develop a property which he had recently acquired at 33 Palliser Road, adjacent to his home. He asserts that had he not received the return of funds when he did, or had he believed that it was not a valid payment and might be clawed back, he would not have proceeded in that way. He would not have wanted to begin the development project and incur so much more overall debt, nor would his bank have funded him in that project.

[101] The respondent lives at 35 Palliser Road, in a home owned by a family trust. In late 2010 or early 2011 he thought that due to the financial situation of its then owner, the adjoining property, 33 Palliser Road, might come on the market. He thought that the owner's financial position might mean that he was willing to sell it cheaply. He was concerned that a new owner might develop it, possibly to the detriment of his own property. He made an offer for the property when it was advertised for sale by closed tender in May 2011. That offer was rejected. A subsequent offer was also declined. In August 2011, the land agents asked him to submit a third offer. He did so, by an offer dated 12 August 2011 to purchase the property for $986,000, for settlement on 9 September 2011. That offer was accepted.

[102] Throughout the offer process, the respondent had been in touch with his financial advisers at Westpac, about the purchase. When his offer was accepted he emailed Westpac on 14 August 2011 in the following terms:

> I somehow succeeded on the No 33 Palliser purchase, at last.
>
> I have bought it for $986,000. Help.
>
> Settlement is 9 September.
>
> I will be talking to my accountant this week on the best ownership and development vehicle/structure, and will report back asap. … I am thinking we will need roughly $4m in total, drawn down progressively over 3 years, starting with the purchase price next month:
>
> $1m purchase.
>
> $300 for project feasibility, demolition, consents and legals.
>
> 2m for building.
>
> $400 for interest costs.

> At 3x units sold at average $1.3m each, that would clear me $200k. Hardly worth the candle at that, but if I can get the costs down [a] bit and the sales up a bit, it will make a big difference.
>
> However, all of the above will have a stop/go decision after the feasibility investigation.

[103] Westpac responded on 15 August 2011 in these terms:

> [C]ongratulations ! I was hoping it would be third time lucky !
>
> We have an approval on file for the initial purchase. Have you decided on the ownership structure and name of the new entity ?
>
> Once this is confirmed I can set up a new account and organise the $98.6k.
>
> Who will be completing the conveyancing? I will request a copy of the Sale & purchase agreement from them.

[104] The respondent replied on 17 August 2011 in the following terms:

> 1. Here is the ASP, as requested. The conveyancing will be done by Claire Puntenney at Harkness Law Ltd.
>
> 2. As to the nature of this project, as know you my primary thoughts had been only to secure the land so as to protect my properties on either side, and also then to take advantage of that position to develop it into three units if possible. From there, however, I hadn't really thought much further about what to do with the units, because until I had the property I didn't have to. However, your comment when we met a month ago about giving to consideration to holding the units as rentals rather than selling them has had me thinking, and I now think that that is the way to go if I can manage it, ie build and hold the three units for rental purposes (ie like my Dublin St house). If I could inject some capital later to reduce the bank debt to just below the rental income level, the units would then pay themselves off over time and provide an income stream for me for the future. I am also familiar with that sort of process, whereas I am not at all familiar with property development in the normal sense, nor am I set up for it. I presume that the bank would be Ok with a rental investment plan like that, because the security is the same, and it provides revenue for the bank, but obviously I would be happy to discuss.
>
> 3. So, in light of that plan, I think the ownership structure can simply be a new LAQC, and I am getting that set up now. It will hopefully be called Anne Elliot Ltd. Please could you get someone to start setting up a new account for that entity.

[105] As noted in that email, the respondent purchased 33 Palliser Road through a company. That company is a look-through company under the Income Act 2007.

The respondent is the sole director and shareholder of the company. The respondent is a guarantor of the company's borrowings from Westpac, under a guarantee dated 8 September 2011.

[106] On 18 August 2011, the respondent received an email from another of his financial advisors within Westpac in which he said:

> I understand congratulations are in order! Exciting Project in front of you now.

[107] The respondent replied on the same date:

> Thanks, Nick. And thanks also for your help early on.
>
> It is a bit daunting, actually. But I guess I can just pretend it's not there.

[108] On 13 September 2011 the respondent sent to Westpac an email from his insurance brokers about his life and disability insurance position. Westpac indicated a wish for further discussion. In a reply on 13 November 2011 the respondent said:

> Nick, I'm starting to feel a bit hassled. Is $250k per year not enough cover?
>
> Is life insurance a requirement of the Anne Elliot loan? If so, please let me know. If not, I'm happy to look at any proposal you want to show me.
>
> Meanwhile, I emailed Ross Asset Management 30 days' notice on Sunday.

[109] Westpac replied later that day. The email made no mention of the notice to RAM. It said:

> It is certainly not my intention to make you feel hassled, as a professional adviser I just want to discuss what I have highlighted as an area of concern with regard to your financial well-being; and talk you through your options to make sure you are aware of and are happy with your current structure and also discuss alternatives.
>
> The question is not really whether I think its enough, its whether you do. Also whether the current benefits is paid to you gross of net, how and when the payments are made and if this reflects your wishes.

[110] These quotations from the emails between the respondent and Westpac do not include all emails. I have included only those most relevant to the purchase of 33 Palliser Road. In other emails, there are references to the respondent exceeding some loan limits. This email of 30 August 2011 conveys the tenor of that issue:

> I have just noticed that your personal 95 account and Lavender Ridge 91 account are out of order by $1,332.95 and $1,143.26 respectively. Would you like me to move some money around to place these back into order or would you prefer to do this yourself on-line?

[111] The following email from the respondent on 1 September 2011 is also relevant to that issue:

> … do you think I will be able to access the new facility from tomorrow night, because I'm overdrawn on my 91 account, and also for tax claim reasons I need to pay the deposit amount back from my 95 account. Or are you saying that it cannot be set up until we have met?

[112] The respondent's evidence is that from the date of settlement of the 33 Palliser Road property he began to look seriously at development options for the property because he was incurring an interest cost on the purchase price with no prospect of income or other return for a long time. He looked at options for a two or three unit development on the site, and whether those units should be sold or leased. On 8 December 2011, after the last payment received from RAM on 23 November 2011, he engaged architects to proceed with formal design.

[113] The respondent then took a number of steps in relation to the development, which he described in a letter to the liquidators dated 16 August 2013 in these terms:

> (b) Taking many material steps thereafter to progress a development opportunity at No 33 Palliser Road, in the belief and on the basis that my debt level had been so reduced, including over the next 12 months (that is before the liquidation of RAM):
>
> > (i) Commissioning, and paying/incurring fees over $160,000 for, architectural design work, engineering design work, land survey work, quantity survey work and legal work associated with the design of and consents for the project.
> >
> > (ii) Applying to WCC for, and obtaining, demolition and resource consents.
> >
> > (iii) Altering the boundaries of, and applying for and the obtaining the issuance of new titles, for my home property and No 33 Palliser Road.
> >
> > (iv) Entering into a contract for $50,000 for the demolition and removal of the existing dwelling on the site.
>
> (c) After the liquidation of RAM, entering, on 5 July 2013, into a new construction contract for $3m for two new dwellings on that property.

> (The steps in (b) and (c) above were mostly taken in the name of a new LTC, Anne Elliot Ltd, and the costs paid for from that company's Westpac loan account, but I am the sole director and shareholder, and, as explained below, I was (and still am) personally liable to Westpac for the debts of the LTC, so for the purpose of a s 296(3) there can be no real question practically that the steps were taken by me.)

[114] In his submissions, Mr Smith submits that by acting in this way, the respondent acted to his detriment in a number of ways:

(a) He lost the opportunity to simply on-sell the land and existing dwelling at the time without incurring any further cost.

(b) He incurred personal liability for significant further debt, that is, over $3.5 million over and above the property acquisition debt.

(c) He altered the legal boundaries of his personal residential property, thereby reducing its overall size, in order to accommodate the development.

(d) Having so embarked upon the project, because of the nature of property development, he lost the opportunity to simply cease it at any time later and recoup all of the costs incurred to that point. Instead, having started, he was obliged to carry it through to completion or else face significant losses.

(e) He also incurred the particular and significant commercial risk associated with developing property.

(f) Moreover, that risk has in part been realised, because the development has proved to be significantly loss-making.

[115] The immediate step which the respondent took when the payments from RAM were received was to apply those in reduction of his indebtedness to Westpac. He repaid two accounts for loans that related solely to the portfolio. That reduced his total indebtedness to Westpac from $5.26 million to $4.3 million. The repayment is not an alteration of the respondent's position, in terms of the s 296 CA test. The

reduction in indebtedness is relied upon as supporting an alteration of position by a decision to incur greater debt and commercial risk by proceeding to develop the property at 33 Palliser Road. Mr Smith submits that the respondent’s evidence supports the proposition that had he not received the return of funds when he did, or had he believed that it was not a valid payment and might be clawed back, he would not have proceeded with the development project which involved incurring much more overall debt, and that Westpac would not have funded him in that project.

[116] Without in any way doubting the respondent’s credibility, some caution is required in making factual findings based on the respondent’s evidence, after the event, of what he might have done if he had suspected that the payment might be clawed back. The focus, in considering whether the respondent altered his position, must be on the evidence of what was done at the time. The best evidence of that is the email exchanges with Westpac which I have set out above. Also, it is necessary to focus quite specifically on the steps which were actually taken, to determine whether those constituted an alteration of the respondent’s position. The issue of the respondent’s belief, and the reasonableness of that, must also be assessed at the time each step was taken.

[117] It is also necessary to bear in mind that on this inquiry the Court is concerned only with that part of the amount claimed by the liquidators which falls within the second limb of s 296(3)(c). My finding that the respondent gave value for $500,000 of the repayment means that I must assess the claimed alteration of position in the light of a belief that the balance of $454,000 was valid and would not be set aside. I address the evidence with these points in mind.

[118] The property at 33 Palliser Road had been purchased before the repayment. The respondent had borrowed the purchase price, $986,000, while his loan accounts for borrowing to finance the RAM investment were in place. It is also clear, from the emails, that the respondent’s then intention was to develop 33 Palliser Road. He took steps quite soon after the purchase, several weeks before he received the first of the payments, to investigate those options. He was conscious of a need to move quickly, because he was by then incurring the interest cost on the $986,000 purchase loan, without any prospect of receiving any income or other return back from it for a

long time. In an email to an architectural designer, dated 19 September 2011, whom he instructed to investigate the issue of required consents with the City Council, he said:

> Any progress on the town planner?
>
> Don't want to hassle but if we can't get consent I will need to flick property asap before it breaks me.

[119] The respondent instructed architects in October 2011. He received a project outline from the architects on 5 December 2011. He made a decision to proceed on 8 December 2011.

[120] I consider that the decision to proceed was not an alteration of the respondent's position, based on a belief that part or all of the payments were valid and would not be set aside. The commitment entered into was the continuation and culmination of a position which had already been decided on, in principle. The decision to realise the RAM investment was not motivated by the 33 Palliser Road purchase or redevelopment. The respondent had made that decision in July 2011, to pay for a new dwelling in Queenstown.

[121] Had the respondent been aware, before or after he closed his account with RAM, that his investment with RAM was likely to be worthless, he may well have made a different decision about whether to purchase 33 Palliser Road, and, if it was purchased, whether to develop it and on-sell it. But he had no reason for any such concern. His position in principle was that he would develop 33 Palliser Road. That position did not alter after he received the payments.

[122] The contemporary evidence does not suggest that, if the RAM loan accounts had not been repaid, and the RAM portfolio, as it was believed to be, had remained in place, the respondent would have been unwilling to undertake the additional borrowing, or that Westpac would have been unwilling to lend it. The tenor of the contemporary emails does not indicate any pressure by Westpac to reduce the respondent's debt. He had significant borrowings, which demonstrate a considerable willingness on his part to take on a large debt burden.

[123] Further, after the liquidation and when the RAM problems were known to both the respondent and Westpac, there is no evidence of concern about the respondent's debt level. Whatever the respondent's belief about the security of his receipt from RAM, it might be expected that Westpac would have considered that issue for itself, if the respondent's debt level was of concern to it. There is no evidence that it did so.

[124] Repayment of the RAM portfolio was not undertaken to finance 33 Palliser Road, and was not critical to the decision to develop it. The evidence does not establish that the respondent's ability to borrow from Westpac to fund the development was dependent on the repayment of the investment.

[125] The respondent relies, as an alteration of position, on the costs which he incurred in progressing the development proposal, before entering into a development contract. The timeline indicates that over the period from December 2011 to November 2012 the respondent incurred professional fees and Council fees in respect of the development of the order of some $83,000. Those sums were all incurred in pursuit of the decision in principle to develop the property, which had been made before the payments from RAM. They do not reflect an alteration of the respondent's position, but rather an implementation of the position which he had already adopted. Further, they are comparatively modest in relation to both the scale of the development project, and the level of the contested repayments.

[126] It is also relevant, as the liquidators submit, that the development was undertaken by Anne Elliot Ltd (AEL), not the respondent. They submit that a look-through company is a body corporate which retains all the legal benefits and obligations imposed by New Zealand laws, including the CA. Mr Colson submits, in relation to the respondent's claim that he and AEL are one and the same, that AEL is simply a corporate structure for some of his interests. Liability for the costs in progressing the proposed development would have rested with AEL, not the respondent.

[127] Mr Smith contests this. He submits that for income tax purposes the shareholders are treated as carrying on the activities of a look-through company and

having the purposes of the company. He submits that it cannot be correct that the respondent is to be treated as the company for tax purposes but not for alteration of position purposes.

[128] I consider that the position of the respondent and that of AEL cannot be simply equated, as the respondent submits. Despite the particular tax status of the company, it is a separate legal entity. It is necessary to consider whether the actions taken by AEL have led to a change in the respondent's personal position.

[129] The money needed to pay the development costs was borrowed from Westpac. Westpac had granted AEL a credit limit of $1.1 million in September 2011. The respondent has guaranteed AEL's indebtedness to Westpac. That guarantee of AEL's borrowings, along with the borrowings of other entities set up by the respondent, was also granted in September 2011. If he was called up to meet that guarantee, that would affect his personal position at that point. At the time when the obligations were incurred, I consider that there is force in the liquidators' submission that at that time, the preliminary costs in connection with the development affected the position of AEL, not the respondent. The effect of those comparatively minor costs on the respondent was indirect rather than direct.

[130] For these reasons, the costs incurred up to the date of the liquidators' appointment were not sufficiently large, and did not have a sufficiently direct effect on the respondent, such that they constitute an alteration of position in terms of s 296(3)(c).

[131] After the appointment of the liquidators, the timeline shows further minor preliminary expenses of approximately $6,000. The major commitment was a building contract signed on 5 July 2013. The contract price was $3 million. An increase in AEL's Westpac facility, to $2.529 million, was arranged. In April 2014, total development work of $1.9 million had been completed, with an estimated $1.086 million still to complete.

[132] The first question with regard to the development costs is whether the decision to proceed, by AEL letting the development contract, was an alteration of

the respondent's position. It was a continuation of the earlier decision in principle to proceed with development. I have held that incurring the relatively modest costs prior to liquidation did not amount to an alteration of position. The decision to have AEL incur a liability of $3 million, with the possibility that this might involve personal liability on the part of the respondent through the guarantee, is however of a different order of magnitude. In deciding whether that is sufficient to constitute an alteration of position, other factors must also be considered.

[133] A relevant consideration is that the entry into the development contract must have been seen, when it was entered into, as having the potential to create value for the respondent. The alteration of position tests in s 296(3) are predicated on the proposition that it would be unjust to deprive a recipient of a payment when he has acted to his detriment. That must be judged when the contract was let. At that stage, the contemporary documents and actions suggest that the respondent saw value in the development.

[134] The respondent deposes, in an affidavit dated 18 March 2015, that the development project now has negative equity of about $60,000. That subsequent reassessment of the position cannot be taken into account as relevant to the claimed alteration of position, or to any detriment arising from it.

[135] The respondent should not lightly be held to have altered his position in the way required by s 296(3) by continuing down the path on which he had earlier embarked, and which he then saw as likely to produce a benefit to him. I find that, taking all the circumstances into account, the entry into the development contract was not an alteration of the respondent's position under s 296(3)(c).

(e) Reasonable belief in the validity of the payments

[136] In case I am wrong in that conclusion, and the commitment incurred by AEL in entering into the building contract is an alteration of position, I must consider whether, when that contract was entered into, a reasonable person in the respondent's position could have held a reasonable belief that the payments were valid and would not be set aside.

[137] By July 2013, the fact that Mr Ross had been operating a Ponzi scheme was well known. The liquidators' initial report to this Court dated 13 November 2012 indicated that at that stage the liquidators had identified 1,720 investor accounts holding purported investments of $449.6 million. They had been able to identify only $10.214 million of investments actually held. That situation received extensive publicity, from that time. From that publicity, investors knew that the returns which had been reported to them were fictitious. The proposition that an investor who had been paid fictitious returns would be entitled to retain those returns (which, on the information then available, must have come from the funds of other investors) must have been at least questionable.

[138] The respondent's position, in his response to the liquidators' letter of claim, was that even after the liquidation of RAM he had no reason to believe that the return of the funds to him would repayable. His evidence is that he still believed that the return could be legitimate. On investigating his legal position he considered that he had satisfied all of the s 296(3) criteria.

[139] Mr Smith acknowledges that the respondent was aware of the potential risk of setting aside, and that is why he took advice on the point. The respondent also said in his letter to the liquidators that, on the liquidation, he investigated his legal position and realised that he had already satisfied all of the s 296(3) criteria. The content of the advice the respondent obtained is not in evidence, and I cannot take it into account in determining whether it might have provided a reasonable basis for a belief that the payment was valid. His statement that he realised that he satisfied all of the s 296(3) criteria does not advance the matter. Crucial to that is what a reasonable person in his situation would have believed about the validity of the payment. That requires a full analysis of the circumstances. The respondent's subjective view of whether he met that criterion is not relevant. The test is objective, in that it requires an examination not only of the respondent's actual belief but also of the reasonableness of that belief.

[140] I do not consider that taking legal advice directed only to s 296(3) would be sufficient to form the basis for a reasonably held view that the payment was secure from challenge. A challenge by the liquidators was one potential source of

challenge. Some action on behalf of other investors collectively might also have been a possibility. The consideration of the respondent's legal position needed to extend beyond the scope of s 296(3). Furthermore, in advising whether the requirements of the s 296(3) defence had been met it would have been necessary to consider whether any belief on which the respondent had acted in altering his position was reasonably held or not. That requires a much wider consideration of the respondent's legal position than a narrow consideration of s 296(3).

[141] For these reasons, I am also unable to accept Mr Smith's submission that when the development contract was entered into in July 2013, the fact that the respondent had not heard anything from the liquidators justified him in proceeding, and he could not sensibly be expected to defer a decision indefinitely. The question on this point is whether, in July 2013, a reasonable person would have believed the payment to be valid. The absence of recovery action by the liquidators before then is not a factor carrying weight on that question.

[142] I do not consider that, following the first public revelation of RAM's position, a reasonable person in the respondent's position could have held a reasonable belief that the payments were valid and would not be set aside. Such a person should have entertained very considerable doubt. Soon after the publication of the liquidators' report to the Court, and their communications with the investors, investors must have known or suspected that they had been the victims of a fraud by Mr Ross, of substantial proportions. By the time the respondent entered into the building contract in July 2013, he was well aware of the situation. He was aware that the profit which had been reported to him, and which had been paid to him, was fictitious. It must, at a broad level, have given rise to concerns for a reasonable person in the respondent's position that the money that he had received purporting to be those fictitious profits must have come from funds to which other investors must have contributed unwittingly. In those circumstances, a reasonable person would have anticipated that the payments might be challenged, and the possibility that they would be set aside could not be excluded. A reasonable person who altered his position in those circumstances could not have done so in the reasonable belief that the payment was valid and would not be set aside.

[143] For these reasons, I find that the second limb of s 296(3)(c) is not satisfied, for the payment of $454,000.

[144] My discussion of the alteration of position limb of the s 296(3)(c) CA defence is relevant also to the s 349(2)(b) PLA defence. That defence is that the respondent's circumstances have so changed since receipt that it is unjust to order repayment.

[145] The requirement for a change of circumstances is broadly equivalent to the s 296 requirement of an alteration of position. The circumstances must have *so* changed that it is unjust to order repayment. That requires an examination of the respondent's circumstances which extends beyond the financial extent and effect of the change. It includes a consideration of the respondent's state of knowledge when the change of circumstances happened. His knowledge is relevant to the justice of making an order. In broad terms, on the facts of this case, a change of circumstances would not make it unjust to order repayment unless the respondent reasonably believed that his entitlement to the funds was secure. That involves an inquiry similar to that which I have undertaken in considering the reasonable belief limb of s 296(3)(c).

[146] The reasons which have led me to the conclusion that the s 296(3)(c) CA test is not met for the fictitious profits part of the payment lead me also to the conclusion that the s 349(2)(b) PLA test is not met for that part of the payment.

[147] Mr Smith submits that the one material difference between the s 296(3)(c) CA test and the s 349(2)(b) PLA test is that the PLA test is discretionary, in that the Court may decline to make an order if the test is met, whereas the CA test is mandatory, in that the Court must not order recovery if the test is met. Mr Smith submits that the CA test must be applied to the PLA claim, because s 296(3) applies to claims by a liquidator under any Act, or in law, or in equity. My conclusion that neither test is met for the fictitious profits component makes it unnecessary to address that submission.

[148] My conclusion that the defence is not made out means that the payment of the fictitious profits of $454,000 may be set aside under both s 348 of the PLA and s 294(5) of the CA.

[149] My conclusions on the claim under s 294 CA make it unnecessary for me to consider the liquidators' alternative claim under s 297 CA.

Result

[150] The liquidators' claims fail in respect of the payment of $500,000 to the respondent.

[151] I make an order setting aside the payment to the respondent of $454,047.62.

[152] I order under s 348(2)(b) of the PLA and s 295(a) of the CA that the respondent pay to the liquidators the sum of $454,047.62.

[153] Questions of costs, and interest, are reserved. The parties may submit memoranda if they are unable to agree.

A D MacKenzie J