IN THE COURT OF APPEAL OF NEW ZEALAND

CA384/2015
[2016] NZCA 74

BETWEEN	HAMISH MCINTOSH Appellant	
AND	JOHN HOWARD ROSS FISK AND DAVID JOHN BRIDGMAN Respondents	

Hearing:	19 November 2015
Court:	Harrison, French and Miller JJ
Counsel:	J B M Smith QC and J L W Wass for Appellant M G Colson and L W Brazier for Respondent and Cross-Appellant
Judgment:	16 March 2016 at 2 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The cross-appeal is dismissed.

C There is no order as to costs.

REASONS

HARRISON AND FRENCH JJ

(Given by Harrison J)

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Introduction

[1] Subject to proving certain preconditions, the liquidator of a failed company is entitled to recover any payments made by the company to a creditor within the two year period before liquidation unless the creditor can prove that either he or she (1) gave value or valuable consideration for the payment or (2) has altered his or her position in the reasonably held belief that the payment was valid.[1] While these alternative defences are simply expressed, the application of the first to the facts at issue on this appeal and cross-appeal is not without its conceptual difficulties, and our decision on it will directly affect the rights and obligations of the company and many of its creditors.

[2] Ross Asset Management Ltd (RAM) managed funds deposited for investment by members of the general public. The company was the corporate ego of

[1] Companies Act 1993, s 296(3); Property Law Act 2007, s 349.

David Ross, a Wellington accountant. It appeared to be most successful, reporting substantial profits on investments in nominated securities. But the truth was otherwise.

[3] Mr Ross operated an elaborate fraud, known colloquially as a Ponzi scheme. The reported securities were largely non-existent. He used new investments to repay maturing deposits, including a substantial but fictitious profit component. When it was placed in liquidation RAM's liabilities exceeded its assets by at least $100 million. The company was, and had been for many years, hopelessly insolvent.

[4] Hamish McIntosh was a depositor. Some four years after his original deposit, and about a year before its liquidation, RAM repaid Mr McIntosh's deposit of $500,000 plus fictitious profits of $454,047, a total of $954,047. On the liquidators' application to recover the payment MacKenzie J found that Mr McIntosh had given value for and was entitled to retain $500,000 of it.[2] But he was ordered to repay the balance of $454,047 because he had neither given value nor altered his financial position in the reasonably held belief that this element of the payment was valid. In legal terms, this part constituted a voidable transaction[3] or a prejudicial disposition.[4]

[5] Mr McIntosh appeals; the liquidators cross-appeal.

Facts

[6] The relevant facts are not in dispute and for these purposes can be stated shortly.

[7] Mr McIntosh met Mr Ross in March 2007. He agreed to deposit $500,000 with RAM to establish and manage what he called an international equity portfolio. He had borrowed the $500,000 from Westpac which he paid to RAM in April 2007. He described his goal as to achieve consistent medium to long-term capital growth from a diversified share portfolio.

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2 *Fisk v McIntosh* [2015] NZHC 1403 [HC decision].
3 Companies Act 1993, s 292.
4 Property Law Act 2007, s 346.

[8] The legal relationship between the parties was governed by a contract whereby Mr McIntosh appointed RAM as his agent for the purpose of managing and administering his portfolio. The company was to hold the funds upon a bare trust for Mr McIntosh. Another company, Dagger Nominees Ltd, was appointed to hold any assets comprised in the portfolio or managed by RAM. The agreement was terminable on 30 working days' notice. RAM undertook to discharge its duties in a proper manner. Management fees were payable. A limitation of liability to a figure three times a year's fees did not apply to fraud.

[9] Mr McIntosh's deposit suffered the same fate of misappropriation as Mr Ross practised on all other depositors. MacKenzie J described Mr Ross' modus operandi more fully as follows:

> [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.
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> [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.
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> [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.

[10] Mr McIntosh understood from RAM that his investment was profitable. By September 2011, however, he decided to terminate his contract with the company. He wanted to use the $500,000 deposit and what he understood were accumulated profits for another purpose.

[11] In November 2011, RAM made six payments to Mr McIntosh totalling $954,047 in settlement of his withdrawal notice. RAM's investment report sent to Mr McIntosh with the funds purported to show that the monies were realised from the sales of eight separate share parcels. MacKenzie J's findings are not challenged that (1) none of the shares existed and none of the monies paid to Mr McIntosh were derived from the sale of shares held on Mr McIntosh's behalf;[5] (2) the monies paid to Mr McIntosh were derived from the sales of other shares and securities, intercompany transfers within the Ross group and deposits paid by other investors;[6] and (3) there was a deficit of assets to liabilities throughout the relevant period, starting at $18 million on 31 March 2008 and rising to $109 million by 6 November 2012.[7]

[12] There is no challenge also to MacKenzie J's findings that the liquidators had satisfied all the statutory conditions necessary to establish a right of claim against Mr McIntosh to repay the money. In particular (1) the payment of $954,047 constituted a disposition of property by RAM or a transaction;[8] (2) the payment was made by a debtor;[9] (3) RAM was insolvent at the time of the payment because it was unable to pay its debts as they fell due;[10] (4) the payment was made with intent to defeat RAM's creditors;[11] and (5) the payment enabled Mr McIntosh to receive more than he would have received on RAM's liquidation.[12] There was no question that Mr McIntosh received the money in good faith and without knowledge or suspicion that RAM was insolvent.

5 HC decision, above n 2, at [17].
6 At [18].
7 At [25].
8 At [32]–[34], Companies Act 1993, s 292; Property Law Act 2007, s 346.
9 At [35].
10 At [36]–[51].
11 At [52]–[55].
12 At [56]–[57].

[13] The questions in the High Court, as they are for us, were whether Mr McIntosh could establish either that he (1) gave value or acquired for valuable consideration all or part of the payment; or, if not, (2) altered his position in the reasonably held belief that the transfer was valid and would not be set aside. We shall determine the appeal and cross-appeal together because the first defence is equally at issue on both.

Statutory defences

[14] The relevant statutory preconditions to the liquidator's right of recovery and the defences available to Mr McIntosh are defined separately. First, ss 292 and 296 of the Companies Act 1993 state:

> **292 Insolvent transaction voidable**
>
> (1) A transaction by a company is voidable by the liquidator if it—
>
> (a) is an insolvent transaction; and
>
> (b) is entered into within the specified period.
>
> (2) An **insolvent transaction** is a transaction by a company that—
>
> (a) is entered into at a time when the company is unable to pay its due debts; and
>
> (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.
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> (3) In this section, **transaction** means any of the following steps by the company:
>
> (a) conveying or transferring the company's property:
>
> …
>
> (c) incurring an obligation:
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> …
>
> (e) paying money (including paying money in accordance with a judgment or an order of a court):
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> (f) anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it.
>
> …

(5) For the purposes of subsections (1) and (4B), **specified period** means—

(a) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order was made; and

…

296 Additional provisions relating to setting aside transactions and charges

(1) The setting aside of a transaction or an order made under section 295 does not affect the title or interest of a person in property which that person has acquired—

(a) from a person other than the company; and

(b) for valuable consideration; and

(c) without knowledge of the circumstances under which the property was acquired from the company.

…

(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.

(4) Nothing in the Land Transfer Act 1952 restricts the operation of this section or sections 292 to 295.

[15] Second, s 349 of the Property Law Act 2007 (PLA) states:

> **349 Protection of persons receiving property under disposition**
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> (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
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> (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.

First defence: giving value or valuable consideration

(a) High Court

[16] The essence of Mr Smith QC's argument in the High Court, as it was before us, was that Mr McIntosh gave value for the payment of $954,047 or acquired it for valuable consideration in (1) making the original investment of $500,000; (2) giving RAM the benefit of the use of his money for four years, with the corresponding detriment or deprivation to him; (3) promising to pay management fees even though they were not deducted; and (4) discharging RAM's debt on repayment.[13]

[17] MacKenzie J was content to adopt the four components of Mr Smith's composite test for the existence of value or valuable consideration, but by separate

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[13] At [65].

application to the two distinct elements of the payment. He focussed first on the original deposit of $500,000, concluding in Mr McIntosh's favour that:

> [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.

[18] The Judge found that RAM's use of Mr McIntosh's money,[14] the promise to pay management fees,[15] and the discharge of debt[16] did not satisfy the statutory requirement of value or valuable consideration for the balance of $454,047. We shall return to his reasoning.

(b) Principles

(i) Legal relationship

[19] Our starting point for consideration of Mr Smith's argument is with the nature of the legal relationship which existed between RAM and Mr McIntosh at the date of payment and its subsequent evolution.

[20] The relationship was not in the orthodox nature of debtor and creditor. Initially it was that of trustee and beneficiary. As MacKenzie J found, and Mr Smith accepted, the parties created a bare trust of the deposited funds with a related contractual obligation to manage the $500,000 in accordance with Mr McIntosh's instructions.[17] RAM assumed legal ownership of the funds but Mr McIntosh

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[14] At [79].
[15] At [80].
[16] At [81]–[83].
[17] At [43].

retained beneficial ownership. The company was not obliged to repay any or all of the monies provided it performed its contractual duties.

[21] However, the nature of the legal relationship changed when RAM misappropriated the money for its own purposes. As MacKenzie J found, Mr McIntosh acquired a right of action for breach of trust against RAM.[18] An equitable debt was created in Mr McIntosh's favour for the amount of the deposit together with equitable damages, being the amount necessary to restore Mr McIntosh to the position in which he would have been but for RAM's misappropriation.[19] His measure of compensation is the same as for a restitutionary remedy. In short, by misappropriating the funds RAM breached the bare trust, reconstituting the relationship into one of debtor and creditor.

(ii) Antecedent debt or obligation and discharge tests

[22] This unorthodox genesis of the debtor and creditor relationship between RAM and Mr McIntosh marks out its point of factual difference from other cases considered by New Zealand and Commonwealth courts in the context of an inquiry into whether value or valuable consideration is given for an impugned payment, as is illustrated by *Allied Concrete Ltd v Meltzer*.[20] In reversing a decision of this Court where insolvent companies had made payments to entities supplying goods and services on credit, the Supreme Court found that the criterion of value did not require proof of new value given when or after a payment is received. Instead it extended back to value given at an earlier time when the antecedent debt was created. In all three consolidated appeals payments were made under what were 60 or 90 day credit arrangements for goods supplied within a month or two before submission of invoices.

[23] In one of the decisions appealed in *Allied Concrete*, this Court had held that the requirement under s 296(3)(c) of the Companies Act that the payee gave value when receiving the impugned payment imported a temporal restriction: accordingly,

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18 At [45].

19 *Ex Parte Adamson*, *in re Collie* (1878) 8 Ch D 807 (CA) at 819, discussed in *AIB Group (UK) Plc v Mark Redler & Co* [2014] UKSC 58, [2015] 2 All ER 747 at [61]. See also *Target Holdings Ltd v Redferns* [1996] AC 421 (HL).

20 *Allied Concrete Ltd v Meltzer* [2015] NZSC 7, [2016] 1 NZLR 141 [*Allied Concrete*].

the payee had to give value contemporaneously with receipt.[21] However, the Supreme Court was satisfied that this gloss was unwarranted. It accepted that the word "when" imports a requirement of a linkage or connection between the payment and the elements of the statutory defence. However, it does not require proof that the creditor gave value at the time the payment was made: as a matter of construction, the words "gave value" extend back to value given earlier.[22]

[24] On this premise the majority in *Allied Concrete* applied what is known as the antecedent debt test. Value in this statutory context includes value given either when the debt was initially incurred or arising from a reduction or extinguishment of liability incurred as a result of the earlier transaction.[23] The majority did not draw a distinction between the statutory tests of giving value or valuable consideration provided the value was real and substantial and not the contractual notion of consideration.[24] While concurring in the result, Elias CJ apparently favoured a test confined to the second stage in the transaction.[25] William Young J, who agreed with the Chief Justice, described her approach as the discharge hypothesis.[26]

[25] Both the majority and concurring minority judgments in *Allied Concrete* examined the history, purpose and meaning of the relevant statutory provisions including a close comparative analysis of the relevant Australian legislation. It is unnecessary for us to repeat that exercise except to identify the majority's identification of the two important but potentially conflicting policies underlying the voidable preference regime. One key purpose is the protection of an insolvent company's creditors as a whole against the diminution of assets available to them which results from a transaction that confers an inappropriate advantage on one creditor by allowing it to recover more than it would in a liquidation; the other is that creditors who have entered into transactions with companies which have reached the point of insolvency are entitled to be protected in some circumstances where considerations of individual fairness and commercial confidence apply.[27] The

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21 *Farrell v Fences & Kerbs Ltd* [2013] NZCA 91, [2013] 3 NZLR 82 at [86].
22 *Allied Concrete*, above n 20, at [68].
23 At [105].
24 At [75]–[76].
25 At [158]–[168].
26 At [177]–[194].
27 At [1] and [96].

Supreme Court was particularly influenced by the latter policy and the commercial imperative of maintaining the free flow of trade where third parties supply goods or services to companies according to standard credit arrangements.[28]

[26] Mr Smith bases Mr McIntosh's appeal on the antecedent debt test. In formulating this test, the majority in *Allied Concrete* was directly influenced by the reasoning adopted by the Full Court of the Federal Court of Australia in *PT Garuda Indonesia Ltd v Grellman*,[29] which our Court had distinguished because it was decided within a different statutory context.[30] In that case a former accountant defrauded an airline, Garuda, of $250,000 between 1975 and 1983. In October 1985 the ex-employee confessed and agreed to repay the money if Garuda did not go to the police. In October 1985 he repaid $100,000; in December 1985 he transferred his house property to Garuda in satisfaction of the balance of $150,000. In August 1989 he was bankrupted.

[27] Both the payment and transfer were challenged as voidable preferences. The payment was upheld against the trustee in bankruptcy; but the transfer was set aside. Only the payment is relevant for our purposes.

[28] Under the relevant legislation applying in *Garuda*, which is materially similar to our voidable preference regime, a disposition could be set aside if it was not made "for valuable consideration". The Federal Court was satisfied on the authorities that "consideration consisting of an antecedent debt constitutes valuable consideration for a payment or transfer of property in discharge of that debt".[31] Its rationale was that:[32]

> … the payment or transfer of property *is made in performance of an obligation incurred by the payer or transferor at the time of, and as part of, the original transaction which created the debt. The payment or transfer is made in discharge of an obligation which has been subsisting since that time* … the consideration is adequate in the sense that its relationship to the value of the payment or transfer is real and substantial and not one which is merely nominal or trivial or colourable … No question of adequacy of the consideration arises in the present case. The payment of $100,000

[28] At [43].
[29] *PT Garuda Indonesia Ltd v Grellman* (1992) 35 FCR 515 (FCAFC) [*Garuda*].
[30] *Farrell v Fences & Kerbs Ltd* [2013] NZCA 329 at [15].
[31] *Garuda*, above n 29, at 531.
[32] At 531–532.

> discharged the antecedent obligation of Mr Simpson to the extent of the payment … and was made for valuable consideration.
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> (Emphasis added.)

[29] Significantly, the Federal Court in *Garuda* did not draw a conceptual distinction between the existence of an antecedent debt and its later discharge. Both were treated as integral steps in the process of creating and settling a debt, and of providing value or valuable consideration for the impugned payment.

(c) Payment

(i) Deposit

[30] In challenging MacKenzie J's finding that Mr McIntosh gave value for $500,000 of the payment, Mr Colson did not take direct issue with the temporal separation of over four years between the dates of deposit and repayment.

[31] Instead, Mr Colson submitted that the antecedent debt and discharge tests were not readily applicable because Mr McIntosh's payment of the deposit did not constitute an exchange of value. In particular:

(1) The deposit was intended to be held in trust and applied to investments and did not add value to RAM's assets; but, if value was added, it was taken by the company, not given by Mr McIntosh as s 296(3) of the Companies Act requires. RAM never acquired beneficial title through its own breaches of trust.

(2) RAM has received nothing of value from reducing its liability by $500,000 to Mr McIntosh. The company still remained liable on a breach of trust claim for that amount but just to another depositor. In this sense no advantage has been conferred on RAM and extinguishing an obligation cannot therefore be said to be of value or valuable consideration.

[32] In rejecting this submission we agree with MacKenzie J that RAM took value of $500,000 when misappropriating Mr McIntosh's deposit and treating the money

as its own.[33] It does not matter whether the antecedent debt or discharge tests are applied. They are simply the two sides of the same contractual coin of giving consideration; a debt is created when the deposit is misappropriated and payment is later accepted in settlement. The time lag between the two is immaterial.

[33] On the antecedent debt hypothesis, the focus is on the time when Mr McIntosh gave value or valuable consideration and RAM acquired legal title to the deposit, just as it did to all other monies misappropriated from other depositors: Mr McIntosh's beneficial entitlement to the monies is relevant only to his right of action for equitable damages for breach of trust. What is decisive is the creation of a debt owed by RAM or the assumption of an obligation to Mr McIntosh. And while Mr McIntosh may not have intended to give value when making his deposit, that was objectively its effect.

[34] On the discharge hypothesis, RAM's payment settled the first and readily quantifiable element of its obligation. It is immaterial that in doing so RAM has incurred a matching liability to another depositor. That neutrality of position is a constant feature where, for example, an insolvent company pays a creditor by resorting to a bank overdraft facility. In terms of the statutory tests, value was given either when the debt was initially incurred or Mr McIntosh discharged RAM from its liability for the deposit on receipt of the company's payment.

[35] Mr Colson advanced two other grounds of challenge to MacKenzie J's primary finding. First, he submitted that the majority's decision in *Allied Concrete* is distinguishable because of the unusual nature of RAM's relationship with depositors when compared to those carried out on normal, everyday trade credit arrangements. Here there is no risk of causing disruption to the routine flow of credit in commercial transactions or of interfering with commercial confidence in clawing back payments made as part of a Ponzi scheme. In such cases all investors are victims of fraud. It is thus preferable to adopt an interpretation of the statutory defences that favours the benefit of all investors resulting in pro rata justice between all.

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33 HC decision, above n 2, at [67].

[36] We do not accept this submission. While we have acknowledged the problematic nature of the relationship between RAM and its depositors, the legal principles adopted by the majority and minority in *Allied Concrete* apply equally here. So does the same requirement of commercial certainty or consistency. The context of transactions outside the usual trade credit arrangements does not justify a departure from the principles of statutory construction formulated by both the majority and minority in *Allied Concrete*; they cannot be applied for some factual purposes and not others — there is no room for a sliding scale of circumstances. Nor can the fact that the scheme was of a Ponzi nature influence the legal analysis. That factor is neutral, as Mr Smith submitted.

[37] Second, Mr Colson submitted that this case is distinguishable from *Allied Concrete* because the companies received full consideration for their payments. The Supreme Court was not required to engage with the issue of adequacy of consideration beyond confirming that the value must be real and substantial, not merely nominal or trivial.

[38] However, we note that the consideration given by Mr McIntosh for the deposit element of the payment received from RAM does not raise any question of adequacy of value. It was not only real and substantial but, to that extent, quantifiable and equivalent. By virtue of RAM's misappropriation, it added corresponding value to the company's assets. This conclusion is ultimately our point of departure from Miller J's analysis.

[39] In summary, we are satisfied that the liquidators claim to recover $500,000 of RAM's payment to Mr McIntosh must fail for the reasons that:

(1) immediately upon its misappropriation of Mr McIntosh's deposit in April 2007 RAM acquired legal title to the money while assuming an indebtedness or obligation for this amount together with any additional sums necessary to restore him to the position in which he would have been if RAM had performed the terms of its contact;

(2) the amount of RAM's liability to Mr McIntosh was undetermined when in November 2011 it paid him $954,047 but the amount of $500,000 was a quantifiable element; and

(3) Mr McIntosh gave value for RAM's payment of $500,000 by discharging the company from its quantifiable liability to him in that amount.

[40] We add that were it not for our view that *Allied Concrete* is indistinguishable, and we were free to approach the issues of statutory construction afresh, we would be attracted to adopting Miller J's analysis.

(ii) Balance

[41] MacKenzie J found that Mr McIntosh did not give value for the balance of the payment of $454,047, known as the fictitious profits element. The Judge accepted Mr Colson's submission that some equivalence of value was required for this element,[34] adding that:

> [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 $954,047, 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 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.
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> [92] The defence in s 296(3) is intended to promote certainty for debtors and creditors alike. 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.

34 At [85]–[86].

(Footnote omitted.)

[42] In challenging this finding Mr Smith submitted that there was no warrant for the Judge's division of the payment into two identifiable elements — the transaction must be examined as a whole. The law does not allow allocations of value between parts of the payment and the Judge's approach was contrary to *Allied Concrete*. We note that, if the underlying premise of Mr Smith's argument of indivisibility fails, so does his argument.

[43] In this context again Mr Smith's focus was on value. In his submission, based on passages from the Chief Justice's judgment in *Allied Concrete*,[35] Mr McIntosh was only required to prove to a low threshold that some value was given for the total payment. Contrary to the preceding legislation, s 296(3) of the Companies Act does not allow equities to be carved up or evaluated. Mr McIntosh easily met the value threshold by paying RAM the $500,000 deposit: beyond that, an inquiry into adequacy or sufficiency of value is prohibited.

[44] We reject this proposition. Mr Smith cannot have it both ways. He relies on the majority's antecedent debt approach in *Allied Concrete*. However, RAM was not indebted to Mr McIntosh for $954,047 at the date of payment: it was indebted for $500,000, a quantifiable element of its liability, together with an undetermined amount of equitable damages. The balance actually paid of $454,047 bore no tangible relationship to RAM's liability. It was simply a figure calculated from a fabricated foundation of non-existent investments in securities. Mr McIntosh gave no value for a payment to which he was not entitled.

[45] In support of his contrary submission, Mr Smith observed that even a damages claim confined to use of money interest over the term of the deposit would equate to a significant proportion of the $454,047 profit component. Mr McIntosh must be given credit for this amount as constituting value given.

[46] We accept that on a claim against RAM Mr McIntosh would have obtained judgment for a significant sum even if settling the measure of loss may have been a

[35] *Allied Concrete*, above n 20, at [158]–[159].

problematic exercise. But that is largely beside the point because Mr McIntosh's right remained inchoate. He had no right to retain funds against RAM's unquantified liability; there was no exchange of values.

[47] Mr Smith accepted that the payment of $954,047 did not discharge the company's antecedent obligation to Mr McIntosh. There was no accord or satisfaction at that stage of Mr McIntosh's claim. Given that acknowledgement, it is artificial, and contrary to the purpose of the voidable preference provisions, to ignore the notional nature of the $454,047 component.

[48] We add three points. First, if taken to its logical extension, acceptance of Mr Smith's argument would immunise from scrutiny any payment on account of fictional profits, however excessive it may be. It is no answer for Mr Smith to speculate that a plainly excessive figure would necessarily raise questions about whether Mr McIntosh received the payment in good faith. There is no room for importing a test based on degrees of excess.

[49] Second, in *Allied Concrete* the Chief Justice discussed sufficiency of value in a different context. She accepted, nevertheless, that there must be an "inquiry into whether some real value has actually been passed over," after recognising that no difficulties arise where the payment is in settlement of a debt.[36] We repeat that RAM's payment of $954,047 was not made in discharge of a debt and cannot be attributed to that obligation. An inquiry into all aspects of the payment becomes necessary. And Lord Wilberforce's dictum in *Midland Bank Trust Co Ltd v Green*,[37] adopted by the Chief Justice in *Allied Concrete*,[38] is direct authority against Mr Smith's submission: given that the payment of $454,047 was legally indefensible, no part of it conferred an advantage on Mr McIntosh or amounted to a detriment suffered by RAM.

[50] Third, in written submissions, but not in argument, Mr Colson sought to justify a variant of the division between deposit and fictitious profits. He relied upon RAM's payment of six separate amounts to Mr McIntosh totalling $954,047. He

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36 At [159].
37 *Midland Bank Trust Co Ltd v Green* [1981] AC 513 (HL) at 531.
38 *Allied Concrete*, above n 20, at [158].

suggested that each payment should be treated as an individual transaction. On that basis Mr McIntosh provided full consideration for three payments, no consideration for two payments and partial consideration for one payment. Adoption of this approach would require Mr McIntosh to repay $509,297 as opposed to $454,047.

[51] Like MacKenzie J we reject this approach. It is artificial to attempt to allocate value to individual payments where all were made in response to Mr McIntosh's withdrawal notice.

[52] The liquidators are entitled to recover $454,047 from Mr McIntosh for the reasons that:

(1) payment of this amount was not made in discharge of RAM's liability to Mr McIntosh in equitable damages but according to a notional calculation based upon a fabricated foundation of non-existent securities;

(2) Mr McIntosh gave no value for payment of this amount; and

(3) ultimately Mr McIntosh cannot retain money to which he had no legal entitlement or by this means enrich himself at the expense of other creditors.

(d) Comparative jurisprudence

[53] There are no analogous Commonwealth authorities on point. But a comparison with the North American jurisprudence is informative. Courts in the United States have considerable experience with the corporate failures of Ponzi schemes. The terms of the United States Bankruptcy Code are of course differently worded from our statutory regime. But relevantly the Code provides a defence to payments made by insolvent companies where value is given in exchange for payment.[39] In this context value is described as, among other things, "satisfaction …

[39] 11 USC § 548(c).

of a present or antecedent debt of the debtor", treated as being identical to "reasonably equivalent value".[40]

[54] The American courts have undertaken the same value allocation as we have, and on a similar conceptual basis. Courts there have held that an investor in a Ponzi scheme obtains a claim in restitution against the company immediately when it fraudulently misappropriates the investment, constituting a debt owed by the company to the investor. Accordingly, each dollar of the initial investment returned constitutes a reduction of the claim for restitution and, as it satisfies an antecedent debt, constitutes value given to the debtor.[41]

[55] However, the American courts have consistently held that payments made to investors in Ponzi schemes are voidable to the extent that they exceed the investor's initial investments.[42] As we have done, the courts have separated the notional profit component from the initial investment and then inquired whether the payee received value for the profit transferred. One principled ground for this approach is an acknowledgement that the investor gives value in the amount of the initial investment but not for any amount paid out in excess. The underlying policy is that if the investor is allowed to retain profits the fraud of the Ponzi scheme operator will be furthered by unfairly enriching early claimants at the expense of later investors.

[56] The Canadian courts have followed a different approach. Two first instance decisions have found in favour of receivers of Ponzi companies against investors who have been paid amounts inclusive of the deposit and fictitious profits. The courts have ordered the recipients to repay the full amount on the premise that the company was insolvent from its inception, tainting all payments with dishonesty.[43] The reasoning is cursory and was apparently influenced by a construction of the

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40 11 USC § 548(d)(2)A.

41 *Wyle v CH Rider & Family* 944 F 2d 589 (9th Cir 1991); *Merrill v Abbott* 77 BR 843 (D Utah 1987) at 857; *Rosenberg v Collins* 624 F 2d 659 (5th Cir 1980); *Scholes v African Enter., Inc.* 854 F Supp 1315 (ND Ill 1994) at 1326; *In re United Energy Corp* 944 F 2d 589 (CA 1991).

42 *In Re Bayou LLC* 362 BR 624 (Bnkrtcy SD NY 2007) at 636, citing *Soule v Alliot* 319 BR 225 (Bankr ND Okla 2004) at 239; *Sender v Buchanan* 84 F 3d 1286 (10th Cir 1996) at 1290; *Scholes v Lehmann* 56 F 3d 750 (7th Cir 1995) at 757; *Wyle v CH Rider & Family*, above n 41, at 595.

43 *Re Titan Investments Ltd Partnership* [2005] ABQB 637; *Den Haag Capital LCC v Correia* [2010] ONSC 5339.

relevant voidable preference legislation and in particular the word "void" which is materially different from our statutory provisions.

Second defence: alteration of position

(a) Legal principles

[57] Mr McIntosh's alternative defences were that: (1) he had altered his position in the reasonably held belief that the payment of $954,047 was valid and would not be set aside;[44] or (2) his circumstances have so changed that it would be unjust to order repayment.[45]

[58] The defences were run in the High Court on the basis that there was no material difference between the requirements imposed by the two statutory tests. The same facts were relevant to both. MacKenzie J's enquiry was directed to the question of whether Mr McIntosh had altered his position, given that the alleged change of circumstances arose from it.

[59] In his written submissions Mr Colson appeared to advance a different approach, identifying the key difference between the two statutory defences as being that the PLA defence is discretionary while the Companies Act defence is mandatory. The practical consequence would be that if the Court found Mr McIntosh had materially altered his position it could still order him to pay compensation under the PLA if such an order were not unjust but could not make an order under s 295 of the Companies Act. Mr Colson agreed with Mr Smith, however, that Mr McIntosh's defence under either section would stand or fall on whether he had materially altered his position in reliance on RAM's payment.

[60] In the High Court, and before us, Mr Smith accepted that these principles drawn from this Court's decision in *Madsen-Ries v Rapid Construction Ltd* applied: (1) Mr McIntosh has the onus of proving the defence; (2) his alteration of position must be conscious; (3) proof of detriment is required; and (4) the altered position

[44] Companies Act 1993, s 296(3)(c).
[45] Property Law Act 2007, s 349(2)(b).

does not have to be contemporaneous with receipt but must follow it.[46] Mr Smith accepted that a mere reduction of indebtedness is not in itself ordinarily seen as an alteration of position. He also submitted that the change of position need not be by the application of the money itself.

[61] The principal issue arising on Mr McIntosh's appeal is one of causation. The inquiry, which is of an intensely factual nature, is whether there is a causal link or nexus between the payment and a detrimental alteration in Mr McIntosh's position. Or, expressed another way, the question is whether he would have acted or refrained from acting in a certain way but for the payment.

[62] MacKenzie J summarised the core of Mr McIntosh's defence as follows:

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

(b) Mr McIntosh's financial circumstances

[63] The Judge noted that:

> [101] [Mr McIntosh] 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.

[64] We add that Mr McIntosh purchased 33 Palliser Road for a price significantly below its government valuation. The dwelling was classified as a leaky home.

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46 *Madsen-Ries v Rapid Construction Ltd* [2013] NZCA 489, [2015] NZAR 1385.

Mr McIntosh plainly contemplated that its demolition and redevelopment by building three residential units was the appropriate option.

[65] On 14 August 2011, two days after he signed the agreement to purchase 33 Palliser Road, Mr McIntosh took tax advice on whether to rent or on sell the units. At the same time he requested Westpac to finance the project. He forecast a provisional profit of $200,000. In reliance on accounting advice Mr McIntosh formed a look-through company (LTC) called Anne Elliot Ltd (AEL) which he formally nominated as the purchaser. AEL settled the acquisition on 9 September 2011, two days before Mr McIntosh gave notice of repayment to RAM.

[66] Mr McIntosh then owed Westpac about $4 million. He had used these funds to pay the $500,000 deposit to RAM and to acquire and develop residential properties in Queenstown and Wellington. By 31 October 2011 Mr McIntosh's borrowings from Westpac had increased to $5.25 million to include the purchase price of $986,000 for 33 Palliser Road. In November 2011 Mr McIntosh applied RAM's payment first in reduction of Westpac's loan of $500,000, with the balance applied to other secured indebtedness.

[67] On 8 December 2011 AEL engaged a firm of architects, Kerr Ritchie, to design two new houses at 33 Palliser Road for a fee of $150,000. In a letter to the liquidators on 16 August 2013 Mr McIntosh summarised the steps taken and costs incurred by him relating to the development project at 33 Palliser Road as follows:

> (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):
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> (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 [Wellington City Council] for, and obtaining, demolition and resource consents.
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> (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 purposes of s 296(3) there can be no real question practically that the steps were taken by me.)

[68] In their first report to the Court dated 11 November 2012 the liquidators advised that they had only been able to identify assets held by RAM of $10.214 million. The aggregate of all investor portfolios as recorded in the company's records showed that assets in excess of $449.6 million should have been available. The report was well publicised. By December 2012 at the latest Mr McIntosh as an experienced lawyer would have been on notice of the risk that the liquidators might take steps to claw back RAM's payment to him.

[69] Mr McIntosh's evidence was that he was satisfied the liquidators did not have a valid claim against him. He deposed to taking accounting, not legal, advice sometime in early 2013 about his risk. He remained satisfied that his position was inviolate. However, as MacKenzie J noted, the statutory requirement is objective — what a reasonable person in Mr McIntosh's situation would have believed about the validity of the payment. Mr McIntosh's subjective view was not relevant.[47] A full examination of the circumstances was required.

[70] On 4 July 2013 AEL entered into an agreement to build new dwellings at 33 Palliser Road for a price of $2.63 million plus GST. On 18 July 2013 the liquidators made demand on Mr McIntosh for repayment.

[71] When completed, the development project at 33 Palliser Road was valued at $3.745 million against total indebtedness of $3.809 million. AEL's net loss and thus Mr McIntosh's personal liability was around $60,000.

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47 HC decision, above n 2, at [139].

(c) Decision

(i) Purchase of 33 Palliser Road

[72] Before us Mr Smith cast Mr McIntosh's alteration of position defence on two alternative factual bases. The terms of MacKenzie J's comprehensive judgment suggest that in the High Court the defence was a composite of the two, with the emphasis on the second alternative.

[73] First, Mr Smith submitted, Mr McIntosh would not have bought 33 Palliser Road but for receipt of RAM's payment. He referred to Mr McIntosh's emails to Mr Ross following his notice of withdrawal of funds from RAM on 11 September. He referred to evidence of Mr McIntosh's anxiety about his mounting debt and associated costs and completion of RAM's payment to offset his increased debt position with the bank resulting from his acquisition of 33 Palliser Road, at a time when he wanted to reduce debt and improve the feasibility of the development project.

[74] In our judgment Mr Smith's submission is factually untenable for a number of reasons. Mr McIntosh's decision to buy 33 Palliser Road was not consciously made in reliance on RAM's payment. His interest in buying the property was longstanding and well preceded his notice of withdrawal and receipt of the deposit. Mr McIntosh attempted on three occasions to buy 33 Palliser Road, starting in May 2011. His third offer was accepted on 12 August 2011 with settlement due on 9 September 2011. He had committed himself to the purchase a month before giving notice to RAM.

[75] As Mr Colson pointed out, Mr McIntosh foresaw saw two benefits in acquiring 33 Palliser Road. One was the intrinsic value in the security of knowing that the property would not be developed in a manner prejudicial to his properties located on either side of 33 Palliser Road; the other was the extrinsic value potentially available from redevelopment with a projected profit of $200,000.

[76] Moreover, Mr Smith tended to gloss over the contradictory evidence of Mr McIntosh's own contemporaneous rationale for making and withdrawing his

deposit with RAM. When depositing the funds in 2007 Mr McIntosh advised Mr Ross that he hoped to use the returns to pay for a dwelling in Queenstown. When writing to Mr Ross on 5 July 2011, Mr McIntosh confirmed that he would like to start selling off his RAM portfolio "this year" to pay for a new dwelling in Queenstown. In August 2011 Mr McIntosh had in fact completed the development project of a Queenstown property at a price of $1.1 million. As Mr Colson pointed out, development costs had been at a level of about $100,000 per month for the first half of 2011. These commitments exceeded Mr McIntosh's monthly income.

[77] While Mr Smith is correct that debt is fungible, the inference is unavoidable that Mr McIntosh withdrew his deposit to reduce debt owing on his Queenstown property. Mr Smith's acceptance of the principle that a reduction in indebtedness cannot constitute an alteration of position answers his own submission that the defence is made out because Mr McIntosh wanted repayment to reduce debt and improve the profitability of the 33 Palliser Road project.

[78] Mr McIntosh has failed to discharge his evidential burden of proving that his decision to buy 33 Palliser Road was causally linked to his receipt of RAM's payment in November 2011. All the evidence suggests that he applied the funds in accordance with his longstanding intention to reduce his substantial indebtedness incurred in developing the Queenstown property earlier in 2011.

(ii) Lost opportunity

[79] Second, Mr Smith submitted that the payment caused Mr McIntosh to lose the opportunity to sell 33 Palliser Road and abandon his development project immediately after November 2011. Mr Smith accepted that Mr McIntosh would have suffered a loss on resale. But, he says, resale would have been preferable to proceeding with the project. Instead, Mr McIntosh incurred preliminary costs in excess of $200,000 including $50,000 for demolishing a leaky building.

[80] The Judge found against Mr McIntosh on the alteration of position argument in these terms:

> [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 [Mr McIntosh]'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 [Mr McIntosh] 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.
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> [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.
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> …
>
> [135] [Mr McIntosh] 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).

[81] The Judge found against Mr McIntosh on the alternative defence that when the building contract was entered into a reasonable person in Mr McIntosh's position could have held a reasonable belief that the payments were valid and would not be set aside. He concluded as follows:

> [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.

[82] In Mr Smith's submission, MacKenzie J erred in overlooking the simplicity of Mr McIntosh's position. It was that Mr McIntosh brought 33 Palliser Road and began incurring expenses to develop it in the belief that RAM's payment to him was valid and available for him to apply to reduce debt as he saw fit. The venture was loss making throughout. Mr McIntosh would not have embarked on the redevelopment if he had known the liquidators would be able to claw back the payment, removing $1 million from his gross asset position while leaving the debt acquired to fund 33 Palliser Road unpaid. Axiomatically Mr McIntosh would not have proceeded but for receipt of RAM's repayment. Mr Smith submits that the Judge was unduly influenced by Mr McIntosh's tolerance for debt in finding that his decision in principle to proceed with the development did not change after the payment.[48]

[83] In support Mr Smith subjected much of the contemporaneous material such as exchanges of emails to careful scrutiny. However, our concern is with the core objective facts and the inferences available from them. What Mr McIntosh, his banker and professional advisors might have said to each other along the way assumes less importance in this context.

[84] The question, in causative terms, is whether in reliance on the payment Mr McIntosh consciously decided to proceed with the development of 33 Palliser Road when he would not otherwise have done so. Alternatively expressed, the question is whether Mr McIntosh would not have proceeded with the development but for receipt of the payment and his belief in its validity. On either basis, he must establish that he acted to his detriment.

[85] Again, Mr McIntosh has fallen short of discharging his burden of proof. While a decision not to act can constitute an altered position in some circumstances,

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[48] At [121].

the proposition that receipt of RAM's payment caused Mr McIntosh to lose an opportunity to abandon a property development at a substantial loss is artificial.

[86] In summary:

(1) As noted, Mr McIntosh viewed the development as being gainful to him, intrinsically in protecting the amenities of his properties on either side of 33 Palliser Road and extrinsically from a modest, even marginal, profit forecast of $200,000.

(2) Once he had acquired 33 Palliser Road, the next and logical step in Mr McIntosh's long term plan was to demolish the leaky dwelling and reconstruct new units.

(3) This was a standalone project. There is no evidence that its financial feasibility would be affected by RAM's payment of $954,047. By 31 October 2011 Mr McIntosh had arranged a facility with Westpac for $1.1 million to meet the purchase price of $986,000 together with other costs. It was not until about July 2013, well after he was aware of the extent of RAM's insolvency and was on notice of his risk, that he arranged an increase in Westpac's facility, to $2.529 million, to finance AEL's obligations under the building contract.

[87] The artificiality of Mr McIntosh's defence is exposed when viewed through the lens of detriment. His hypothesis of abandonment in November 2011 after he had purchased 33 Palliser Road can properly be measured against his position on completion of the development. Mr Smith accepted that Mr McIntosh would have suffered a loss on resale if he had abandoned the project in reliance on the November 2011 payment. There is no direct evidence on the magnitude of such a loss. But, given the absence of other interested buyers and the state of the dwelling, we can infer that the loss would probably have been significant.

[88] On Mr McIntosh's own evidence, AEL and thus himself as its guarantor suffered a loss of about $60,000 following completion of the project. In substantive

terms he has not shown that this position was in fact materially worse than it would have been if he had abandoned the project, or that he suffered any real detriment in proceeding. We repeat that throughout he saw the project as viable regardless of his receipt of RAM's payment and one which offered him both intrinsic and extrinsic gains. Moreover, on completion Mr McIntosh secured the intrinsic gain and thus a benefit, unquantifiable in financial terms, of protecting his adjacent properties.

[89] Even if the question of detriment is viewed without this comparative assessment and restricted, as MacKenzie J did,[49] to the date when Mr McIntosh decided to go ahead, the first positive step taken was on 8 December 2011 when AEL entered into a contract with the architect to design two new houses for a fee of $150,000. This and all subsequent steps set out in Mr McIntosh's letter to the receivers on 16 August 2013 were necessarily taken to add value in what Mr McIntosh saw was a financially gainful course of conduct.

[90] Mr Smith submitted that by the time of RAM's known insolvency in November 2012, and the extent of its losses a month later, Mr McIntosh had passed the point of no return. It was unreasonable to contend that he should have discontinued his project at this stage. He said incurring development costs of $200,000, which the Judge described as relatively modest, amounted to a change of position.[50]

[91] However, as Mr Smith himself acknowledged, "the project was always a high risk one"; Mr McIntosh considered it to be marginal but he was prepared to take the risk so that he could control what happened at 33 Palliser Road. We would add that these risks were inherent in May 2011, when Mr McIntosh made his first offer to purchase. All his subsequent decisions were made against that background. We are in no doubt that he made an informed commercial decision to proceed with the development project independently of receipt of RAM's payment of $954,047.

[92] Furthermore, even with knowledge from December 2012 that the liquidators may challenge the payment, Mr McIntosh elected to commit AEL to a construction

49 At [133].
50 At [132].

contract for $2.63 million plus GST. He was, by then, on reasonable notice that the payment may be clawed back.

[93] It follows that Mr McIntosh's second ground of defence of a change of position in answer to the liquidator's claim for the balance of $454,047 fails.

Result

[94] The appeal is dismissed.

[95] The cross-appeal is dismissed.

[96] In these circumstances, there will be no order as to costs.

MILLER J

[97] I agree that Mr McIntosh's appeal should be dismissed on the grounds that he did not give value for fictitious profits and further did not relevantly alter his position. In my opinion he did not give value for the return of his capital either; accordingly, I dissent to the extent that I would allow the liquidators' cross-appeal.

[98] In my opinion *Allied Concrete* does not govern this case.[51] It established relevantly that "value" in s 296(3) of the Companies Act may extend to value in a transaction antecedent to the insolvent debtor's payment. The Supreme Court was not asked to decide the issue before us — the measure of value exchanged by debtor and creditor — because there was no controversy about value on the facts. Further, the case involved trade creditors who had supplied products on normal trade terms, and the majority recognised that trade creditors form a class meriting protection for reasons of commercial confidence. Mr McIntosh is not a trade creditor.

[99] The real question is how much value Mr McIntosh's capital contribution delivered. The measure is real and substantial value, meaning that the creditor must

51 *Allied Concrete*, above n 20.

have given value substantially equivalent to the value he received on payment.[52] In my opinion, an investor's antecedent contribution to a Ponzi scheme is not nearly equivalent to the payment that the scheme makes to the same investor on his timely exit; indeed, it delivers no value at all. So it was here.

[100] For these reasons, no distinction should be drawn between Mr McIntosh and the general pool of unsecured creditors. To prefer him is to undermine the core principles of collective realisation, which seeks to maximise the debtor's estate relative to the free-for-all that would otherwise happen as each creditor pursued its own interests, and equal distribution, which holds that unsecured creditors should be paid rateably.

[101] I will elaborate briefly on these conclusions. I begin by noting that trade creditors form a distinct class, for two reasons. First, trade credit is a species of business financing in which the supply of goods and services is bundled with a credit transaction. It is by no means inevitable that firms should finance themselves in this way; payment could be made on delivery or firms could turn to third party lenders such as banks. A standard explanation for trade credit appears to be that suppliers enjoy a monitoring advantage over banks; indeed, their presence may encourage banks to lend.[53] Dependency on the debtor offers another explanation.[54] Whatever the explanation, the prevalence of trade credit and its persistence across time indicate that it performs a valuable economic function. Hence the relevance of finality of payment, or commercial confidence, when examining apparently preferential transactions with trade creditors.

[102] Second, trade credit exhibits several characteristics that distinguish it from other lending in relevant ways. Trade creditors supply value in kind, in the form of goods or services. It appears that very seldom do they lend cash.[55] Payment terms

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52 I use the male pronoun because the investor here happens to be male.

53 Thomas H Jackson and Anthony T Kronman "Secured Financing and Priorities among Creditors" (1979) 88 Yale LJ 1143 at 1160; Mike Burkart and Tore Ellingsen "In-Kind Finance: A Theory of Trade Credit" (2004) 94 Am Ec Rev 569 at 569–570.

54 Benjamin S Wilner "The Exploitation of Relationships in Financial Distress: The Case of Trade Credit" (2000) 55 J Fin 153 at 154.

55 Burkart and Ellingsen, above n 53, at 570.

are short, usually somewhere in the range seven to 90 days.[56] And it appears that credit is seldom rolled over.[57] The creditors in *Allied Concrete* appear to have exhibited these characteristics, which enabled them to point to some discrete asset that the debtor obtained in return for a payment made soon afterward. Where such connection is sufficiently close, it may be that no distributional unfairness is done to other unsecured creditors by allowing the creditor to retain the payment; they may not recover the money, but the asset it purchased is available for realisation.[58]

[103] Those who lend cash are not in the same position. The debtor may benefit from a loan, of course, but the connection between an unsecured loan and an asset is likely to be less immediate. Nor is there any reason to prefer lenders as a class; they are third parties, such as banks, that are in the business of lending money and likely to take security.

[104] Hence my conclusion that Mr McIntosh is not a trade creditor. He supplied money, not goods or services, and he created no identifiable asset, still less one that might be said to mitigate the effect of the repayment, years later, on RAM's creditors. His advance merely enabled RAM to repay other unsecured creditors.

[105] That brings me to the question of "value". The term is not defined in the legislation, so we may adopt a meaning that best serves the statutory objectives, which are mixed: the core objectives are collective realisation and equal distribution but these are qualified by exceptions, one of which is for value given by a creditor. That exception recognises that it may be unfair to recover from a paid creditor in some circumstances, notably where the creditor points to an asset that is directly attributable to the payment and available for realisation.

[106] Two general points may be made about value. First, the majority in *Allied Concrete* did go so far as to hold that the words "gave value" in s 296(3) connote movement of real and substantial value, so treating the exchange of value as a practical question of fact and substance. That approach leads to substantial

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56 At 581. For example, in *Allied Concrete*, above n 20, the payment terms between Allied Concrete Ltd and Window Holdings Ltd were usually 60 days, occasionally with an extension to 90 days.

57 Burkart and Ellingsen, above n 53, at 571.

58 *Allied Concrete*, above n 20, at [91].

equivalence, which happens to be the measure of value that best reconciles the statutory objectives. Second, if real value was received by the debtor it is likely to be found in the antecedent transaction (for a trade creditor, the supply of goods; in this case, the advance of capital). That is why *Allied Concrete* is an important case. I acknowledge that the debtor receives fresh consideration for s 296 purposes[59] when its liability is discharged by payment, but by definition that second transaction is insolvent[60] and the reduction in its liabilities may well deliver no real value.

[107] In my opinion the value that RAM received when Mr McIntosh advanced his capital in 2007 was not substantially equal to the value he received when it was repaid in 2011. He received full value. The converse is not true, for Ponzi schemes do not generate profits sufficient to yield their promised profits but rather use new investor money to pay "profits" and to repay existing investors, with each such payment exacerbating the scheme's financial position. That is their distinctive characteristic. It follows that the introduction of new money creates no value but merely delays and worsens the inevitable ruin. As the Supreme Court of the United States put it in 1924 when speaking of the man who lent Ponzi schemes his name "[h]e was always insolvent, and daily become more so, the more his business succeeded."[61]

[108] The evidence of Mr Fisk is that from 2006 onward RAM operated as a Ponzi scheme, dependant on new capital to meet its expenses and repay prior investors. Consistent with that, Mr McIntosh's advance was immediately misappropriated and pooled. It is true, as Mr Smith urged, that RAM made some genuine investments and reports show that its investor assets exceeded investor contributions by $7.2 million as at 31 March 2007. But in my opinion RAM must be considered insolvent at all material times.[62] The real significance of those same reports is that from 2006 RAM made very few investments but mostly used new money to repay old. It followed the natural trajectory of all Ponzi schemes; investor contributions exceeded investor assets by $17.4 million on 31 March 2009, $99 million on

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59 At [105].

60 The repayment is not voidable unless it is an "insolvent transaction" as defined in s 292(1) of the Companies Act.

61 *Cunningham v Brown* 265 US 1 (1924) at 8.

62 Dorothy T Eisenberg and Nicholas W Quesenberry "Ponzi Schemes in Bankruptcy" (2014) 30 Tuoro L Rev 499 at 503.

31 March 2010 and $108.4 million on 12 November 2012. I observe too that the reports offer an incomplete accounting, as the trial Judge recognised.[63] Because it had stolen its investors' funds, RAM had a present liability in restitution at any given date to repay all contributions together with promised or declared profits.[64] By way of illustration, it appears from correspondence between Mr McIntosh and RAM that he was initially told his investment would yield a return of approximately 25 per cent per annum, and subsequent reports recorded that he had achieved net yields of about 23 per cent per annum. If I am wrong in my view that RAM owed investors declared profits, it must have owed them compensation for use of money, and its collapse was in any event only a matter of time.

[109] For these reasons, RAM must be taken to have received no value from Mr McIntosh in the antecedent transaction. The discharge that he gave on repayment was worthless because RAM was by then hopelessly insolvent.

[110] I acknowledge the majority's point that American courts have held that an investor who exits a Ponzi scheme before its collapse gives value for the capital portion of the repayment,[65] which discharges pro tanto the investor's claim for restitution.[66] However, that approach has been forced upon them by the expansive wording of the bankruptcy legislation. As the Court of Appeals for the Ninth Circuit explained in *Wyle v CH Rider & Family*:[67]

> Value is defined for purposes of section 548 of the Code as "property, or satisfaction or securing of a present or antecedent debt of the debtor …" 11 USC § 548(d)(2)(A). The term "antecedent debt" is not defined in the Code. "Debt," however, is defined in the general definition section of the Code as "liability on a claim." 11 USC § 101(12). "Claim" is defined as:
>
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to

63 HC decision, above n 2, at [25].
64 Under the Management Deed profits were not paid periodically but rather accrued until withdrawn. However, investor reports were made quarterly. Funds could be withdrawn at any time.
65 *Merrill v Abbott*, above n 41, at 857.
66 See, for example, Eisenberg and Quesenberry, above n 62; *Donnell v Kowell* 533 F 3d 762 (9th Cir 2008).
67 *Wyle v CH Rider & Family*, above n 41, at 595.

> an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, secured, or unsecured….
>
> The legislative history of the Code evidences Congress' desire to provide an expansive definition of "claim" under section 101(4). … The term "debt" should be read as being coextensive with the term "claim" … Thus, it is plain that Congress intended "debt" and, therefore, "antecedent debt," to be construed broadly.

[111] In marked contrast, most American courts to have considered the issue appear to have held that the legislation does not compel them to recognise value in either use of investors' money in a Ponzi scheme or the payment of fictitious profits, and given the choice they have refused to do so.[68] Their reasons apply no less persuasively, as I see it, to the return of capital. As it was put in *Merrill v Abbott*:[69]

> It is undisputed that the debtors here had no legitimate source of earnings but were operating a Ponzi scheme. Therefore, any money that [an investor] might recover in excess of his [investment] could not come from the debtors but would have to come from money that rightly belonged to other, defrauded [investors] …
>
> …
>
> "Value" must be determined by an objective standard. If the use of the [investors'] money was of value to the debtors, it is only because it allowed them to defraud more people of more money. Judged from any but the subjective viewpoint of the perpetrators of the scheme, the "value" of using others' money for such a purpose is negative. …
>
> In theory, the trustee is not allowed to avoid transfers made for reasonably equivalent value because creditors are not hurt by such transfers. If the debtor no longer has the thing transferred, either he has its equivalent, in which case his creditors can reach the equivalent to satisfy their claims, or his liabilities have been proportionately reduced. But if all the debtor receives in return for a transfer is the use of the [investor's] money to run a Ponzi scheme, there is nothing in the bankruptcy estate for creditors to share. In fact, by helping the debtor to run his scheme, the transfers exacerbate the harm to creditors by increasing the amount of claims while diminishing the debtor's estate …
>
> (Citations omitted.)

[112] I acknowledge that Mr McIntosh conducted himself in good faith and should not be blamed for his predicament. But it may be assumed that RAM's other unsecured creditors are equally deserving. His change of position defence has been

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68 A McDermott "Ponzi Schemes and the Law of Fraudulent and Preferential Transfers" (1998) 72 Am Bankr L J 157 at 164.

69 *Merrill v Abbott*, above n 41, at 859.

rejected and he points to no other distinction that warrants allowing him to prevail over them. He differs only in that he was paid and they were not. The repayment being an insolvent transaction, he should disgorge it in full and share rateably in the proceeds of liquidation.

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