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6 July 2018

Submissions on Ministry of Business, Innovation and Employment (MBIE) Discussion Paper - A new regime for unravelling Ponzi schemes

Introduction

PricewaterhouseCoopers (PwC) has one of New Zealand's longest established and largest Insolvency Practices.

Currently, PwC's New Zealand Insolvency Practice comprises four full time Partners. In addition, PwC has approximately 25 professionally qualified full time staff employed in its Restructuring practice including seven experienced Directors.

PwC operates as a national practice with seven offices spread throughout New Zealand.

PwC handles a large volume of insolvency assignments, comprising liquidations, receiverships and voluntary administrations. In addition, PwC routinely undertakes a large number of business appraisals, monitoring assignments and restructurings relating to companies and other businesses encountering financial stress. As part of its insolvency and restructuring work, PwC frequently works with New Zealand's major trading banks, Inland Revenue, the Official Assignee, MBIE, the Financial Markets Authority (FMA) and numerous creditors and other stakeholders in relation to the assignments carried out.

Over the last three years PwC partners and directors have been appointed to in excess of 30 receiverships, and in excess of 780 liquidations. PwC is one of the three firms that Inland Revenue have approved as their nominated liquidators in Inland Revenue initiated liquidations that come before the High Court. PwC handles more formal insolvency appointments than any other firm in New Zealand.

All PwC Partners and Directors who are active insolvency practitioners and who take appointment as receivers or liquidators are members of the Restructuring Insolvency and Turnaround Association New Zealand Incorporated (RITANZ), and are all Accredited Insolvency Practitioners (AIP's) under the RITANZ accreditation regime. John Fisk, a PwC Partner and the Leader of PwC's National Restructuring Practice, was a member of the Insolvency Working Group (IWG) and is currently the chair of RITANZ.

John Fisk and David Bridgman have since 2012 acted as liquidators of Ross Asset Management Limited (RAM) and several related parties. RAM is the largest reported Ponzi scheme in New Zealand's history, reportedly managing approximately $450m of client funds or assets upon liquidation in late 2012. The losses suffered by RAM investors exceed $100m. These submissions are the views of PwC itself, and while reference to RAM may be made, the views contained within these submissions in respect of changes to the framework of Ponzi scheme administration may not reflect the liquidators' approach to the administration of RAM under the existing law.

Overview of submissions

Our submissions are largely structured as responses to the 53 questions contained in the discussion paper, however, we wish to draw attention to four key issues identified while preparing our submissions, particularly arising from knowledge obtained by administering the liquidation of the RAM Ponzi scheme:

1. The appropriateness of a separate Ponzi scheme regime
2. Assumptions made by the discussion paper
3. Calculations for distribution models
4. Practical issues

The need for a separate Ponzi scheme regime

This discussion paper takes the position that because the outcome of the RAM Ponzi scheme has been perceived to be unfair to many investors, as a consequence, New Zealand requires law reform targeted specifically at Ponzi schemes. We believe that a review of the existing regime to determine if it could be improved and made more efficient when dealing with Ponzi schemes is valuable and necessary. However, we question whether wholesale change is required when changes to some existing legislation may also deliver the desired results.

Initially, it is important to consider that some aspects of the outcome of RAM were outside of the control of any regime. That is, Ponzi schemes by their very nature will be unfair to some investors. RAM's Ponzi scheme appears to have operated for 20 years or longer, during which many investors unknowingly received funds they were not entitled to, at the expense of later investors. A significant amount of the losses suffered as a result of RAM were in effect crystallised prior to RAM being placed into liquidation. As dealt with later in these submissions, the ability to recover 'capital' as part of the clawback claims would not necessarily have resulted in as significant a recovery as 'profits', on a percentage of claim basis.

The decision to implement a Ponzi regime appears to be a reaction to a discrete high profile Ponzi scheme, namely RAM. To our knowledge such schemes are very infrequent in New Zealand, however, we believe it would be beneficial to attempt to gather some statistical information around the frequency of such schemes and the loss suffered as a result of them and compare this to loss suffered by other types of fraud or insolvency more generally We believe it is important to take a cautious approach to law change to ensure it is a response to Ponzi schemes generally, not all of which will necessarily look like RAM.

As touched on within this discussion paper, many legitimate businesses may take on the appearance of being a Ponzi scheme when trading insolvently. The line may often be very blurred when attempting to make this distinction and it is important that any criteria are clear to avoid the creation of two "classes" of liquidation where a new Ponzi liquidation may capture business that it was not intended to capture.

It should also be noted that although it has taken a number of years to realise monies via clawback in the RAM liquidation there is now authoritative law which can be relied on in future Ponzi scheme cases. This has in fact occurred in the liquidation of Arena Capital Limited (In Liquidation) to allow recoveries in that case to be made much more quickly.

Assumptions made in the discussion paper

In addition to assumptions regarding the basis for the proposed law change, addressed above, we have identified a number of assumptions which we feel would benefit from either further evidence or further consideration.

Firstly, this discussion paper does not refer to section 522 of the Financial Markets Conduct Act 2013 (FMCA). This is the section of the FMCA which currently grants the FMA the ability to apply to court for a receiver to be appointed over an entity suspected of being in breach of the FMA's regulations. The FMCA was recently implemented in place of the previous Financial Advisers Act 2008, under which John Fisk and David Bridgman were appointed receivers and managers of Ross Asset Management Limited, and section 522 was used to appoint receivers to Arena Capital Limited (In liquidation) trading as BlackfortFX. We believe that, in principle, the mechanisms contained within the FMCA are sufficient to commence action placing a Ponzi schemes under the control of an independent third party for review which may result in liquidation of the scheme if appropriate. Should there be any concerns with this process, these concerns should be noted for discussion as we believe that the desired changes, at least in relation to identifying a Ponzi Scheme and subsequently appointing a liquidator, can be achieved under these provisions, and have in fact been successfully applied.

Throughout the discussion paper, it is suggested that the existing framework would not capture certain types of investment structure. We believe this should be considered in the context of section 522 of the FMCA. Some practical examples of where the existing regime has or could fail to capture such structures would also assist.

Secondly, at paragraph 64, the discussion paper implies that if the ability to recover 'capital' existed "almost all investors would have received the same percentage" from the RAM Ponzi scheme. We think this conclusion fails to take into account some of the other consequences of recovering capital. As the RAM Ponzi scheme had been in operation for upwards of 20 years, the vast majority of claims by number would have encountered limitation issues. Additionally, this assumption does not take into account the likelihood of actually recovering amounts from individual investors. The existence of a claim does not guarantee full, or even partial, recovery.

Our experience, as liquidators of the RAM Ponzi scheme, is that recovery from investors who had received back their 'capital' sums would be significantly lower than recovery from investors who had received 'profit' amounts, as:

- Conceptually, the requirement to repay funds to the scheme when the investor had not recovered their initial investment was difficult for investors to understand, which lead to refusal to engage on the issue. This would increase the costs of recovery, and accordingly reduce the net impact of any recovery made.

- Investors who had only recovered 'capital' were generally in worse financial positions when compared to investors who had recovered 'capital' and profits. Such investors may have a defence under any reasonable financial hardship provision.

- Any recovery of investors' 'capital' would also increase the total losses suffered by investors as a whole, reducing the net impact of the recovery. From a practical perspective it is likely that liquidators would settle capital claims against investors by the investor agreeing to waive their claim in the liquidation in part or in full, rather than requiring the investor to actually pay more money into the liquidation.

Thirdly, we disagree with the assumption that equitable tracing and proprietary claims are unfair. As detailed in the body of our submissions, we consider these to be inherent property rights which investors should be entitled to if such tracing is possible. We consider that if such rights are to be restricted this would represent a large deviation from the existing law and requires more consideration than has been set out in the discussion paper.

Finally, from our interpretation of this discussion paper, it is clear that MBIE has listened carefully to the genuine concerns of a number of parties affected by and associated with the RAM Ponzi scheme. We would encourage MBIE to also consider the views of those investors less likely to be vocal in response to this paper, primarily due to fear of unwanted attention and embarrassment. These investors will include those who have unknowingly received funds from a Ponzi scheme. Their personal circumstances will be varied, and the proposed law changes will potentially have significant impacts for some of them. The clawback claims which we have brought as liquidators of RAM have caused significant distress to many people who have been subject to them, aside from the time it has taken to reach a conclusive position. That is unlikely to change even if a regime is clear that any monies received must be repaid.

Calculations for distribution models

Paragraphs 257 through 269 of the discussion paper detail a number of calculations which have been adapted from page 34 of John Fisk's first affidavit in support of an application for directions currently before the High Court. We feel it is important to clarify certain issues arising from this adaptation, as we feel they may be misinterpreted by the public as the adaptation was carried out without reference to the data underpinning the summary table in the affidavit. Particularly, we note that the outcomes of the tables at paragraphs 257 and 263 are not comparable as they are based on different sums available for distribution.

From our analysis, the Rising Tide model and Alternative model have an identical net effect. The two models take two different approaches, but ultimately arrive at the same proportional maximum recovery (one framed as a maximum distribution rate, with the other a final percentage loss). The basis for the Rising Tide model being included within the application for directions was that the Amicus Curiae raised this as a model to consider which has standing in other jurisdictions and there is substantially more discussion around its appropriateness.

Further details on the impact of the Rising Tide model have been provided in John Fisk's second affidavit at paragraphs 12 to 27. We are open to conducting further analysis on any specific intricacies of these models, or other models, should these be requested by MBIE.

Practical issues

There are a number of practical issues which we have identified in applying the proposed new regime which we feel should be considered further:

- The assessment of whether a Ponzi scheme is being operated may depend on the availability of records, which may not always be available or sufficient, particularly where fraud is involved.

- Under the current regime, and on the basis of the conventional Net Contributions approach to distribution, investors can reliably determine whether they will be subject to a claim, whether they are eligible for a distribution, and to some extent they are able to assess the value of future distributions. If 'capital' were able to be recovered, investors may wish to forgo their claims in return for not being required to repay any funds, particularly where their assets are tied up in long-term investments or a family home. If this is permitted under a new regime, the value of the claims forgone will be difficult to estimate reliably. Additionally distributions under the Alternative Model and Rising Tide Model are inherently contingent on the claims which other investors have in the liquidation, and the value of the pre-liquidation losses suffered by those other investors. It would therefore be impossible for individual investors to calculate their own distribution unless they knew the details of all other investor claims. As a general rule the value of individual investor and creditor claims remains confidential and accordingly to make this information available would be large deviation from current practice which requires further consideration.

- Any changes to the fundamental aspects of the voidable transactions regime (with respect to Ponzi schemes) may result in new uncertainties, which may require further litigation to clarify. We believe that the position on the existing law is now reasonably clear, following *McIntosh v Fisk*, albeit there may be fact specific arguments that people subject to clawback claims would seek to raise.

- The exact treatment of non-cash transactions is far more important under an Alternative or Rising Tide model distribution, particularly transfers of amounts between related investors, division of relationship property, and returns of assets under valid proprietary claims. How such transactions are treated may extinguish claims, or sever the nexus between an investor's pre-liquidation returns of capital and their claim in the liquidation.

  The table overleaf illustrates an example where this may be a factor. In this example, Investor 1 contributes $200,000 and later requests a withdrawal of $50,000 (25% of their contribution), and two transfers of $50,000 to other investors, Investor 2 and Investor 3. Investors 2 and 3 would then appear to have separate investments in the scheme, each with contributions of $50,000 with no withdrawals, while Investor 1 would appear to have contributions of $200,000 with withdrawals of $150,000. The result of this example, if the transfers were accepted, would be that Investors 2 and 3 would share in the distribution at the maximum rate, while Investor 1 would not participate in the distribution unless the maximum rate exceeds 75%. If the transfers were rejected, Investors 2 and 3 would have no claim, and Investor 1 would participate in the distribution, but only if the maximum rate exceeds 25%. For reference, in the example of RAM, our first distribution is below 25% in all models.

A situation where this may occur would be a trust that seeks to distribute funds amongst its beneficiaries, funded by a withdrawal from a Ponzi scheme, and some beneficiaries opt to invest their funds within the scheme as opposed to receiving the funds in cash. This type of situation was a regular occurrence in RAM, although we are not aware whether it is common practice amongst other investment schemes.

Investor 1

Date	Contribution	Withdrawal	Balance	Notes
1/01/2000	200,000.00		200,000.00	NZD
1/01/2001		- 50,000.00	150,000.00	NZD
1/01/2001		- 50,000.00	100,000.00	Transfer to Investor 2
1/01/2001		- 50,000.00	50,000.00	Transfer to Investor 3
Total	200,000.00	- 150,000.00		

Investor 2

Date	Contribution	Withdrawal	Balance	Notes
1/01/2001	50,000.00		50,000.00	Transfer from Investor 1

Investor 3

Date	Contribution	Withdrawal	Balance	Notes
1/01/2001	50,000.00		50,000.00	Transfer from Investor 1

Yours Faithfully

John Fisk
Partner

Submission template

Discussion paper - A new regime for unravelling Ponzi schemes

Instructions

This is the submission template for the discussion document, *A new regime for unravelling Ponzi schemes*.

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in the discussion document by 5pm on **Friday 6 July 2018**. Please make your submission as follows:

1. Fill out your name and organisation in the table, "Your name and organisation".
2. Fill out your responses to the consultation document questions in the table, "Responses to discussion document questions". Your submission may respond to any or all of the questions in the discussion document. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.
3. We also encourage your input on any other relevant issues in the "Other comments" section below the table.
4. When sending your submission:
    a. Delete these first two pages of instructions.
    b. Include your e-mail address and telephone number in the e-mail or cover letter accompanying your submission – we may contact submitters directly if we require clarification of any matters in submissions.
    c. If your submission contains any confidential information:
        i. Please state this in the cover letter or e-mail accompanying your submission, and set out clearly which parts you consider should be withheld, together with the reasons for withholding the information. MBIE will take such objections into account and will consult with submitters when responding to requests under the Official Information Act 1982.
        ii. Indicate this on the front of your submission (e.g. the first page header may state "In Confidence"). Any confidential information should be clearly marked within the text of your submission (preferably as Microsoft Word comments).
        iii. Please provide a separate version of your submission excluding the relevant information for publication on our website (unless you wish your submission to remain unpublished). If you do not wish your submission to be published, please clearly indicate this in the cover letter or e-mail accompanying your submission.

Note that submissions are subject to the Official Information Act 1982.

5. Send your submission:
    - as a Microsoft Word document to ***corporate.law@mbie.govt.nz*** (preferred), or
    - by mailing your submission to:

      Business Law team
      Building, Resources and Markets
      Ministry of Business, Innovation & Employment
      PO Box 1473
      Wellington 6140
      New Zealand

Please direct any questions that you have in relation to the submissions process to ***corporate.law@mbie.govt.nz***

Submission on discussion document: *A new regime for unravelling Ponzi schemes*

Your name and organisation

Name	John Fisk
Organisation	PwC

Please select if your submission contains confidential information:

☐I would like my submission (or specified parts of my submission) to be kept confidential, and attach my reasons for this for consideration by MBIE.

Responses to discussion document questions

1	Are there currently any other methods for resolving a Ponzi scheme which officials should keep in mind? If so, what are they?
	There is an existing mechanism for the Financial Markets Authority (FMA) to commence a process to address a situation where there is concern around the ability of a financial service provider to properly undertake their role. This is contained in section 522 of the Financial Markets Conduct Act 2013. This mechanism allows the FMA to apply to the Court for an order appointing a receiver over an entity to protect the interests of aggrieved persons. The FMA used this mechanism in order to appoint receivers to a Ponzi scheme, Arena Capital Limited (trading as BlackfortFX). The receivers were later appointed liquidators by the court. The precursor to this section was section 137G of the Financial Advisors Act 2008. It was under this legislation that John Fisk and David Bridgman were appointed receivers of Ross Asset Management Limited and then by order of the Court were subsequently appointed liquidators. The proposed process outlined in the discussion paper would appear to largely mirror this mechanism which has proven to be effective in the case of Ponzi schemes. An advantage to this process is that it is not limited to situations where a Ponzi scheme is suspected. There may be scope for widening the parties who are able to make an application under section 522 rather than introducing an entirely new regime. *While generally a court ordered liquidation will be on the basis that the company is unable to pay its due debts pursuant to section 241(4)(a) of the Companies Act 1993, it is also possible that a court may determine that it is just and equitable that the company be put into liquidation pursuant to section 241(d) of the Companies Act 1993. The reasons for such an application are deliberately wide and could conceivable include a situation where a Ponzi scheme is suspected.* *In addition to the appointment of liquidators, the court is able to order that a company be put into interim liquidation for the purpose of maintaining the value of the assets owned or managed by a company. This mechanism may be utilised for several purposes as the powers of an interim liquidator can be set by the court. It is generally intended that an interim liquidation will be ordered when there is a risk of the dissipation of assets of the Company prior to the liquidation hearing. This could conceivably be used in conjunction with the just*

	and equitable liquidation referred to above. *Another mechanism by which Ponzi schemes may be resolved is Voluntary Administration (VA). We note this for completeness and are not aware of any Ponzi schemes which have been resolved through this mechanism and our belief is that this process, although it should be considered, is unlikely to be appropriate for the resolution of a Ponzi scheme as such a business will not be able to be rehabilitated.*
2	Do you agree with Glazebrook J's statement that "an accident of timing as to when funds are withdrawn should not favour one defrauded investor over another"?
	This statement was made in the context of investor clawback proceedings, and in that context it implies that all transactions should be treated equally, abandoning the concept of commercial confidence in the validity of payments a legitimate third party creditor receives. *It is an unfortunate reality of all insolvent estates that accidents of timing do typically favour certain parties over others.* *Generally speaking, within insolvency law, the ability to recover funds distributed to creditors has been balanced against this commercial confidence and certainty. These are relevant and important considerations for both commercial enterprises and investors in financial markets. However, Glazebrook J's view appears to be that the certainty of withdrawals is not as large a factor within private investment schemes.* *Our view is that this distinction requires further consideration. Both businesses and individuals will, to some extent, rely on the validity of payments received and this must be weighed against the benefit of recovering funds to be distributed to creditors.* *It is worth noting that the mechanism for clawback proposed within this discussion paper does not completely mirror Glazebrook J's statement. The paper proposes a 4 year period (prior to a scheme being declared a Ponzi scheme) during which funds can be recovered. An 'accident of timing' will favour an investor who withdrew funds earlier than this period over an investor who withdrew funds more recently, as well as investors who did not withdraw any funds.*
3	Do governing documents ordinarily cover the scenario where an investor is overpaid? If so how is this provided for?
	We are not aware of whether standard governing documents do so, but in respect of Ross Asset Management Limited, the management agreement did not cover such a scenario.
4	Do you consider that, where investors are all the subjects of fundamentally the same fraud, the strict legal form of a Ponzi scheme should not impact the outcomes of investors?
	We agree with this statement, as the entity itself is only a vehicle for the fraud. *We note that within existing legislation, the mechanisms for winding up entities are often very similar, for example the Insolvency Act 2006 and the Companies Act 1993 mirror each other, and the Friendly Societies and Credit Unions Act 1982 refers to the Companies Act 1993 for administration of a liquidation of the entities governed by the 1982 Act.* *We note that the discussion which precedes this question in the discussion paper covers topics much wider than legal structure.* *We also note that in general the distinctions made between structures appear to be theoretical insofar as they are not supported by real or other examples so it is difficult to provide useful feedback on the effect that structures may have on an investment scheme that transpires to be a Ponzi scheme, or other type of fraud.*

5	Do you agree with the objectives we have identified for the regime for unwinding Ponzi schemes?
	We agree with the objectives identified, and in addition we believe that the regime should seek to mitigate the damage caused by Ponzi schemes before a liquidator is appointed to the scheme. *An onerous process leading up to a court order, or an investigation period which allows the scheme to continue to operate may risk investors being exposed to the fraud and cause further damage to existing investors. As noted under 1 above we believe there are mechanisms within the existing law which can effectively address this risk.* *We also note that the objectives identified appear to be the same as the objectives guiding general insolvency law.*
6	Do you agree with problems identified with the status quo? Are there any additional issues which we should seek to address?
	We make the following comments regarding the paper's view of the status quo: ***94a –** A Ponzi scheme may become insolvent once the entity misappropriates funds, and investors' breach of trust or damages claims arise. A Ponzi scheme must be insolvent otherwise all investor claims would be able to be paid. Our view is that, as grounds for appointing liquidators, proving insolvency may be easier. Whether a scheme is a Ponzi scheme may be secondary to whether a scheme should be placed into liquidation.* ***94b –** Whilst we agree with the logic of removing the value defence, it's removal may not have as significant an impact on the recoveries from investors subject to clawback as may be expected for three reasons:* • *Anecdotally, from discussions with investors within the RAM Ponzi scheme (from prior to the Supreme Court decision in McIntosh v Fisk when the clawback of 'capital' was still a possibility), investors who would rely on a value defence would often not have the means to settle any claim against them.* • *Investors also generally did not accept that they may be required to repay funds when they had not recovered their initial investment (which can be likened to the resistance encountered with trade creditors for commercial voidable transactions). It follows that a requirement to repay 'capital' would likely greatly increase the number of clawback claims which require legal proceedings, and would therefore increase the costs involved with clawback claims.* • *The recovery of 'capital' also increases the overall value of the pool of investors who have claims against the Company, to some extent mitigating the increase to the pool of funds available for distribution.* • *Recovery of 'capital' will also mean that until all clawback claims have been resolved it will not be possible to make an interim distribution to creditors/investors as it will not be possible to crystallise all claims.* *We also note that the change of position defence is an established legal defence in a number of areas of the law so any attempt to remove such a test would make the proposed regime inconsistent with established law.* ***94c –** Our view is that the existing regime is robust and effective at recovering funds through legal proceedings following the Supreme Court ruling in McIntosh v Fisk, which clarified the main ambiguities within the clawback provisions with respect to Ponzi schemes. Going forward, in any situation where an entity is in essence a Ponzi scheme, we would anticipate*

that a liquidator would rely on the McIntosh decision to recover funds regardless of the legal structure of the scheme. In fact, the vast majority of clawback claims within the RAM Ponzi scheme have been settled outside of legal proceedings following McInotsh v Fisk.

Despite this, any mechanism for recovery of such payments will never be 'easy'. Investors will always be resistant to repayment, and court proceedings will always carry an element of cost and litigation risk.

We note that this question refers specifically to arbitrary results arising from different structures. As noted above it would be useful to understand in more detail, with examples if possible, what those anticipated arbitrary results are.

***94d –** We agree with this statement. The perpetuation of the fraud delays the identification of such claims. The circumstances of a Ponzi scheme differ from a standard liquidation where creditors are usually aware of their claims, and consciously decide whether to enforce their rights.*

Claims made under the Property Law Act 2007 are currently only limited by the Limitation Act 2010. It should be noted that the Insolvency Working Group's report recommended that Ponzi Scheme clawback claims fall under the Property Law Act 2007 as a way to limit the period of vulnerability under the insolvent transaction regime without adversely impacting clawback under Ponzi schemes. One matter that is unclear in relation to the Property Law Act 2007 is whether the claim can only be brought in relation to transactions six years prior to the claim being brought or whether the liquidator can bring claims back as far as they can be proven but must do so within six years of being appointed.

***95c –**This statement suggests that upholding of proprietary claims are a 'problem' within the existing regime. In our view, while proprietary claims to specific assets are often complex to determine factually and impose costs on the liquidation, they serve an important purpose by returning assets which did not become a part of the Ponzi scheme to their original owner as they had not been misappropriated. Any alteration to proprietary claims would undermine established property rights as a whole. This issue is discussed further later in these submissions. The removal of such rights should be done cautiously, however, we believe there would be benefit in providing clarity as to when they can be enforced, and clear rules around the costs associated with establishing such a claim being borne by the investor who benefits may be appropriate.*

***96 –** We do not consider the above distinction at 95c to be arbitrary. We also note that differences in timing of transactions may be a reason for investors to share losses unequally, particularly in the interests of certainty (such as for transactions occurring outside of whichever time period for clawback is adopted). We are also concerned at the use of language like "blameworthy". We do not believe this is a relevant consideration as in most instances of a Ponzi Scheme no investor will be worthy of blame and the fact of one investor being in a better position than another will be simply a matter of timing rather than blame. Use of the latter terminology suggests an element of wrongdoing on the part of those investors who have profited from what they had no reason to believe was a Ponzi scheme. As discussed later the position should be different if there are circumstances where an investor should shoulder some of the blame for the fraud, for example if they had knowledge of the existence of the Ponzi Scheme.*

***97a –** In our view, identifying RAM as a basis that there is uncertainty surrounding the application of the existing regime is not accurate. Greater uncertainty existed within this administration due to the relatively recent Supreme Court decisions on voidable transactions and the lack of robust and relevant precedents for Ponzi schemes. We anticipate that Korda Mentha, who administered the liquidation of the BlackfortFX Ponzi scheme, will provide submissions in response to this discussion paper, and may be better placed to speak to the*

costs of administering such a liquidation following McIntosh v Fisk.

***97b –** As noted above, we do not believe RAM is an appropriate example given the significant amount of time required to obtain High Court, Court of Appeal and Supreme Court decisions on clawback, as well as the directions application with respect to distribution currently before the High Court.*

We also note that, should law changes result in liquidators being able to recover 'capital', it is unlikely that liquidators will be in a position to pay an interim distribution until all clawback claims have been resolved and investors' positions are crystallised. Clawback claims are currently ongoing in relation to RAM, however, we are also seeking to pay an interim distribution as we have certainty that investor claims will not change as a result of those clawback claims.

***98 –** The intention of this paragraph was not clear to the liquidators and further clarification or examples may be needed.*

One argument raised within McIntosh v Fisk was that the investor had signed a management agreement and the funds he received were in accordance with the contract signed, however, this position was rejected by all three Courts as it would give legitimacy to the contract even though the investment advisor had not itself honoured the contract by conducting fraudulent activity in relation to the investments as reported to investors.

***99 –** The intention of this paragraph was not clear to the liquidators and further clarification or examples may be needed.*

As noted earlier in our submissions, our understanding is that the FMA have an existing power under section 522 of the FMCA to appoint receivers, who are then able to recommend to the Court that the entity be placed into liquidation. There are also mechanisms for assets to be forfeited under the Criminal Proceeds (Recovery) Act 2009, and a Court can direct their distribution.

7 Do you agree with the preferred option we have chosen?

We are not significantly concerned with the exact form which any legislative change takes, so long as the operation of the legislation practically achieves the desired outcomes of being more timely, cost effective, and understandable than the current regime.

As practitioners, we note that it may confuse the public if there are several Acts under which liquidators can operate, and they hold differing authority or powers. We would also note that a circumstance may arise whereby liquidators appointed under the Companies Act 1993 discover that the entity is in fact a Ponzi scheme. The practitioner would then need to apply to the Court to be appointed as liquidators under a separate act, while if the legislative changes were codified under the existing acts the practitioner may simply be able to apply the relevant Ponzi framework without incurring the additional cost of a further court application.

Despite this, and as noted in question 6, it may be appropriate that clawback under a Ponzi scheme be separately dealt with under the Property Law Act 2007 rather than the wholesale introduction of a new regime that largely mirrors the existing one.

It is our view that new regime may not be necessary and that the intended efficiencies may be able to be gained through modification of the current regime.

8	Do you agree with our design goals? Are there any other goals which the system should be designed to achieve?
	We generally agree with the goals, and make the following comments: *B – As previously noted it would be useful to see some practical examples of how different outcomes have or may occur under different structures.* *D – This appears inconsistent with paragraphs 92a and 92b and the relevant criteria is not defined. Further explanation of this goal may be required.* *E – We agree and note that clarity around the circumstances under which investors are required to repay funds would significantly reduce costs associated with clawback.* *We note that the Alternative / Rising Tide models of distribution do not align with the latter part of this statement, as the likelihood an investor will receive a distribution and the value of that distribution depends the ratio of funds available to the liquidator compared to losses suffered by other investors, rather than anything inherent in the investor's own positon.* *We also note that consideration should be given as to whether the outcomes from the proposed scheme are consistent with recovery in other types of fraud. More consideration should be given to why a Ponzi scheme warrants its own regime as distinct from commercial fraud more generally.*
9	Are there any other factors which you think should be treated as indicating that an investment scheme is a Ponzi scheme?
	The US Securities and Exchange Commission has guidelines around what constitutes a Ponzi Scheme and Red Flags that investors should be aware of. This would appear to be a helpful guide to defining what will constitute a Ponzi Scheme: https://www.sec.gov/fast-answers/answersponzihtm.htm *We would draw particular attention to the concept of commingling as a key indicator of a Ponzi scheme.*
10	What are your views on our proposed definition of a Ponzi scheme: • Do you consider that our definition of a Ponzi scheme might capture any investment structures or products which it should not? • Do you consider that the definition of a Ponzi scheme should seek to capture any other investment structures or products?
	In our view, as the decision as to whether a scheme is a Ponzi scheme is proposed to be ruled upon by a Court, it is more appropriate to 'cast a wide net', and allow the Court to determine whether the Ponzi regime is appropriate in the circumstances. As noted in 8, limiting this definition works against the objective identified in 107b. We note the definition does not appear to be concisely stated in the discussion paper so some clarity around this would be beneficial. We note that para 120 does not appear to define a Ponzi Scheme, per se, rather it lists categories of structures or investment products that may, depending on other factors, be Ponzi schemes.

11	Do you consider that the third limb of the proposed definition of a Ponzi scheme should be expanded to capture investments more generally?
	It is not clear which limb of the proposed definition is being referred to. We assume this refers to the 'client money or property service' (limb four at paragraph 120). In respect of that, we would recommend expanding to capture more than just the defined financial products, as an investment intended to be in a different form but still misappropriated could show all the signs of being a Ponzi scheme, and should be dealt with accordingly. *The focus should be on dealing with any type of investment scheme whereby investors monies have not been dealt with in the manner reported to investors. Limiting the regime in the manner proposed is focussing on commercial risk, rather than the incidence of fraud, which should be the focus of the regime. There is a risk that unsophisticated Ponzi schemes not subject to regulation would arbitrarily fall outside the proposed regime even though they share the characteristics of a Ponzi scheme that would be subject to the proposed new regime.*
12	Are you aware of any cases in which our proposed definition would have failed to capture a Ponzi scheme?
	The proposed definition may not cover some less sophisticated frauds, where the exact form of the scheme is never defined. *An example of a scheme which may not be captured is a relatively small scale scheme operated by Jan Lewandowski in the USA in the early 2000's. This 'investment' was proposed as the sale of shares with a promised rate of return in a gift store and entertainment business he operated.*
13	Do you agree with the criteria for identifying when an investment scheme should be able to be declared a Ponzi scheme?
	We have concerns with paragraphs 134b & 134c. These may limit what can be captured where the business operated by the scheme operator has some legitimate transactions, while providing little additional guidance. We note that RAM undertook significant business, although there may be questions around its legitimacy and there were also significant earnings or profits, albeit significantly less than reported to investors. *The criteria in paragraph 134d should also include circumstances where the funds used to pay investors are sourced indirectly from investors, for example where the operator engages in the sale and purchase of shares, or other business activities, utilising investor funds but not on their account, or uses the proceeds of sale of shares previously acquired using investor funds. This pattern can repeat many many times over the life of a Ponzi scheme.*
14	Do you consider that there are any additional or alternative criteria which should need to be met in order for a scheme to be declared to be a Ponzi scheme?
	Our recommendation is: - *Paragraph 134a,* - *the operator makes a representation to investors which is inaccurate (including over-reporting profit, reporting profit when in loss, under-reporting loss),* - *investor funds are commingled to an extent greater than that agreed by investors,* - *paragraph 134d (including by indirect methods).*

15	Do you consider that proving fraudulent intent on the part of the operator of an investment scheme should be a necessary requirement to establish that that scheme is a Ponzi scheme?
	We consider that this aspect of the emergence of a Ponzi scheme is best dealt with through criminal or civil charges against the operator, likely by the FMA, police, or SFO. Absent such action, there may also be a claim by a liquidator against the operator personally where the operator's fraudulent intent may be relevant. *Fraud is a high bar to prove and intention is inherently difficult to assess and may be best ultimately determined in Court. Ultimately if the effect of the scheme is that it meets the criteria in 14 above it should be considered a Ponzi scheme, even if it was not the operator's intention to commit a fraud, such as where the Ponzi scheme has arisen through incompetence or lack of appropriate safeguards.*
16	Do you consider that the test for whether an investment scheme is a Ponzi scheme should be: • based on a set of fixed criteria? • At the absolute discretion of the courts? • a combination of limited discretion by the courts based on a set of criteria?
	We recommend a combination of both tests as noted earlier in these submissions. Any fixed criteria should be broad enough to capture all potential schemes, with Court discretion so as not to inappropriately apply the Ponzi framework to other investment schemes (eg. where discrete errors in reporting in portfolios lead to inappropriate distributions, individual orders for repayment of funds may be more appropriate than a complete clawback of all funds).
17	Is it appropriate for the liquidator of a Ponzi scheme to have the same duties and powers of the liquidator of a company under the Companies Act?
	Yes. An operator of a Ponzi scheme may have other assets and have conducted other activities and these need to be dealt with.
18	Do you agree that a liquidator should be able to exercise all powers, rights, and privileges that the operator of the Ponzi scheme had prior to that liquidation – notwithstanding that any arrangements contemplate that those powers, rights, and privileges would end on the appointment of a liquidator?
	We recommend that examples of such arrangements be identified in further discussion points as we are not aware of any specific arrangements. It will likely depend on what the powers, rights and privileges are as to whether it is appropriate that they should survive liquidation.
19	Do you think that liquidation is an appropriate model for resolving a Ponzi scheme? If you think a different model is more appropriate please explain why you consider this to be the case.
	Yes. *We note that there may be other specific entities with intricacies which may need special attention. While we are not aware of any specific instances of Ponzi schemes being operated by these entities, these may include joint ventures, Crown Entities, and charities, as well as the potential entities identified in the discussion paper. See also our comments under 1 in relation to the adequacy of the existing regime.*

20	Do you agree that the process for appointing a liquidator is an appropriate model on which to base the process for declaring an investment scheme is a Ponzi scheme?
	As identified in question 1, we note there are other mechanisms which may precede this, such as receivership, or interim liquidation, although we note that liquidation appears to be the appropriate regime to manage the unwinding of a Ponzi scheme. The critical issue in our opinion is the necessity to be able to take immediate action to freeze the activity before further losses are incurred.
21	Do you agree that that in order to declare an investment scheme to be a Ponzi scheme the High Court must be satisfied on the balance of probabilities that it is in fact a Ponzi scheme?
	Yes. *We note that such a process, particularly if the conditions to satisfy the Court are higher than exist currently for similar orders, may result in time delays, and consideration should be given to whether any interim orders such as interim liquidation, or asset protection orders may be appropriate. Being able to have a scheme declared a Ponzi scheme should be relatively easily achieved, assuming sufficient evidence is available, however, determining when it crossed the line from being a legitimate investment scheme to a fraudulent Ponzi scheme may involve significant investigation, which has the potential to be more time consuming and accordingly costly than an investigation into the solvency of the operator. We note that in relation to RAM, due to insufficient records being available we remain unable to conclusively determine when the Ponzi scheme commenced or whether it was a Ponzi scheme from the outset.*
22	What are your views on the list of parties that would be able to seek a declaration that an investment scheme is a Ponzi scheme?
	We would recommend removing auditors, actuaries, and investors from this list. *Auditors and actuaries have existing obligations to report financial crime to authorities, however as they do not have a vested interest or custodial role in the scheme itself it does not seem appropriate for these parties to make an application themselves.* *Providing an avenue for investors to make such an application may result in abuses of such a process, or the process not delivering the outcome expected by investors due to the evidential requirement of the Courts.* *Investors are currently able to report their concerns to regulators such as the FMA and SFO and a liquidator, receiver or interim liquidator if appointed. If there are concerns with this reporting process itself, our view is that the appropriate response is to consider changes to the reporting process. Although this would require further consideration, a mechanism similar to the Privacy Act or Official Information Act whereby a regulator is required to respond to an investor within a specified time period with details of what steps they are taking as a result of the investor's complaint may help mitigate any perceived delay which could result from making such a complaint, rather than a direct Court application.* *We also note that Investors will often have significantly less complete information than any other party on this list, and as such they would be unlikely to meet the requirements of a Court without the assistance of a regulator. We do not consider it to be practical or appropriate to grant access to investors to the records of the Company sufficient to allow them to make out a claim that an investment scheme, as a whole, is a Ponzi scheme.* *This should not in any way limit the rights of investors to bring claims on other bases, such as breach of contract or specific performance.* *We would also recommend adding a voluntary process to this list whereby the operator could*

	declare themselves a Ponzi scheme.
23	Do you agree that where the courts consider that a scheme may be a Ponzi scheme, but lack sufficient evidence to make an order to that effect, that the court be able to appoint an insolvency professional to examine the affairs of the scheme?
	Yes. However, we note that such an appointment will be damaging to the business if it transpires it is not a Ponzi scheme. As previously noted we believe this can be achieved under existing provisions of the FMCA.
24	What level of certainty that a scheme may be a Ponzi scheme should be required to make such an appointment?
	Reasonable suspicion. However, we note that limiting this to suspicion of a Ponzi scheme is narrower than the existing provisions under the FMCA.
25	How long would it take, and what do you think the cost would be, for an insolvency professional to examine the affairs of a scheme and advise the court whether, in their professional opinion, there is sufficient evidence to conclude that that scheme is in fact a Ponzi scheme?
	We anticipate that any such process would be achievable within a month. With RAM, the receivers were able to confidently state that the entity was insolvent after a week as well as determining that there appeared to be a significant number of reported assets that could not be accounted for (on this basis, the Court ordered RAM be placed into liquidation), but the scheme was not referred to as a Ponzi scheme until after discussions with management. *The costs involved in this process would depend on the scale of the scheme, access to staff, management, and records, the scope or level of certainty required by the Court, and the specifics of the fraud.*
26	Where an investor seeks a declaration that an investment scheme is a Ponzi scheme should the Crown be required to fund the appointment of the relevant insolvency professional if it is found that the scheme is not a Ponzi scheme? If not who should bear that cost and why?
	As noted above, we do not consider that it is appropriate that investors take such action. However, generally we consider that it is appropriate for the party seeking the declaration to fund an unsuccessful process, which may include an adverse costs award.
27	Should there be a set period for which an insolvency professional should be able to be appointed?
	We recommend that this process follow similar terms to the appointment of a voluntary administrator, with a fixed term which the insolvency professional is able to apply to the Court to have extended if they are not able to adequately report in time. As noted above we believe a month is realistic to reach a preliminary view, although the detail around the Ponzi scheme and timing of its commencement may take significantly more time. It would be necessary for the insolvency professional to have wide ranging powers to access information and interview relevant parties to ensure that the necessary information can be obtained in a timely manner.

28	Do you consider that investment schemes which are invested in only by investment businesses, large persons and government agencies should not be able to be declared to be Ponzi schemes?
	No. All schemes should be treated equally regardless of the investor makeup. Such larger investors are still subject to a similar fraud. The fraud should be the focus, not the structure.
29	Do you consider that it may be in investors' interests for investment schemes, which have invested substantially in a Ponzi scheme, to be able to be wound up as if they were a Ponzi scheme themselves?
	While a scheme which has invested substantially in a Ponzi scheme (a second tier scheme) has been a victim of the Ponzi scheme, this does not necessarily mean that the second tier scheme has defrauded its investors. Consideration should be given to whether it is appropriate to treat this scheme as such, or whether there are other mechanisms to unwind such entities. In theory, there should be little to no commingling within the second tier scheme's investor funds, and as such it may be possible to redress any wrongful dispositions without a Ponzi regime. *If it is decided to treat the second tier schemes as essentially part of the Ponzi, we recommend that this be both voluntary and enforceable by third parties. Restricting this to a voluntary process may result in second tier scheme operators seeking to protect their investors who have already received a distribution of profits, on the basis that the second tier scheme no longer has the means to repay any funds to the liquidator.* *It should also be considered whether it is appropriate to legislate that where a substantial portion of a scheme is held in a Ponzi scheme, the second tier scheme is automatically considered a Ponzi scheme and the operator is on notice of this when they are made aware of the liquidation.* *Declaration of the second tier Ponzi scheme would be the same process as the first – being by FMA, SFO etc, potentially the liquidator of the first tier scheme, or voluntarily (which we have suggested is added to the list at 145).* *We note that the clawback provisions in the Property Law Act 2007 allow for a liquidator of a Ponzi scheme to 'look through' entities to claim against the ultimate beneficiary of a disposition of funds. This process may still be effective under a new regime.*
30	Do you think that measures are needed to minimise or mitigate the consequences for an investment scheme or its operator of a failed attempt to have it declared to be a Ponzi scheme?
	Yes. *It should be noted that reducing the parties who can apply to the court should limit the number of such failed attempts.* *There are two general approaches to mitigating the consequences of a failed attempt which we detail below.*

Public Process

It is assumed that any public process would include a freezing of assets, or some form of administration process to restrict the disposition of assets pending the outcome of the investigative process.

Pros	***Cons***
Liability of operator for action or inaction resulting from the investigation during this period could be limited by statute.	*Significant disruption to regular business.*
Court, Insolvency Practitioner and applicant can appropriately manage public opinion.	*Investors' legitimate investments may be in volatile products and operator's ability to avoid losses or make profit may be constrained.*
Process can be formally concluded.	*Investors may still not trust the scheme.*
Operator can legitimise any disruption.	*The negative coverage of such an investigation may limit new investment, compromising the organisation's long term viability.*

Private Process

It is assumed that any private process (i.e. subject to Court suppression orders) would include an administration process to restrict the disposition of assets. A complete freezing of funds may not be possible.

Pros	***Cons***
Lower risk of disruption to the operator's business.	*Keeping such a process closed would likely be difficult to execute, require significant planning, and may need to be expedited, all of which would carry a large cost.*
Provides the best chance of the scheme continuing.	*Difficult to justify to staff of operator.*
Mitigates privacy concerns of a legitimate scheme operator's internal processes which may be present if the affairs of the scheme were reported publicly.	*A closed process may result in distrust of the process. By example, following Madoff there were serious accusations of corruption within the SEC as they had investigated the organisation previously.*
	May give rise to liability on the part of the insolvency professional if investigation is discovered by third parties.

31	Should there be a limit placed on the ability of investors to bring proceedings to have a scheme declared to be a Ponzi Scheme?
	As detailed previously we do not believe there is a need for investors to be able to take this action provided there is sufficient accountability from regulators for complaints investors make to them.
32	Should a defence be available to investors who in good faith bring a proceeding that a scheme is a Ponzi scheme from claims for damages brought by the operator of the investment scheme?
	As detailed previously we do not believe there is a need for investors to be able to take this action. If investors are able to take such action, they should be aware of the risk of a claim against them by the operator.
33	Do you consider that there should be a presumption that a Ponzi scheme was a Ponzi scheme for all time (so there is no need to identify when the scheme became a Ponzi scheme unless there is evidence to the contrary)?
	The insolvency practitioner should have an obligation to attempt to determine the date on which the scheme became a Ponzi scheme in the first instance, however if records do not support this, there should be a rebuttable presumption that the scheme was always a Ponzi scheme. *A broad Ponzi assumption has a negative impact on early investors who could lose legitimate gains they realised on their investments, which could also increase their rights to a distribution.*
34	Do you think that there should be a statutory default (say 5 years) for how far back a scheme is a Ponzi scheme in cases where a liquidator is not able to identify a point (or period) at which the scheme became a Ponzi scheme?
	We do not think that the selection of an arbitrary date is appropriate if the actual date can not be determined. If the actual date was earlier those investors who had been in the scheme for more than five years would arguably be able to retain the benefit of any reported growth prior to that date even if such growth was fictitious. This would have a negative impact on those investors who put money into the scheme less than five years ago.
35	Do you agree that, in the case of Ponzi schemes, tracing is an inappropriate remedy to resolve investors' claims?
	Equitable tracing claims, on a first in first out basis as detailed in Claytons Case, should always be a starting point unless it is determined that the Ponzi scheme is too complex to allow this process to take place consistently and efficiently (for example, in RAM this process would be impossible prior to 2006 due to limitations in bank records, and very costly, incomplete, and uncertain post 2006 due to the intermingling of assets). In the instance of a very small scale Ponzi scheme this may still be appropriate. *The proposal would sever proprietary rights to specific assets. The basis of the proposed Ponzi regime is to provide a fair and efficient mechanism for distribution of assets which were misappropriated. If the assets were not misappropriated then there are strong grounds they should not be dealt with by the regime. If assets belonging to a particular investor can be identified and it is clear they have not been tainted by elements of the Ponzi scheme it would seem to be very draconian to not allow them to exercise their right to have those assets*

	returned to them. *Particularly we note the following:* *183a –A scheme operator not commingling specific assets is not an accident of timing, but an accident of action, or possibly not an accident at all. To illustrate this, we give an example of a bank transfer from an investor the day after a liquidator is appointed. We believe it would be unthinkable to consider the funds offered by the prospective investor to form part of the liquidation simply because they were received into the operator's bank account.* *183b –Segregation between funds may be fictitious in some instances, such as was the case with RAM, but may be real in others. Where funds are truly separate, they should be treated as such. It is possible for an operator to operate several schemes, only one of which is a Ponzi scheme, and the investors in legitimate schemes should not bear the costs or losses of the Ponzi scheme in such instances.* *184c – Our position in any liquidation is that any claim is for the claimant to assert, potentially with the assistance of the liquidator. If the information does not establish a claim, then generally speaking no claim will be admitted.*
36	If you favour keeping tracing as a potential remedy in the case of Ponzi schemes how would you address the issues identified with its application?
	As previously noted, we do not consider all the issues identified as being considerable barriers. We accept that the cost associated with identifying whether an investor has a proprietary claim can be significant due to the time involved in reviewing records which only the Liquidator has access to. Any ability to mitigate that cost should be considered, if it means it does not end up being borne by the other investors subject to the Ponzi scheme. *It may be appropriate to legislate that costs of any such tracing claim must be funded by the proprietary claimant, regardless of the outcome and only when an investor asserts such a claim would the liquidator be required to deal with it. In our experience with RAM the costs associated with investigating and determining a proprietary claim often outweighed the value of the assets to be returned and we were limited to recovery of unpaid management fees based on the value of those assets, which, in some instances, were less than the cost associated with investigating the claim. As noted, this shortfall is ultimately borne by the general body of investors.*
37	Do you agree that investors should not be able to retain any fictitious profits paid to them?
	Yes, although this must be balanced against the commercial certainty point discussed above so in that regard we do support a limited time period in which clawback claims can be sought.
38	Do you agree that there should be a limit on the period of a clawback?
	Generally, we believe that some form of limit is required in the interests of certainty. Further, should a change of position defence remain in force, this will also be more prevalent with older claims. *Should clawback be extended to capital' thought should be given to whether it is appropriate to place a time limit on clawback generally, but only with respect to 'capital', allowing liquidators to recover any profits paid while the scheme can be proven to be operating as a Ponzi scheme. We do note this may weight against commercial certainty.*

39	Do you agree that four years is a reasonable period for a clawback to operate? If not what alternative would you propose?
	Any limitation period is ultimately arbitrary and will allow certain investors to benefit from the perpetuation of the Ponzi scheme. We believe that a period of six years would fall in line with the Limitation Act 2010, subject to our comments under 6 above.
40	Do you think that the liquidator of a Ponzi scheme should be able to apply to the courts to extend the period of vulnerability, in respect of specific investors, where it can be shown that the investor received distributions in bad faith?
	Our view is that if such an extension were to be implemented then in instances where bad faith can be demonstrated the limitation period should not apply. *It should be noted that bad faith is generally very difficult to identify in any liquidation. What may be preferable is where knowledge, either subjectively or objectively, can be shown then a claim against that party is not subject to a time bar, as far back as that knowledge can be established. Other than in the case of people working within the business of the operator we would not anticipate these types of claims to be very common. In the case of RAM no such claims have been identified, although we note there has been significant speculation in this regard.*
41	Do you agree that in order to have the benefit of a defence against the clawback powers of the liquidator investors should be required to demonstrate that *a reasonable person in their position would not have suspected, and they did not have reasonable grounds for suspecting, that a Ponzi scheme existed*? If not, what alternative test would you propose?
	We agree that any defence needs to be subject to this test. If other defences are removed, leaving only significant financial hardship, a party who suspected the Ponzi scheme existed but is in significant financial hardship will in any event still be unable to settle a claim.
42	Do you agree that significant financial hardship is an appropriate criterion for determining whether an investor merits retaining funds received from a Ponzi scheme?
	We consider that the level of hardship identified to be far too low in the circumstances, particularly when an investor's investment in a Ponzi scheme may often be an investor's retirement savings or inheritance. *The basis for this standard with regards to Kiwisaver where an individual is in such severe circumstances that they are unable to meet basic living costs, meet a mortgage on their home, or pay medical or care costs. In the event that an individual meets this criteria, they will be able to access their Kiwisaver funds (in other words, their standards improve as they meet the criteria).* *Using this standard for investors as the only means of defending a clawback claim would have the effect of leaving defrauded investors on the 'bread-line', consequently, in or close to financial hardship.* *We have settled clawback claims in the RAM liquidation on the basis that the investor is not realistically able to pay any more than the amount settled. This will come down to a case by case basis but in general leaves investors in a better position than they would be in if the proposed level were the default.*

43	Do you consider that alternative criteria should be used for determining whether an investor merits retaining funds received from a Ponzi scheme?
	We feel that the criteria should reflect the unfortunate reality that frequently those affected by Ponzi schemes are investors nearing, or in, retirement, and the investments which they held in the Ponzi scheme may comprise all or a substantial proportion of their retirement savings. *Options may include a fixed dollar amount for any investor, or a variable amount calculated based on the age of the investor, to allow a reasonable living standard in retirement. Any prescriptive test will need to consider the impact on other investment vehicles, such as trusts, partnerships, and companies, which may involve several 'investors'.* *Alternatively it may be appropriate to keep the criteria subjective and allow insolvency practitioners to exercise their professional judgment, as typically occurs at present.* *We note that the Kiwisaver test is focused on an investors 'cash flow' hardship, rather than considering their assets and liabilities. We believe that discussion is required around which types of assets investors would be permitted to retain in the proposed criteria. Our view generally is that if an investor has significant equity within their family home, but doesn't have available cash to settle a claim and meet their living expenses, they may not qualify as being in financial hardship.* *Consideration also needs to be given to how to treat situations where an investor has an asset, such as the family home, which has been acquired or significantly contributed to by the Ponzi scheme withdrawals, but the investor is not otherwise in the financial position where they can access the equity in that asset to make payment.* *Litigation risk is also a factor which should be taken into consideration when pursuing any claim to recover monies.*
44	Do you consider that a whistle blower safe harbour should be provided to investors in a Ponzi scheme? If there is to be a safe harbour, do you consider that this should be available to all investors or just the first investor to 'blow the whistle'?
	We do not believe a safe harbour is necessary, and agree that it could produce perverse outcomes as noted in paragraph 210. *We note that prior to the liquidation of RAM several investors complained to the FMA, some of whom were later subject to clawback claims.*
45	Do you think that a defence should be provided for investors who substantially alter their position in the reasonably held belief that a distribution or withdrawal was valid and would not be set aside?
	Our view is that it would be helpful for application if such a defence were more prescribed than currently exists. Matters for consideration include • *Whether the funds received must be directly applied to the change of position.* • *Whether the investor must have had no other funds available to rely on.* • *Whether the alteration of position must result in the investor being in a worse position financially, i.e. medical costs or charity.* *We note that we do not consider that just because something was done with the money, eg. an asset was purchased, that the investor qualifies for the defence otherwise all withdrawals would be likely to qualify under this defence. As noted some clarity around the extent of*

	change required would assist both practitioners and investors to understand whether a claim is valid.
46	Do you agree that recovery against trade creditors of a Ponzi scheme should continue to be dealt with under the ordinary principles of insolvency law?
	Yes. However, it should be clarified as to whether trade creditors should be eligible to share in a distribution of trust money.
47	Do you agree that a proportional distribution of assets is preferable in the case of all Ponzi schemes regardless of the legal structure of the Ponzi scheme?
	Yes, subject to the above comments regarding proprietary rights. There may be other factors which would weigh against a strict proportional distribution in the particular facts of Ponzi schemes other than RAM, although we consider such instances are likely to be exceptional.
48	Do you have any information about the cost to find out whether the losses specifically attributable to individual investors are able to be identified?
	It is unclear from this question whether it refers to the losses suffered by individual investors as a result of their investment being misappropriated by the Ponzi scheme operator or whether it refers to the loss suffered by reference to the actual assets acquired, or not acquired. *The former is the approach which has been taken in the RAM liquidation, and which we envisage is intended by the discussion paper. This process has taken a lot of time and accordingly incurred considerable cost. However, this is due to the size and length of operation of RAM so thousands of transactions have needed to be reviewed. In a smaller Ponzi scheme this may not be as significant.* *The latter exercise was not undertaken as full records were not available and, even if they were, would likely have required the review of hundreds of thousands of transactions at significant cost. Again, there may be instances in other Ponzi schemes where this can be done efficiently and accurately.*
49	Do you agree that investors in a Ponzi scheme should not be entitled to the benefit of any fictitious profits allocated to them when deciding their proportional entitlements to the assets of a Ponzi scheme?
	Yes. The claim should be based on any available 'real' contributions (which may include profits earned prior to the scheme becoming a Ponzi scheme). Should any surplus exist after investors' initial investments are repaid in full, all investors should be able to prove for damages or some other form of compensation, such as interest.
50	What is the most appropriate model for distributing assets?
	The question of appropriateness is one best determined by Government policy. The appropriate scheme will be the one that remedies the losses suffered in the manner considered to be most equitable. Ultimately there is unlikely to be a regime that will make everyone happy. *There are a number of practical complications which require further consideration, which are detailed in the RAM liquidators' application for directions before the High Court, as well as the submissions of counsel for Investor A (the investor most negatively impacted by the Alternative / Rising Tide model). We enclose these for your reference and no doubt you will*

	refer to the decision of the High Court once it is released.
51	Are there any additional models which we should consider?
	We are not aware of any additional models that warrant consideration.
52	Should investors' losses be able to be adjusted to take account of inflation or any other factors?
	Yes, particularly for schemes which operate for longer periods of time. Inflation adjustments may be unnecessary for short periods of time, especially given the costs involved in calculation and lack of clarity for investors may outweigh the benefit of improved accuracy of the resulting distribution. *Care should be taken to ensure that the concept of inflation is differentiated from the concept of interest. These issues are similar in application but reflect very different issues. Inflation calculations are performed to determine what the value of two transactions are at the same point in time, even though they themselves occurred at different earlier points in time. Interest is compensation for not having the use of money for a period of time.* *If the Alternative / Rising Tide models are utilised it should be noted that a liquidator would effectively be treating an investor as the subject of a voidable transaction, without the investor having the respective defences available under the voidable transaction regime. Discussion around such a model should consider whether it is possible to factor any hardship defence into the distribution model. We note that in practicality, this would create a significant burden on the distribution process.*
53	Are there any additional or alternative criteria which we should use to assess the various models for distributing assets to investors?
	No. However, we do not agree with the assertion that there is substantial uncertainty surrounding the application of the current regime. The application of the voidable transaction regime is largely established with respect to Ponzi schemes following McIntosh v Fisk, and it is anticipated that any issues relating to distribution will be clarified following the High Court ruling on the RAM liquidators' application for directions. The introduction of a new regime may well require a similar series of Court cases to resolve these issues under that regime. *We also think that "Fairness" is a very subjective criteria and in the case of insolvency what will seem fair to one person will seem inherently unfair to another person, particularly when something is being taken away from one person to give to others. Accordingly we do not believe this is an appropriate criteria and should certainly not be an overriding criteria. We understand that the process does need to be equitable and reasonable, but that needs to be assessed objectively.*

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

I TE KOTI MATUA O AOTEAROA
TE WHANGANUI-A-TARA ROE

CIV-2012-485-2591

UNDER	Sections 271 and 284 of the Companies Act 1993 and the High Court Rules
IN THE MATTER OF	Ross Asset Management Limited (In liquidation) and related entities
BETWEEN	**J H R FISK** and **D J BRIDGMAN** as Liquidators of Ross Asset Management Limited (In liquidation) and related entities, each being Chartered Accountants of Wellington and Auckland respectively
	Applicants
AND	**E D FEHSENFELD**
	Respondent

SUBMISSIONS OF AMICUS CURIAE
Dated 11 June 2018

Next even date: Hearing 22 June 2018
Judicial officer: Associate Judge Johnston

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MAY IT PLEASE THE COURT

Introduction

1. Counsel was appointed Amicus Curiae by way of this Honourable Court's Minute dated 13 December 2017.

2. A first memorandum to the Court was filed by counsel on 16 March 2018. The memorandum, at the request of the Court, addressed each particular order sought by the Liquidators. Arising out of that, together with further liaison with the Liquidators' counsel and in conjunction with orders already granted by the Court, the specific orders remaining in the Liquidators' application need to now be addressed, substantively, by the Court.

3. On 18 May 2018 the Liquidators filed their submissions together with a second affidavit of John Fisk dated 18 May 2018 which has provided further helpful information as to the specific orders sought.

4. The factual background and overview of the distribution models available as set out at [3] and [4.1] – [4.4] in the submissions for the Liquidators is adopted.

5. These submissions will address:

    (a) A summary of the orders sought by the Liquidators identifying those that are seen as appropriate and those where more substantive consideration is seen as required.

    (b) Fixing of creditor/Investor claims.

    (c) Classes of assets held by the Liquidators

        (i) Trust funds.

        (ii) Company assets.

        (iii) Liquidators' fees and expenses.

    (d) CPI adjustment.

    (e) Distribution model - Rising Tide (RT).

    (f) Distribution model - Alternative Distribution Model (ADM).

    (g) Order of distribution if more than one class of fund.

6. While the appointment of counsel assisting the Court was on the basis of advancing the merits of the ADM, it remains incumbent to draw all relevant issues arising out of the application to the Court's attention.[1] The submissions will accordingly apply that frame of reference.

Orders sought by the Liquidators

7. The orders sought by the Liquidators (excluding those already granted by her Honour Justice Thomas in the Court's minute of 13 December 2017 and the orders of Associate Judge Johnson dated 10 April 2018) are set out in Schedule One to the Liquidators' submissions (amended as shown in red). A summary of the orders sought (following the numbering used in Schedule One) is set out in the below table. Comment is made as to whether the order should be seen as appropriate or whether it should be substantively considered.

No.	**Summary of order sought**	**Amicus comment**
2	That the assets of RAM and Dagger are pooled and the liquidations of those companies proceed as one.	This is seen as appropriate.
3	That the recovered assets of RAM and Dagger, after costs, be treated as one pool of assets available for distribution to unsecured creditors and investors.	The Court to consider whether two pools should arise in light of the facts, one in respect of company assets and one comprising funds impressed with a trust for Investors.
4	Distribution of assets takes place as follows:	
(a)	No tracing of particular Investor's investments occurs.	This is seen as appropriate
(b)	Any Investor who received payments from RAM (adjusted for CPI to 17 December 2012) which exceeded their contributions to RAM (adjusted for CPI to 17 December 2012) is not entitled to any distribution.	This order is supported aside from the addition/adjustment of CPI which is not supported for either any company assets or any trust funds.

[1] Refer High Court Rule 10.22 and [8] of the Court's minute in this proceeding dated 13 December 2017 citing *The Beneficial Owners of Whangaruru Whakaturia No 4 v Warin* [2009] NZAR 523 (CA).

(c)	In respect of investor portfolio transfers:	
(i)	Transfers are recognised to the extent of any positive net 'contributions balance' in the transferring portfolio as at the date of transfer.	This is seen as appropriate.
(ii)	'Contribution balances' are calculated by deducting from contributions made by an Investor, payments to that investor by RAM (both adjusted for CPI to 17 December 2012).	This is seen as appropriate aside from the addition of CPI.
(d)	If due to extraordinary circumstances the method for calculating the value of transferred portfolios described in (iii) above is unjust or ineffective in specific instances:	This is seen as appropriate.
(i)	The Liquidators are permitted to apply a reasonable and logical alternative methodology.	This is seen as appropriate
(ii)	Where such alternative methodology is adopted,	
(A)	The Liquidators will write to the Investor detailing why the usual inter-portfolio approach is ineffective, the alternative methodology applied and the Investor's right to challenge the method.	This is seen as appropriate.
(B)	Leave is granted to Investors affected to apply to the Court to challenge the method adopted by the Liquidators in respect of the specific portfolio transfer in question within one calendar month of receiving the Liquidators' notice.	This is seen as appropriate.
5	The appropriate method of distribution is the Net Contributions Model, the Alternative Model or the Rising Tide Model.	This is seen as appropriate.
6.	The Liquidators be entitled to deduct their costs and expenses in the liquidation from the common pool of assets;	If there are two funds, the Liquidators' costs and

		expenses should be taken first out of company assets.
7.	Claim forms for Investors entitled to receive a distribution in RAM and Dagger shall be as prescribed at (a) – (d) (p 60 of the Liquidators' submissions).	This is seen as appropriate.
8	Where Investors do not either return their claim for or lodge an objection within 6 months the Investors' distribution will be deemed unclaimed money (as set out at (a) – (d) at p 61 of the Liquidators' submissions).	This is seen as appropriate.
9	Leave to apply for further directions is reserved.	This is seen as appropriate.

Fixing creditor / Investor claims

8. An issue common to all distribution models is identified at [4.5] – [4.15] of the Liquidators' submissions - that Investors may have the right to lodge claims for sums in excess of their net contribution balances pursuant to section 303 of the Companies Act 1993 ("the CA"). For example, Investors could seek to prove in the liquidation sums for their loss of opportunity to make an investment return. If claims over and above Investors' net principal balance in RAM (excluding profits) were allowed to be made, that is likely to affect the orderly distribution of the limited funds recovered.

9. The Liquidators seek orders pursuant to the Court's discretion in sections 284 or 307 of the CA valuing any claim made by Investors, other than on a negative net contributions balance, at zero.

10. This order is supported. There is a very real need for finality in this liquidation. To do otherwise would risk complicating the distribution process and give rise to future indeterminate challenges by Investors. In any event, there appears to be a low risk that any Investor will proceed with such a claim as it is understood that to date no such claims have been made. The orders sought by the Liquidators also give effect to the ancillary orders sought for the fixing of Investor claims as set out in Schedule Four of the Liquidators' submissions (at [8] – [14]).

Classes of funds - company and trust funds

11. With regard to the Liquidators' order number 3 (set out above), as foreshadowed in counsel's first memorandum, the Liquidators obtained funds in the liquidation of RAM and its related entities from four primary sources.

    (a) Funds that were derived from the proceeds of the sale of assets held by the entities themselves. Those funds amount to $4,398,947.58, as set out at [8](a) of Mr Fisk's second affidavit.

    (b) The Liquidators have further identified an amount of $457,876.31, being the net proceeds of the sale of shares claimed to have been held by Mr Ross personally. Those shares are noted to be more likely than not paid for by funds derived from RAM (refer [8](q)).

    (c) Other funds realised from Mr Ross that the Liquidators consider were not derived from Investor funds in the sum of $665,473.37 (refer [8](b) and the table at [9] of Mr Fisk's second affidavit).

    (d) Funds derived from the Liquidators' actions to claw back monies paid to Investors by RAM while it was in operation, and in particular, funds paid to Investors in excess of their original capital investment. The total recovered by the Liquidators through those steps amounts to $19,122,249.38 as set out at [8](y) of Mr Fisk's second affidavit.

12. The question arises as to whether the sources of funds should be treated separately for the purposes of the Liquidators' distribution application on the basis that there are different principles of law applying to each. Mr Fisk recognised in his first affidavit: "*as a matter of law that there would usually be a need to distinguish between these two classes of asset: those clearly derived as a result of the misapplication of trust assets; and other assets.*"[2]

13. The Liquidators seek to distribute all funds as one fund, for reasons including that to do so would expedite the distribution process. However, as the Liquidators in this matter are very experienced, qualified and well equipped to efficiently address any calculations needed to give effect to any two funds approach, and as funds held are reasonably substantial, a principled approach is justified in the circumstances.

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[2] Refer [8.3] of Mr Fisk's first affidavit dated 11 December 2017.

14. The Court is invited to consider whether the funds are distinct, depending on their source. Funds derived from RAM may be seen as trust funds whereas the funds recovered from Investors and other sources by the Liquidators in furtherance of their statutory powers may be seen as company assets.

Trust funds

15. For the reasons set out below, it appears that the funds recovered/realised by the Liquidators from RAM or Dagger directly or indirectly (including the proceeds of shares purported to have been owned by Mr Ross, but likely derived from RAM funds) are impressed with a trust for the benefit of Investors. If so, then the Court should give consideration to such funds being distributed in accordance with equitable principles.

16. A summary of what are seen to be trust funds is set out in Mr Fisk's second affidavit.[3]

    (a) Net proceeds from the sale of shares held in the name of RAM or Dagger; totalling $3,023,480.23.

    (b) Dividends from those shares in the sum of $115,962.56.

    (c) Cash at bank of $61,811.65.

    (d) Property purchased by Mr Ross through family trusts using funds derived from RAM or passing through its 00 account plus rental proceeds in the sum of $894,312.85.

    (e) Interest on funds held for RAM/Dagger in the sum of $303,380.29.

    (f) Net proceeds of sale of shares claimed by Mr Ross as held for him personally: $457,876.31.

17. The total funds, on the information provided by the Liquidators, that should be impressed with a trust in favour of the RAM investors amounts to $4,856,823.89.

18. RAM Investors invested on the basis that RAM would hold their cash and shares on trust for each of them.[4] Investors agreed their funds would be used to purchase shares, the legal ownership of which would be held by Dagger, beneficially owned by that Investor and managed by RAM.[5] RAM/Dagger did not keep to those agreements but instead the business was operated by its

[3] Refer [7](a) – (j), (q) – (u) and the table at [9].
[4] Refer 8.1 of the affidavit of John Fisk dated 11 December 2017.
[5] Refer 3.2 and 3.3 of John Fisk's affidavit dated 11 December 2017 at p 63 of the exhibits.

director David Ross as a Ponzi scheme. Investor funds were used on an ad hoc basis to purchase shares, fund RAM expenditure or withdrawals by other Investors.[6]

19. Dagger and RAM (as manager) were trustees for the Investor funds and defaulted in their obligations. The Supreme Court noted in *McIntosh v Fisk*[7] that upon receivership, the defrauded Investors were left with a pro rata claim to the securities and money held by RAM as investment manager.

20. The Liquidators found in their investigations that tracing individual Investor funds was impossible due to the poor record keeping by the Ross Group.[8] This combination and dispersal of Investor funds does not, however, prevent Investors having a claim to such funds or proceeds thereof recovered from a defaulting trustee.

21. This principle was noted in *Finnigan v Yuan Fu Capital Markets Ltd*,[9] a liquidator directions case where the liquidators proceeded on the basis that the funds at issue were trust funds. Associate Judge Bell cited Fogarty J's statement of law in *Eaton v LDC Finance Ltd*:

> *[72] If all the beneficiaries' entitlements are mixed into one fund which contains no other funds in respect of which there are claims by other persons, then equity has no difficulty in allowing the beneficiaries to wind up the trust and make a direct claim to those assets, as is noted by Underhill and Hayton above. This remedy is available even though no individual beneficiary can identify his or her deposit in the mixed fund. Where funds are mixed particularly with the wrongdoer trustee's assets, then there are various methods deployed by equity all designed to give the beneficiary a remedy. Mixing is not fatal.*

22. Justice Fogarty addressed the position if a trustee (in this case RAM or Dagger) mixed funds held on trust with his own funds.

> *[75] So far as other contributions to the fund are concerned, the position is clear. Re Halletts Estate provides that where money held on trust is mixed with the trustee's personal money, the whole of the resulting fund is treated as trust property and can, following a successful tracing exercise be claimed by the trust beneficiaries. The trustees are presumed to act honestly where personal funds and trust funds are mixed and when there is a shortfall the trustee is presumed to intend to deplete their own funds first.*

23. The significance of the characterisation of the trust funds component of the recoveries from RAM goes to the breadth of the Court's discretion when considering an appropriate distribution model. The Court's discretion may be

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[6] Refer 3.9 – 3.11 of John Fisk's affidavit dated 11 December 2017.
[7] *McIntosh v Fisk* [2017] 1 NZLR 863 at [17]
[8] Refer 9.6 – 9.9 of John Fisk's affidavit dated 11 December 2017.
[9] *Finnigan v Yuan Fu Capital Markets Ltd* [2013] NZHC 2899 at [45].

limited when considering the distribution of company funds/assets because the CA regime is prescriptive. On the other hand, the Court's equitable discretion when considering the distribution of trust funds is not so constrained.

24. When considering the distribution of trust funds, the object is to do justice between the Investors; to be fair to them by giving effect to their intentions, inferred if not express.[10] The Court should search for "*the least unfair result for the investors bearing in mind that no method of distribution will result in perfect justice for all.*"[11]

Company assets

25. The major pool of funds held by the Liquidators is derived from clawbacks from former Investors. To date $19,122,249.38 has been recovered. The methods used by the Liquidators in respect of the clawback funds are described in Mr Fisk's second affidavit at [7](y)(i) - (iii). Only Mr McIntosh paid funds to RAM pursuant to a Court order following the Liquidators' application. Mr Fisk said at [7](y)(ii) of his second affidavit:

> *All other investors paid amounts to RAM following the liquidators advising them of claims against them pursuant to the Property Law Act 2007 and/or the Companies Act 1993 and threatening to issue, or actually issuing, proceedings against them.*

26. In his first affidavit, Mr Fisk recognised that the funds obtained by the Liquidators from Investors using the methods described above are not, or are unlikely to be, traceable to investor funds.[12] This must be correct, given those funds have been paid to the Liquidators by third party investors who are, in effect, strangers to the RAM trusts. There were no claims brought in equity by the Liquidators that Investors had knowingly received trust funds (which would apply to principal and profit), for recovery of overpayments (profit) or otherwise participated in RAM's breach of trust (for example, by dishonestly assisting with the breach).

27. As referred to the submissions for the Liquidators, *Re Hibiscus Coast Marine Centre Ltd (in liq)*[13] is authority for the proposition that funds recovered by liquidators through the exercise of CA powers to recover voidable preference payments are for the benefit of the company's unsecured creditors. While *Re Hibiscus* does not specifically address the equivalent prejudicial disposition

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[10] *Re Forresters Nominee Company Ltd* [2012] NZHC 1216 at [38].
[11] *Re International Investment Unit Trust (In Statutory Management)* [2005] 1 NZLR 270 at [73].
[12] Refer 8.2 of John Fisk's affidavit dated 11 December 2017.
[13] *Re Hibiscus Coast Marine Centre Ltd (in liq)* (1986) 3 NZCLC 99,615

provisions of the Property Law Act 2007, the relevant sections themselves direct that funds recovered following an order from the Court are to be paid to the company in liquidation for the benefit of a debtor company's creditors.[14]

28. *Re Hibiscus*[15], determined before the CA came into force, held that money recovered pursuant to section 309 of the Companies Act 1955 was to be distributed pro rata to all creditors equally and would not be subject to a charge in favour of one (secured) creditor. However, in that case the voidable preference payment was held to have been paid to the liquidators in their own right and not the company.[16]

29. The CA, as amended in 2007[17], now provides any funds payable pursuant to a voidable preference order made under section 295(a) are paid to the company in liquidation itself and not the liquidator(s). Section 295(a) provides:

> *295 Other orders*
>
> *If a transaction or charge is set aside under section 294, the court may make 1 or more of the following orders:*
>
> *(a) an order that a person pay to the company an amount equal to some or all of the money that the company has paid under the transaction:*
>
> ...

30. Before it was amended in 2007 section 295(a) provided:

> *295 Other orders*
>
> *If a transaction or charge is set aside under section 294 of this Act, the court may make one or more of the following orders:*
>
> *(a) An order requiring a person to pay to the liquidator, in respect of benefits received by that person as a result of the transaction or charge, such sums as fairly represent those benefits:*
>
> ...

31. Following the change in wording in section 295(a), the Court's finding in *Re Hibiscus* - that such payments were paid to the liquidators - is unlikely to continue to apply. However, the finding that voidable preference payments

[14] Refer ss 350(1)(b) and 350(2)(a).
[15] *Re Hibiscus Coast Marine Centre Ltd (in liq)* (1986) 3 NZCLC 99,615
[16] Section 269 of the Companies Act 1955 provided: *"If a transaction or charge is set aside under section 268 of this Act, the Court may make one or more of the following orders: (a) An order requiring a person to pay to the liquidator, in respect of benefits received by that person as a result of the transaction or charge, such sums as fairly represent those benefits."*
[17] On 1 November 2007 with the coming into force of the Companies Amendment Act 2006.

recovered by liquidators are expressly for the benefit of all the company's unsecured creditors seems to remain good law.

32. If the funds recovered by the Liquidators pursuant to their exercise or threatened exercise of their statutory powers are company assets, then sections 312 and 313 of the CA should have application.

> *312 Preferential claims*
>
> *(1) The liquidator must pay out of the assets of the company the expenses, fees, and claims set out in the Schedule 7 to this Act to the extent and in the order of priority specified in that Schedule and that Schedule applies to the payment of those expenses, fees, and claims according to its tenor.*
>
> *(2) Without limiting clause 2(1)(b) of the Schedule 7 to this Act, the term "assets" in subsection (1) of this section does not include assets subject to a charge unless the charge is surrendered or taken to be surrendered or redeemed under section 305 of this Act.*
>
> *313 Claims of other creditors and distribution of surplus assets*
>
> *(1) After paying preferential claims in accordance with section 312 of this Act, the liquidator must apply the assets of the company in satisfaction of all other claims.*
>
> *(2) The claims referred to in subsection (1) of this section rank equally among themselves and must be paid in full, unless the assets are insufficient to meet them, in which case payment shall abate rateably among all claims.*
>
> ...

33. The language of sections 312 and 313 is mandatory; "*The liquidator must*". It is therefore axiomatic that any company assets must be distributed in accordance with Schedule 7 first, then, in respect of unsecured creditors, if funds are insufficient to meet all claims, those claims abate rateably amongst those creditors.

34. The mandatory effect of these provisions was noted, for example, by Associate Judge Bell in *Finnigan v Yuan Fu Capital Markets*[18] where it was recognised that if the CA applied (which it would have if the funds in issue were company assets), then there would have been no difficulty with the distribution given the CA's prescribed distribution method. The CA's prescribed method of distribution was seen to be in keeping with the CA's objective - to provide a straightforward and fair procedure for realising and distributing the assets of insolvent companies.

[18] *Finnigan v Yuan Fu Capital Markets Ltd* [2013] NZHC 2899 at [1] and [2]

35. The purpose and objective of the current CA regime was discussed in the Explanatory Note to the Insolvency Law Reform Bill 2005, as cited by the Court of Appeal in *Timberworld Ltd v Levin*.[19]

> *[49] The Explanatory Note to the Bill emphasised the principles according to which the reforms it enacted operated, noting the "fundamental principle" underpinning insolvency law the pari passu or "equal step" principle. The Explanatory Note also described the overall objectives behind the reform of insolvency law as being to:*
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> - *provide a predictable and simple regime for financial failure that can be administered quickly and efficiently, imposes the minimum necessary compliance and regulatory costs on its users and does not stifle innovation, responsible risk taking, and entrepreneurialism by excessively penalising business failure; and*
> - *distribute the proceeds to creditors in accordance with their relative pre-insolvency entitlements, unless it can be shown that the public interest in providing greater protection to one or more creditors outweighs the economic and social costs of any such priority; and*
> - *maximise the returns to creditors by providing flexible and effective methods of insolvency administration and enforcement which encourage early intervention when financial distress becomes apparent; and*
> - *enable individuals in bankruptcy to participate again fully in the economic life of the community; and*
> - *promote international co-operation in relation to cross-border insolvency.* (footnotes omitted)

36. Associate Judge Bell's comment in *Finnigan v Yuan Fu Capital Markets* regarding the prescriptive distribution regime in sections 312 and 313 of the CA accords with the first point of the Explanatory Note to the Insolvency Law Reform Bill 2005. A standard method of distribution provides: "*a predictable and simple regime for financial failure that can be administered quickly and efficiently, imposes the minimum necessary compliance and regulatory costs on its users …*"

37. For the reasons set out, if the clawback funds are characterised as assets of the company then it is persuasive that such funds are subject to the mandatory rateable distribution method provided in section 313.

Claw back funds subject to trust?

38. The Liquidators' counsel notes at [5.49] of their submissions that counsel intended to consider the application of both backwards tracing and remedial

[19] *Timberword v Levin* [2015] NZCA 111

constructive trust in respect of clawback funds. While that correctly sets out what was highlighted in the memorandum dated 16 March 2018, the Liquidators correctly raised those points as issues that may need to be addressed.

39. The question is, in light of the fact that Investors' funds were to be held on trust by RAM, do the clawback funds paid to the Liquidators retain their original characteristic as trust funds or become trust funds in the hands of the Liquidators? The two options initially identified by the Liquidators, *backwards tracing* and *remedial constructive trusts* can be addressed in fairly short order. A third option, arises from a comment in her Honour Justice Glazebrook's decision in *McIntosh v Fisk.*[20]

40. As set out in the Liquidators' submissions at [5.50], backwards tracing provides a substance over form approach to allow a proprietary claim to trust funds where traditional tracing rules (for example, where payments are made into an overdrawn bank account) may preclude traditional tracing. Here, there has been no attempt to traditionally trace RAM funds through to individual Investors. Further, in light of the findings in *McIntosh v Fisk,* any attempt to trace and recover RAM funds in an Investor's hands would, more likely than not, have resulted in a response that the Investor was a bona fide purchaser for value without notice or similar.

41. The Privy Council recognised backwards tracing could arise in *Federal Republic of Brazil v Durant.*[21] To establish this method of tracing, a claimant must show a co-ordination between the depletion of the trust fund and the acquisition of the asset which is subject of the claim. There must be evidence of the coordinated outward and inward movement of assets.[22]

42. In *Federal Republic of Brazil v Durant,* the plaintiffs sought to impose a constructive trust over funds held in companies which were at the relevant times under the practical control of the former mayor of a Brazilian municipality and his son. The plaintiffs' claimed the defendants were liable as constructive trustees of a sum of about US$10.5m, representing bribes that had been paid to the former mayor in connection with a major public road building contract. It was held there was sufficient connection between the bribes and the sums paid into the defendant companies' accounts (which

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[20] *McIntosh v Fisk* [2017] 1 NZLR 863 at [241]-[242].
[21] *Federal Republic of Brazil v Durant* [2016] 1 All ER
[22] Ibid at [40] and [41].

sums constituted an acquired asset) from available inference such that the companies were constructive trustees for the sums paid.

43. Here, in contrast to *Federal Republic of Brazil*, there is no evidence or inference available to establish the kind of coordination understood to be required for backwards tracing. Investors who have repaid clawback funds were third party recipients of misapplied trust funds. They were not entities under the control or effective control of RAM. It is not known whether or not any of the funds paid to Investors were kept separate by them or otherwise used to acquire identifiable assets. Further, the circumstances in which RAM funds were received by Investors have not been tested other than in *McIntosh v Fisk*. Accordingly, no inferences can be drawn as to whether there is any connection between the RAM payment out and the funds clawed back.[23]

44. The second point identified in counsel's first memorandum dated 16 March 2018 was whether or not clawback funds could be impressed with a remedial constructive trust.

45. As noted in the Liquidators' submissions, whether remedial constructive trusts are a remedy available in New Zealand law remains uncertain, although they have not been ruled out as a remedy.[24]

46. In *Fortex v MacIntosh*[25] the Court of Appeal allowed an appeal against a High Court decision to order a restitutionary remedial trust in favour of employees over a sum of money in Fortex's hands equivalent to employee superannuation payments that were required to but were not made by Fortex. The High Court's finding gave the employees as beneficiaries' priority over that sum over Fortex's secured debenture holders.

47. The Court of Appeal held a remedial constructive trust could arise only if it were shown that the debenture holders' consciences were affected such that it would be unconscionable for them to enforce their legal rights to preference over the sum of the retained employee super deductions. Justice Tipping noted further that remedial constructive trusts depended for their very

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[23] No connection was found between funds paid out and those ordered to be repaid in *McIntosh*. The majority finding was that profit had to be repaid because value was not given as required to establish defences to the Liquidators' voidable preference payment or insolvent transaction claims.
[24] For example, see *Paki v Attorney General (No 2)* [2015] 1 NZLR 67 at [163]: *"It is not appropriate in the present proceedings to foreclose the availability of relief by recognition of a constructive trust over property acquired in breach of equitable duties, when the retention of the property would be unconscionable. Whether the classification of any such constructive trust as "institutional" or "remedial" is truly useful is a topic that can be left for another day."*
[25] *Fortex v MacIntosh* [1998] 3 NZLR 171

existence on an order of the Court, with such order being creative rather than confirmatory (at p 173).

48. The situation in this case is somewhat different to that in *Fortex* which involved a fairly commonplace contest between creditors. Here it is not suggested RAM's unsecured creditors are to be prevented from exercising their legal rights given they are unsecured.

49. The starting point for considering whether there could be a remedial constructive trust in this instance is to ask on what basis were the clawback funds recovered from Investors. The clawback funds were paid by Investors to settle with the Liquidators (aside from Mr McIntosh's funds) after they were put on notice that the Liquidators had claims against them to recover voidable preference payments under the CA and/or Property Law Act. For those funds to have been impressed with a remedial constructive trust, a prior order of the Court would have been required declaring the funds paid by the Investors were subject to a trust. No such order was sought or made. As noted above, any attempt to obtain an order would in all likelihood have been met with the equitable defences available to Investors including lack of knowledge.

50. On the other hand, no orders were made (other than in *McIntosh*) that clawback funds were voidable preference payments under the CA or Property Law Act. Since the clawback funds were not the subject of any formal order which could affect their characterisation, it could remain open to the Court to designate them trust funds after the fact. But ultimately, since there is no guidance from prior decisions as to the character of clawback funds in equity (i.e. the availability of equitable defences has not been tested), it would seem to be questionable for the Court to now determine the clawback funds paid back to RAM were impressed with a trust.

51. The third point as to whether clawback funds are trust funds arises from Justice Glazebrook's dissenting judgment in *McIntosh v Fisk.*[26] Her Honour noted, in the context of determining whether funds could be subject to clawback if those funds paid by the company were not that company's property, there was no statutory requirement that the money must belong to the company; only that it was paid by it. This finding approved the Court of Appeal's decision in *Anzani Investments Ltd v Official Assignee*[27] where it was held that a policy choice had been made in respect of the then section

[26] *McIntosh v Fisk* [2017] 1 NZLR 863 at [241]-[242].
[27] *Anzani Investments Ltd v Official Assignee* [2008] NZCA 144

292 such that issues of ownership of property or money paid were deferred and could be addressed either as part of an application for relief under section 296(3) or: "*as part of the liquidator's functions during the distribution phase of a liquidation.*"

52. Justice Glazebrook went on to say: "*While any funds recovered from him would not be available for unsecured creditors (or indeed secured creditors had there been any), they would be available to the other investors.*" (at [241]). In effect this observation (made without detailed reasons) is to the effect that the misappropriated trust moneys paid to Mr McIntosh (and, other Investors) retained their trust character upon being repaid. How that result is reached is not explained further.

53. As previously noted, the Liquidators did not take any actions as trustees on behalf of the Investors, nor was any representative action brought by the Investors as beneficiaries (claiming against other Investors, for example in unjust enrichment or similar). This point was addressed by the parties in *McIntosh* in their submissions to the Supreme Court arising from *Re Diplock*. If any successful claims in equity had been brought then any funds recovered would likely have been impressed by a trust in favour of the Investors.

54. In summary, that clawback funds are company assets appears to be fairly clearly established. The clawback funds received by the Liquidators from settlements with Investors were paid from the Investors' own funds (no tracing was undertaken) and the funds were paid in response to the threatened use of the Liquidators' statutory powers. It is difficult to see how clawback settlement payments could be characterised now as trust property. If the clawback funds are company assets distribution should follow the method prescribed by section 313 of the CA.

Liquidators' expenses and remuneration

55. Liquidators' expenses and remuneration, including legal costs incurred through the liquidation and various proceedings (the present application included), should be paid in accordance with section 278 and Schedule 7, clause 1(1)(a) of the CA, such that all of those costs should be deducted from the company assets prior to pro-rata abatement for the unsecured creditors/Investors.

56. While it is established that the Court may, at its discretion, order liquidators' fees and expenses including legal fees be deducted from funds the

liquidators hold on trust,[28] in this case it is submitted that the Liquidators' expenses and remuneration should be deducted only from company assets and not from the pool of trust funds.

(a) The direction in section 278 and Schedule 7 of the CA for liquidator fees to be paid out of company assets in priority provides a clear statutory basis for the Liquidators' fees to be paid out of company assets in preference to trust funds.[29]

(b) There are sufficient company assets to pay all of the Liquidators' expenses and remuneration.

(c) The company assets form the majority of the funds recovered and held by the Liquidators.

57. The practical relevance of deducting the Liquidators' expenses and remuneration from the company assets is that a greater sum of trust funds will then be available for distribution in accordance with the Court's equitable discretion - which aims to arrive at the most just and equitable outcome for investors.

58. It is not understood this is contentious, with the Liquidators recognising the point at [8.5] of Mr Fisk's first affidavit.

CPI adjustments on Investor balances

59. In proposed order [4](b) the Liquidators' seek Investor contributions to the date of liquidation (17 December 2012) be adjusted for the Consumer Price Index (CPI). It is submitted that the Court should carefully consider whether to grant that given there is already a substantial shortfall to repay Investors. Any upwards adjustment for some will result in a downwards adjustment for others.

60. The relevant considerations of whether to add CPI to Investor claims differ depending whether the Court orders that there are two pools of funds for distribution. With regard to company assets, the CA does not provide for any CPI adjustments on creditor claims (as set out below). In respect of company assets, the Liquidators' application to add CPI is made under the Court's

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[28] For example, refer *Graham v Arena Capital* [2017] NZHC 973 at [44] – [47]; *Finnigan v Yuan Fu Capital Markets Ltd* [2013] NZHC 2899 at [70] and *McKenzie v Alexander Associates ltd (No 1)* (1991) 5 NZCLC 67,030 (HC).

[29] This was held to be the position in *Re Ararimu Holdings Ltd* [1989] 3 NZLR 487 at p 504, albeit in respect of statutory receivers under the Companies Special Investigations Act 1958 and the Corporations (Investigation and Management) Act 1989. However, the relevant provisions were seen as analogous to that provided in the Companies Act 1955.

general discretion pursuant to section 284(1)(a) of the CA. If there is a pool of trust funds then the application to add CPI to claims against that fund will be made in the Court's equitable jurisdiction.

61. The CA itself provides guidance as to whether CPI should be added to claims in respect of company assets. Section 311 provides for pre-liquidation interest on creditor claims in two defined circumstances.

> *311 Interest on claims*
>
> *(1) The amount of a claim may include interest up to the date of commencement of the liquidation—*
>
> > *(a) At such rate as may be specified or contained in any contract that makes provision for the payment of interest on that amount; or*
> >
> > *(b) In the case of a judgment debt, [of the amount that is payable] on the judgment debt.*
>
> *(2) If any surplus assets remain after the payment of all admitted claims, [the specified interest must be paid on those claims] from the date of commencement of the liquidation to the date on which each claim is paid, and if the amount of the surplus assets is insufficient to pay interest in full on all claims, payment shall abate rateably among all claims.*

62. Three points arise.

    (a) Investor agreements with RAM did not provide for interest to be paid, thus do not qualify for interest under section 311(1)(a). Rather, Investor funds were to be invested in securities held in trust on their behalf. There was never an intention that Investor funds would be protected with an interest or CPI adjustment. Investors took the risk of exposure to market fluctuations when investing with RAM.

    (b) None of the Investors have judgment debts owing by RAM or the Ross Group companies thus do not qualify under the second limb of section 311(1)(a).

    (c) There will be no surplus assets to meet all admitted claims so interest, pursuant to s 311(2) will not be payable.

63. It is submitted that the Court should properly be confined to the application of the CA in considering the distribution and treatment of company assets, including as to any upwards adjustment to Investor claims (the Liquidators' application to exclude from claims those parts of Investor balances derived from fictitious statements produced by RAM is, as set out above, endorsed). The absence of any statutory provision to add CPI together with the express

treatment of pre-liquidation interest on creditor claims is a strong indication that Parliament did not intend for CPI to be added to creditor claims. To do so is likely to be contrary to the purpose of the CA's regime to provide a predictable and simple regime for financial failure that can be administered quickly and efficiently.

64. If the Court does decline to add CPI to Investor claims to the company assets then practically it may also be preferable to apply that decision to any trust funds to avoid complicated distribution calculations.

65. If that is wrong, and acknowledging there are no equivalent constraints on the Court when considering the distribution of the trust funds, there are further substantive reasons why it may be seen as inappropriate to add CPI to Investor claims.

66. As noted in the Liquidators' submissions, the issue of whether to add an inflation adjustment to investor balances was recently addressed in the US Madoff Ponzi litigation. In the US Court of Appeal Second Circuit decision *In re Bernard L. Madoff Investment Securities LLC*[30] ("*Madoff*") an application to apply interest or inflation to investor balances was rejected. First, it was found the relevant statute - the Securities Investor Protection Act 15 U.S.C 78 (SIPA) – properly construed, excluded such adjustment to creditor claims. The finding that SIPA constrained the Court's jurisdiction to adjust creditor claims for inflation can be applied by analogy to the points above in respect of company assets. In *Madoff*, the addition of CPI was also rejected on broader grounds.

    (a) The securities that investors purported to purchase in *Madoff* included value that would have incorporated economic circumstances such as inflation given the Ponzi scheme was predicated on fictitious market investments for investors (p 6).

    (b) It was doubtful that the full investor balances would be recovered such that each dollar allocated to earlier investors in recognition of inflation would reduce the amount of principal recovered by later investors (p 8).

    (c) The fact that *Madoff* investors did not bargain for any inflation adjustment was also seen as relevant (pp 8 and 10).

67. All of the factors in (a) – (c) above apply equally to RAM.

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[30] *In re Bernard L Madoff Investment Securities LLC* 779 F 3d 74 (2d Cir 2015).

68. In terms of New Zealand authority, the constant dollar approach (understood to be in effect a CPI adjustment) was applied in *Re Waipawa*.[31] There, in a distribution application arising from a failed illegal finance company, the amicus assisting the Court advocated for the addition of CPI through the 'constant dollar' approach on investor balances payable from trust funds held by the company's liquidators. The trust in that case was statutory, arising from the company's breaches of the Securities Act 1978. As the funds in issue were trust funds, the Court was not considering the application of a constant dollar or CPI adjustment under the CA regime.

69. *Re Waipawa*, like this case, also involved a long-standing fraudulent Ponzi scheme that lasted for more than 20 years. It ended owing investors some $19 million with recoveries available for distribution of less than $1 million. While in *Re Waipawa* a CPI adjustment was ordered, the submission of the amicus in that case started with reference to the United States' SEC submission to Congress in the relation to the Madoff Ponzi which favoured the introduction of a CPI adjustment to investor balances for Ponzi schemes of a substantial duration.[32] However, the SEC position, including its submission to Congress, was subsequently rejected in *Madoff.*

70. Similar arguments against the addition of CPI can be made here, as were advanced by counsel for the investors in *Re Waipawa*. Ultimately it can be seen that a CPI adjustment may not be necessary or appropriate to ensure an equitable division between Investors.

    (a) Earlier Investors' money could not be seen to have increased the value of the investment pool over time as there is no evidence that earlier Investor funds were properly applied or appreciated in value through interest or earnings. That said however, the Liquidators have not been able to trace Investor funds through to any assets of RAM that were recovered in the liquidation.

    (b) Earlier Investors' funds were likely lost years ago (to pay out withdrawals) such that the funds recovered are likely to have been more recently invested. This is a manifestation of the rule in *Claytons*

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[31] *Re Waipawa Finance Company Ltd (in liq)* [2011] NZCCLR 14

[32] Refer *In re Bernard L Madoff Investment Securities LLC* 779 F 3d 74 (2d Cir 2015). at [40] and [41] referring to Michael A Conley, US Securities Exchange Commission. Statement before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee, United States House of Representatives (December 9, 2009).

Case,[33] the now infrequently applied 'first in first out' rule where those funds invested first were used and lost first.

(c) The rule in *Clayton's Case* arose from presumed intention of investors that a first in first out methodology would be applied, but which intention could be displaced. Here, it could be presumed that all Investors into the fraudulent Ponzi scheme intended to share in the losses. But in light of the 'hands off, invest on behalf of' approach taken by the Investors, there is nothing to suggest there was an intention that their investments would be indexed to CPI. They were taking the risk of the market fluctuations. In contrast to *Re Waipawa,* in RAM there was never any intent or contractual arrangement that interest would be paid (as would arise in a debt security issue). This is an important distinction.

(d) CPI adjustments reward or compensate investors who risk their funds over longer periods, as compared with those who invest and take risks with their money for a much shorter period.

71. There are few examples other than *Re Waipawa* where CPI or the constant dollar approach has been adopted. One recent US decision cited by the Liquidators at [7.19] of submissions, *SEC v Amerindo Investment Advisors Inc*[34] ("*Amerindo*"), found that CPI should be added to investor claims where the Court was considering an SEC appointed Receiver's application.

72. The Receiver's application in *Amerindo* involved the US Court's equitable jurisdiction (refer p 2, Part A, and discussed further below). This can be compared to the present case where the Court is considering the distribution of the pool of trust funds. It can be contrasted to *Madoff* and in the present case where the Court is considering the distribution of company assets, which is submitted to be statutorily constrained.

73. Two further distinctions between the situation in *Amerindo* and RAM can be made. First, the Receivers in *Amerindo* had already recovered and distributed all the investors' principal investments owing. The application in that case related to a distribution of some US$20 million recovered in excess of principal investments. Second, the investment products in *Amerindo* were "Guaranteed Fixed Rate Deposit Accounts". Investors accordingly had bargained for and had a legitimate expectation of interest when investing.

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[33] *Devaynes v Noble; Clayton's Case* (1816) 35 ER 781.
[34] *SEC v Amerindo Investment Advisors Inc* USDC SDNY, 14 July 2017

Here, neither of those factors are present and accordingly *Amerindo*, with respect, may not be particularly useful as an example.

74. There is a predictably mixed effect if CPI adjustments are made to Investor claims. Any benefit of adding CPI in terms of doing equity between the majority of Investors is submitted to be inconclusive. Under the NCM the Liquidators have found that 266 Investors would be better off (make a net gain) with a CPI adjustment, on average amounting to $3,699.23 whereas 373 Investors are worse off in an average amount of $2,638.06 (refer [33] and [34] of Mr Fisk's second affidavit). A similar mixed result arises if CPI is applied to the ADM, 188 Investors would be better off by, on average $3,317.50 whereas 250 would be worse off by $2,494.76 (at [37] and [38] of Mr Fisk's affidavit).

75. In the circumstances, particularly in light of the facts that Investors never bargained for interest or any equivalent CPI component in their investments with RAM and that there will be a substantial shortfall for Investors in the distribution (of approximately 80% of total investments), it is submitted CPI ought not be added to Investor claims in respect of company assets or trust funds.

Distribution models – trust funds

76. Here, all the Investors are victims of a substantial fraud and stand to lose the large majority of their investments. As noted by Barker J in *Re Registered Securities Ltd (in liq)*.[35]

> *Each collapse of a contributory mortgage operator inevitably creates varying degrees of hardship for the trusting investors as well as difficult legal problems; the resolution to these problems frequently involves a certain arbitrariness of result.*

77. As discussed above, the task facing the Court is to find the most equitable, or the least unfair, result for the Investors when distributing the shortfall in funds.

78. The Liquidators seek that the distribution to all creditors and Investors is made applying the NCM. This is effectively pari passu distribution based on Investor balances at the time of liquidation that account for deposits, withdrawals and deducts any fictitious profits or adjustments made by RAM.

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[35] *Re Registered Securities Ltd (in liq): National Australia Bank NZ Ltd v Tuck* (1990) 5 NZCLC 66,248, at p 66,250, cited at [72] of *Re International Investment Unit Trust* [2005] 1 NZLR 270.

The Liquidators' approach is the same regardless of whether there is a single fund or two funds.

79. The issue with that approach is that it does not take into account withdrawals made during the currency of the RAM Ponzi scheme, such that Investors who made no withdrawals suffer the entire loss of their investment, while others, who were fortunate enough to withdraw funds prior, lose a lesser proportionate amount of their original investment.

80. In contrast distributions using the ADM and the RT do take account of Investor pre-liquidation withdrawals to ascertain what proportion of their original investment has been recovered and what entitlement (if any) each Investor has to a further distribution.

81. A useful, albeit stark, example of the effect of excluding pre-liquidation withdrawals from assessment as part of a hypothetical distribution of $0.10 (helpfully provided by a member of RAM's Investor committee) is summarised below.

    (a) Investor 1 originally invested $100,000 and over the years prior to liquidation withdrew $90,000. On liquidation Investor 1 would have lost $10,000 from his or her original capital investment. In a post-liquidation net contribution distribution of 10 cents in the dollar, Investor 1 would be paid a further $1,000. This would result in a net loss of $9,000 or, an overall capital recovery of 91 cents in the dollar.

    (b) Investor 2 also originally invested $100,000 but over the years prior to liquidation made no withdrawals. On liquidation Investor 2 would have lost $100,000 from his or her original capital investment. Applying the net contributions distribution model, on 10 cents in the dollar distribution Investor 2 would receive $10,000, being a net loss of $90,000, $81,000 less than Investor 1.

82. As noted in the Liquidators' submissions, the conceptual divide is whether or not the Court should consider all funds paid out to beneficiaries of the RAM fraudulent trust over time as one pool (which pool of funds was always limited and insufficient to repay all Investors due to the fraudulent Ponzi scheme being operated), or whether a line should be drawn at the time of liquidation and all Investors' losses be assessed as at that date for the purposes of distribution.

RT - description

83. The RT distributes losses to compensate investors proportionately on a sliding scale subject to the funds available. The RT treats all funds paid out by or from a Ponzi operator as distributions, before and after liquidation. So, in effect there is a gross pool of funds. All payments from the pool are taken into account when distributing proceeds recovered.

84. By way of example, investors who suffer a 100% loss (those who deposited funds and withdrew nothing throughout the life of the Ponzi) may receive a distribution of funds equivalent to 10% of their loss. If there are funds remaining after that distribution, then investors who suffer a 90% loss (which will include those who have received the first distribution bringing their loss to 90%) will receive a distribution equivalent to say 5% of their loss, and so on.

85. Leading US academic on Ponzi schemes, Kathy Bazoian Phelps described the RT[36] as follows.

> *The general concept of the Rising Tide Method is that all investors should, in equity, receive an equal percentage distribution on their lost investments, considering both the prior payments from the Ponzi perpetrator and the distributions to be made from the estate. "Payments received by the claimant prior to the Ponzi Scheme's collapse are treated as 'distributions' on par with the distributions to be made by the Receiver, so that prior amounts paid by [the debtor] are credited against the amount that would otherwise be paid from the Receiver Estate.*

86. The US District Court described the RT in *S.E.C v Parish.*[37]

> *Under the Rising Tide method, however, prior payments to each investor are credited against investors' pro-rata distributions from the receivership. In effect, an individual investor's loss is deemed to be the gross amount actually invested in the scheme. Payments received by the investor prior to the scheme's collapse are treated as "distributions" on par with the distributions to be made by the Receiver, so that prior amounts paid by Parish are credited against (i.e., subtracted from) the amount that would otherwise be paid from the receivership estate. Under this method, investors who received prior payments are entitled to receive a smaller pro-rata payment from the receivership estate than those who received no prior payment. Moreover, investors who previously received payments exceeding their pro rata amount of the total distribution will receive no distribution from the receivership estate.* (at [19])

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[36] Phelps, *Handling Claims in Ponzi Scheme Bankruptcy and Receivership Cases*, Golden Gate University Law Review, Vol 42, June 2012. Refer also Davis, *The Rising Tide in the Wake of a Ponzi Scheme*, ABI Journal, 89, July 2013 for another useful description and example of the rising tide method.

[37] *S.E.C. v. Parish*, No. 2:07–cv–00919–DCN, 2010 WL 5394736, at *3 (D.S.C. Feb. 10, 2010).

87. Mr Fisk sets out an example of how the RT would work in this case at [12] - [19] of his second affidavit.

ADM - description

88. The ADM, like the RT takes into account pre-liquidation payments to investors when calculating each investor's entitlement to a post-liquidation distribution.

89. It differs from the RT as post-liquidation distributions are not calculated by threshold stages involving a number of calculations. Rather, there is one calculation of the 'Maximum Distribution Rate' with pre-liquidation payments deducted from the fixed rate. However, in this case, as explained by Mr Fisk in his second affidavit, the end result, regardless which of the RT or ADM is applied, is the same (at [22]).

90. It is understood the name 'alternative model' arose in *Graham v Arena Capital*[38] from an investor's application for a different distribution method to that sought by the liquidators. Accordingly, at least by that name, the ADM is not the subject of any prior judicial comment or academic analysis. That can be contrasted with the RT which has been the subject of judicial and academic comment in the US over a number of years. Both models are however discussed in the recent discussion paper published by the Ministry of Business, Innovation and Employment, "*A new regime for unravelling Ponzi schemes*" dated May 2018 (discussed further below under a separate head).

Submissions on distribution model

91. All Investors into the RAM Ponzi scheme are victims of a fraud and significant breach of trust. They have all suffered that common and shared misfortune. When viewed from that standpoint, that all Investors should be treated equally in terms of the funds they recover from RAM overall (before and after liquidation) is easily justified. To do so would accord with the equitable maxim, equality is equity. To not take account of pre-liquidation withdrawals when assessing proportionate distribution - which withdrawals were more likely than not made using other Investors' funds[39] - gives

[38] *Graham v Arena Capital* [2017] NZHC 973 at [31] – [43]
[39] Refer *Fisk v McIntosh* [2015] NZHC 1403 at [2] where McKenzie J found: "*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.*" (emphasis added)

withdrawing Investors a benefit to non-withdrawing Investors' detriment and risks giving the RAM Ponzi scheme an air of legitimacy.

92. Accordingly, to assess whether the RT or ADM should be applied in the Court's equitable discretion there is a need to address first the numerical differences between the NCM, RT and ADM as set out in Mr Fisk's affidavits dated 11 December 2017 and 18 May 2018. Second, relevant New Zealand authority including those applying to RAM is canvassed. Third, overseas commentary and case law examples are addressed.

Numerical differences between the NCM, RT and ADM

93. Mr Fisk sets out an updated analysis of the differences between the NCM and the ADM (adjusted for CPI) in the table at p 24 of his second affidavit. It is noted the comparisons are done on the basis that there is in effect one fund and that a single distribution model will be applied to the total funds available for distribution ($18.8 million as at that time).

94. However, as noted above, it is submitted it would be an appropriate outcome in this case for a different model to apply to each of the two sources of funds held by the Liquidators. For the company asset pool, the method directed under section 313 of the CA will result in the NCM when combined with the orders the Liquidators seek as to the fixing of Investor claims. The trust funds however should be distributed to reach the most equitable outcome.

95. As the Liquidators have calculated the numerical outcome between the RT and ADM produces the same result for Investors (refer [15] of Mr Fisk's second affidavit), the ADM has additional benefits including allowing the Liquidators a more straightforward calculation for individual Investor distributions and the ability to advise Investors of their entitlements in a simple manner. On that basis the ADM should be preferred. There does remain the issue, however, of attempting to rationalise the names given to these models so as to provide precedential guidance if they come to be considered in future cases (or in terms of legislative reform).

New Zealand law and principles of equity

96. The effect of the majority decisions in the Court of Appeal and the Supreme Court in *McIntosh v Fisk*[40] was that Investors who withdrew capital (as opposed to fictitious profits) before liquidation were entitled to assert that the original deposit was value/valuable consideration for the later withdrawal

[40] *McIntosh v Fisk* [2016] 2 NZLR 783 (CA) and *McIntosh v Fisk* [2017] 1 NZLR 863 (SC)

(applying the Supreme Court's prior decision in *Allied Concrete v Meltzer*[41]). It was however recognised by the majority in the Supreme Court that the case fell "*on the borderline of insolvency law and trust law*" (at [100]).

97. The relevance of this point is that if the *McIntosh v Fisk* decision was applied to its logical conclusion, the Court ought not take into account any prior payments to Investors when considering the distribution models (understanding that the Liquidators have settled or are in the process of settling clawback claims). However, the Supreme Court did not consider certain equitable maxims (understandably given the case was brought against the background of insolvency law) that could be applied (discussed below).

98. The minority decisions of Miller and Glazebrook JJ in *Fisk v McIntosh* in the Court of Appeal and Supreme Court respectively would have allowed the Liquidators' appeal for all the funds paid to Mr McIntosh to be clawed back. Those minority decisions can be seen as supporting the submission in favour of the ADM or RT; i.e. prior payments by RAM of capital to Investors should be taken into account for policy reasons when considering equitable distribution.

99. In Justice Miller's dissenting judgment in the Court of Appeal it was found Mr McIntosh did not give value for either the fictitious profit component (agreeing with the majority) or the capital he received from RAM prior to its liquidation. Miller J distinguished *Allied Concrete* on the basis Mr McIntosh was not a trade creditor (at [101] – [104]) and his capital contribution/investment did not provide value to RAM. In his Honour's view, Mr McIntosh's investment gave no value in the circumstances of RAM as a Ponzi scheme, where:

> "*... 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.*" (at [107]) (footnote omitted)

100. Justice Miller cited US authority where the question of whether investors gave value to a Ponzi scheme was considered. It was found that the value given to the scheme was to allow it to defraud more people by using the investor's funds to perpetuate the fraud (refer [111]). Ultimately Justice Miller

[41] The majority decision of the Supreme Court in *McIntosh* found at [115] that Mr McIntosh met the two means to find value as required by s 296(3)(c), identified in *Allied Concrete* could be applied, either by way of antecedent transaction (whereby a giving of credit at an earlier point was value for a later payment), or through the discharge hypothesis (where the discharge of the debt owing at the time of the insolvent payment was value).

found that the distinction between Mr McIntosh and other Investors was that he was paid and they were not, which was insufficient grounds to found a defence to repay what was an insolvent transaction, which, in his Honour's view, should have been disgorged in full and then shared rateably.

101. Justice Glazebrook's dissenting judgment in the Supreme Court also distinguished *Allied v Melzer* on the basis that no value was given by Investors who never intended the money be provided to RAM for its own use (267] – [270]). Her Honour also noted the Supreme Court in *Allied v Meltzer* had favoured according primacy to individual creditors as opposed to the interests of creditors as a whole however, in her Honour's view the circumstances in RAM meant that policy rationale ought not apply.

> *The operation of a Ponzi scheme cannot, however, in any way be described as an ordinary commercial transaction. The only purpose of the scheme is to defraud investors. I accept that Mr McIntosh was an innocent investor who had no knowledge of the fraud. However, this was the same for all the investors. In policy terms an accident of timing as to when funds are withdrawn should not favour one defrauded investor over another. This is particularly the case as the very essence of a Ponzi scheme is that investment by new investors is used to pay out those investors who wish to withdraw their funds. As the liquidators submit, the very purpose of the payments made to Mr McIntosh was to defraud other investors.* (at [275])

102. If Justice Glazebrook's judgment was in the majority all funds paid to Mr McIntosh by RAM would have been ordered to be repaid for pro rata distribution amongst all Investors. It is submitted there are thus sound reasons for the Court to consider Investors 'in the round', and those who received funds from RAM during its existence should be considered, in effect, to have already received a distribution.

103. An example in New Zealand where pre-liquidation payments were taken into account can be found in *Re Trans Capital Ltd (in liq) (No. 4)*.[42] There the High Court in a directions application under section 284 of the CA regarding the distribution of trust funds held by liquidators, applied a very similar model to the ADM which in *Trans Capital* was termed 'the base claim' approach.

104. The base claim approach in *Trans Capital* involved two steps. First, the percentage of the principal sum originally invested by each investor or contributor was calculated against the sum that each would receive back in the distribution on a pro rata basis. Second, any sums received by investors/contributors from the defaulting trustee prior to liquidation would be

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[42] *Re Trans Capital Ltd (in liq) (No. 4)* HC Wellington, M 84/99 22/5/2000 Wild J

deducted from the sum calculated in step one, with the resulting residue then paid (at [24]).

105. In *Trans Capital* equitable principles in support of the base claim approach were identified including that trustees may deduct sums overpaid to a beneficiary from future instalments and can adjust accounts by retaining overpayments from other interests of the beneficiary (at [20] and [21]). A passage from *Re Akerman*[43] was cited as follows:

> *The principle is to be found laid down in Cherry v Boultbee (1839) 4 My & Cr 442 in the passage to which I have just referred, and also in Courtenay v Williams (1884) 15 U Ch 204, and no doubt, if search were made, it would be found to have been laid down in many other cases. It is this. A person who owes an estate money, that is to say, who is bound to increase the general mass of the estate by a contribution of his own, cannot claim an aliquot share given to him out of that mass without first making the contribution which completes it. Nothing is in truth retained by the representative of the estate; nothing is in strict language set off; but the contributor is paid by holding in his own hand a part of the mass, which, if the mass were completed, he would receive back.*[44]

106. The competing distribution model in *Trans Capital* was referred to as the 'residual claim' approach. The residual claim approach appears to have been effectively the same as the Liquidators' preferred NCM approach. The 'residual claim' approach involved pre-liquidation payments being excluded from the calculation of the percentage entitlement to a distribution, with such payments rather being factored into each contributor's starting balance. Arguments in support of the residual claim approach included that investors/contributors would be entitled to the benefit of bona fide purchaser for value defences, similar to the gave value/valuable consideration defences available to Investors in the present case.

107. Justice Wild held:

> *[35] I consider that the base claim approach best achieves fairness and equity. For the purpose of calculating entitlements to distributions from the trust pool or fund, it requires that sums already received from the pool be taken into account.*

108. His Honour went on to say:

> *[37] I do not regard the result of the residual claim approach as according with equity. For instance, it is difficult to reconcile with the maxim that a party who seeks equity must do equity, or that a party who comes into equity must come with clean hands, or that equity is equity.*

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[43] *Re Akerman* [1891] 3 Ch 212

[44] Supra n 32 above at [23].

109. It is submitted this reasoning can be applied there. Ultimately, because of RAM's defalcations, the pool of funds available to repay Investors has always been less than what was originally invested. Accordingly, deductions from this finite pool should properly be taken into account to do equity between the Investors and thereby achieve a fair outcome.

110. In *Graham v Arena Capital Ltd (in liq)*[45] Justice Mander rejected an investor's application for application of what was termed the 'alternative model' which would have – like the base claim method in *Trans Capital* - taken into account pre-liquidation payments when calculating investors' entitlements to distributions of trust funds. The unrepresented investor's application was dismissed on the basis that to allow pre-liquidation payments to be taken into account would run roughshod over defences available under the CA and Property Law Acts, as established in *McIntosh v Fisk* (by the Court of Appeal at that time). However, the equitable principles as referred to by Justice Wild in *Trans Capital* were not considered.

111. The Liquidators refer in submissions to *Foskett v McKeown*[46] as authority for the proposition that innocent contributors to a trust fund, insufficient to meet all claims, must be treated equally between each other where there is no basis for beneficiary claims to be subordinated to any other beneficiary's claim (at 5.23]. It is submitted this principle can also lend support to the ADM.

112. The application of the principle that innocent contributors should be treated equally can be approached in a Ponzi scheme from the starting point that equality is assessed by reference to distributions made both before and after the Ponzi collapses. This is on the basis that there was always in effect one pool of funds which funds were insufficient to repay all investor beneficiaries. In contrast to RAM, all the claimant beneficiaries in *Foskett* (220 investors who had paid deposits to purchase land to be developed in the Algarve, Spain) were in the same position - with none having received distributions prior to the investment entity's collapse. In RAM some Investors are unpaid in full, some are part-paid and others have been repaid their whole capital investment.

113. As referred to by Justice Wild in *Trans Capital*, it is established that trustees can deduct overpayments from beneficiaries from future entitlements/distributions.[47] Here, if all beneficiaries were to be treated

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[45] *Graham v Arena Capital Ltd (in liq)* [2017] NZHC 973 at p 10 and 11.
[46] *Foskett v McKeown* [2001] AC 102
[47] Refer for example Snells Equity, 33rd Edition at 30-047(e): *"A trustee who overpays one beneficiary can adjust accounts by retaining the overpayments out of other interest of the beneficiary, e.g. future*

equally, then those who have received proportionately more than others during the life of RAM can be seen as having been overpaid. To recognise this equitable principle the Court may order the ADM is applied to the trust pool of funds. This equity-based approach, which recognises trustees have the power to adjust beneficiary distributions, would not, on its face, offend against CA or Property Law Act gave value defences.

US approach

114. In the US, Courts have applied the RT in cases where Receivers have brought applications for approval of schemes of distribution of proceeds recovered from Ponzi or other fraudulent investment vehicles. While the US legal system is quite different to New Zealand, on considering a number of these decisions, it appears the principles in issue overlap with the present case to a considerable degree.

115. It is understood Receivers are appointed by the US Securities Exchange Commission (SEC) to take control of entities where the SEC has initiated a prosecution or investigation for breaches of US securities laws. US District Courts exercise a broad, equity-based discretion when considering Receivers' applications for distributions of recovered funds to investors.[48] Receivers are contrasted with bankruptcy administrators there, who are required to apply a prescriptive framework for distributions (the net loss rule) - understood to be in effect the NCM.[49] Thus the equity based consideration of US Receivers' applications for distribution directions has similarities to the present case, at least with regard to the distribution of the pool of trust funds.

116. In *SEC v Huber*[50] the US Seventh Circuit Appeals Court sanctioned the RT for a Receiver's final distribution of $1 million (out of $7 million recovered) to investors in a Ponzi scheme. It was noted:

> *Rising tide appears to be the method most commonly used (and judicially approved) for apportioning receivership assets. See, e.g., In re Receiver, No. 3:10-3141-MBS, 2011 WL 2601849, at *2, *4 (D.S.C. July 1, 2011); CFTC v. Lake Shore Asset Management Ltd., No. 07 C 3598, 2010 WL 960362, at *7-10 (N.D. Ill. March 15, 2010); CFTC v.*

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income." *Livesey v Livesey* (1827) 3 Russ 287 and *Re Robinson* [1911] 1 Ch 502 at 508 are cited as authorities.

[48] *SEC v A Alleca* 1:12-cv-3261-WSD (N.D. Ga. Nov. 16, 2017): *In equity receiverships resulting from SEC enforcement actions, district Courts have very broad powers and wide discretion to fashion remedies and determine to whom and how the assets of the Receivership Estate will be distributed." SEC v. Homeland Commc'ns Corp., No. 07-cv-80802, 2010 WL 2035326, at *2 (S.D. Fla. May 24, 2010); see SEC v. Elliot, 953 F.2d 1560, 1566 (11th Cir. 1992): "The district Court has broad powers and wide discretion to determine relief in an equity receivership. This discretion derives from the inherent powers of an equity Court to fashion relief."* (citations omitted)

[49] For example, see *SEC v. Huber*, 702 F.3d 903 (7th Cir. 2012).

[50] Ibid

*Equity Financial Group, LLC, No. Civ. 04-1512 RBK AMD, 2005 WL 2143975, at *24-25 (D.N.J. Sept. 2, 2005); United States v. Cabe, 311 F. Supp. 2d 501, 509-11 (D.S.C. 2003); CFTC v. Hoffberg, No. 93 C 3106, 1993 WL 441984, at *2-3 No. 12-1285 (N.D. Ill. Oct. 28, 1993)* (p 6 - 7). (References included by way of illustration).

117. The Appeals Court in *Huber* went on to note that the net loss method was sometimes used instead, subject to the circumstances of each individual case which should include an analysis of the overall financial effect on the investor group. If a large proportion of investors would receive nothing under the RT, it is likely the net loss approach would be preferred as a generally more equitable outcome (p 8 – 9). In *Huber* the RT was approved where 18% of investors would receive no distribution using the RT.

118. Against the RT, investors who had made pre-receivership withdrawals argued in *Huber* that they should not be penalised for withdrawing some of their money. However, the Court made an important distinction that applies to Ponzi schemes (as compared to other failed financial market participants) - the money was not their money - rather it derived from stolen funds (p 7).

119. In RAM there were some 860 Investors at the time of its collapse.[51] Under the NCM 639 Investors receive a distribution (allowing for CPI adjustment), whereas 434 receive a distribution under the RT. The distribution percentage between models goes from 14.04% to 22.33% between the NCM and RT respectively (if a single model is applied to all of the funds available for distribution).[52] Counsel calculates, taking the 639 investors as 100% of Investors entitled to a distribution (either they received more than their capital or otherwise), in the RT or ADM 32.08% of Investors miss out on a distribution if the RT was applied to all funds recovered by the Liquidators.

120. However, if the Court follows the CA section 313 distribution method for the company assets and the RT or ADM for the trust funds, all entitled Investors will receive a distribution, albeit those who made prior withdrawals will be paid marginally less with a larger share being paid to those who withdrew nothing during RAM's existence. At this point the figures for distribution to Investors based on the two-model approach is not known.

Order of distribution if two funds

[51] Refer [1.2] of Mr Fisk's first affidavit dated 11 December 2017.
[52] Refer table at p 23 of Mr Fisk's second affidavit dated 18 May 2018.

121. If the Court is minded to direct that there are two pools of funds, the NCM be applied to company assets and the ADM to trust funds, the question arises as to which pool of funds should be distributed first.

122. Conceptually it may be that company assets should be distributed first on the basis that Liquidator fees and expenses are likely to be deducted from that fund, which deduction occurs first in the order of distribution mandated in Schedule 7 and section 312 of the CA. After fees and expenses are deducted the NCM can be applied to Investor and unsecured creditor claims.

123. The sum of company assets distributed to each Investor can then be taken into account when calculating Investor entitlements to implement the ADM. Since the ADM accounts for all funds received by Investors, if the trust funds were distributed first the sum each Investor is entitled to / receives in the company asset distribution may not be taken into account.

124. The Liquidators have helpfully analysed the substantive effect on Investors as to the order of distribution between the NCM / company assets and ADM / trust funds. Their spreadsheet calculations using 10 simplified Investor examples and three different hypothetical pools of funds split between company assets and trust funds (being $20,000 company assets / $10,000 trust assets; $25,000 company assets / $5,000 trust assets and $15,000 company assets / $15,000 trust assets) is attached as schedule "**1**".

125. The Liquidators' explain their analysis as follows:

We explain the analysis below by reference to example Investor B and Investor F in the $25,000 company assets / $5,000 trust assets example. The analysis was run using the Alternative Model for the trust assets, but as previously explained, the Liquidators consider the results would be the same using the Rising Tide analysis.

Trust assets first

- *Where the distribution of the trust assets is calculated first, $5k is available for distribution in accordance with the alternative model, which results in a $1,600 (or 16%) Maximum Distribution.*
- *Investor B has already received $100 or 1% so is entitled to a distribution of $1,500.*
- *Investor G has already received $5,000, or 50%, so is not entitled to a distribution.*
- *After the distributions from the trust assets have been calculated, the net contributions balances (NCB) are adjusted to reflect any distribution received from the trust assets. This results in a slightly lower NCB for those investors who received a distribution from the trust assets. That is, Investor B's NCB reduces from $9,900 to $8,400.*

- *The company assets are then distributed equally at a rate of 45 cents in the $.*
- *Investor B receives a distribution from the company assets of $3,818.18, taking their total distribution to $5,318.18. Investor G receives a distribution of $2,272.73 from the company assets but no distribution from the trust assets.*

Company assets first

- *Where the distribution of the company assets is calculated first, all investors receive an initial distribution of 42 cents in the $ on their NCB. This distribution rate is lower than if the trust assets are distributed first (even though the same amount is being distributed) because where trust assets are distributed first the total value of claims (or NCBs) is $5K lower as the amounts already distributed from the trust assets are deducted.*
- *Investor B receives $4,125.00 at this stage and Investor G receives $2,083.33.*
- *When the distribution of the trust assets is subsequently calculated based on the Alternative Model, the distribution from the company assets is included in the withdrawals of capital figures.*
- *The maximum distribution is $5,486.11. Investor G will not receive any distribution from the trust assets. In contrast, Investor B will receive a further $1,261.11 taking their total distribution to $5,386.11.*

Accordingly, Investor G is $189.39 better off where the distribution from the trust assets is calculated first. Investor B would be $67.93 worse off.

126. There is again a mixed effect when the different scenarios are applied. Accordingly, it is submitted the order of distribution that best accords with principle should be followed, which in this case appears to require company assets to be distributed first followed by trust funds.

MBIE discussion paper

127. MBIE has recently released its discussion paper, "*A new regime for unravelling Ponzi schemes*" dated May 2018 seeking submissions on the Government's proposed legislative reform to specifically address how Ponzi schemes are wound up and administered. The present insolvency regime is seen as inapt for addressing the peculiar legal problems that Ponzi schemes give rise to, including how proceeds are distributed after wind-up. The present case is mentioned in the paper, and, in light of the somewhat complex issues it has given rise to, legislative reform appears an appropriate response.

128. The stated objectives are threefold (p 6 – 7). To:

(a) provide consistent outcomes for investors.

(b) share losses among investors as fairly as possible.

(c) minimise the cost to investors of unwinding that scheme.

129. The MBIE paper identifies the current position as reached in *McIntosh v Fisk* as "*inconsistent with public policy settings*" for the reason that investors who withdraw funds prior to a Ponzi scheme's windup get an advantage by an "accident of timing" as they are entitled to keep capital distributions on the basis that their original investment was value for the later withdrawal under the CA and Property Law Act.[53]

130. The discussion paper contains considerable comment relevant to the present case. For present purposes reference is made only to parts of the MBIE analysis of distribution of assets to investors (Part 5), which includes distribution models and the addition of inflation. As a starting point MBIE noted three considerations to be borne in mind, all of which are applicable here (at p 48):

(a) generally, there is a need to attempt to balance the needs of individuals against investors as a whole;

(b) simple solutions may result in unfair outcomes to some but are likely to be more cost effective than more nuanced options;

(c) investors' recovery comes from the same pool of funds so that a greater recovery for one will result in a lower recovery for another.

131. MBIE's paper identifies four main methods of distribution.

(a) The rule in Clayton's case (first in first out) is considered inappropriate for Ponzi schemes due to its disproportionate effect on investors (p 49).

(b) The NCM approach (the model sought by the Liquidators here) is traversed and noted to be "the conventional approach to distributing assets to investors in Ponzi schemes in New Zealand...". The complaint of some RAM Investors is also noted that the NCM approach allows investors who were able to make a withdrawal end up with a higher effective level of recovery where there are insufficient assets to meet all claims. The pros of the method are seen as it is straightforward and targets returns at those who lost their initial capital investments. Cons

[53] Refer p 16, which references Justice Glazebrook's dissenting judgment in *McIntosh v Fisk*.

are that it results in an uneven level of total recovery and does not take into account differing levels of loss investors have suffered (p 52 – 53).

(c) The ADM, (noted to have been put forward by some RAM Investors), is considered and described at [252]. The ADM:

a. calculates a provisional debt for each investor based only on their contributions to the Ponzi scheme, then

b. applies a provisional distribution rate to those debts

This allows a provisional gross entitlement to be calculated for each investor. This figure can then be compared to the total payments received by the investor from the Ponzi scheme:

a. If the payments previously received by the investor are less than the provisional gross entitlement then the investor is entitled to the balance.

b. If the payments previously received by the investor are more than the provisional gross entitlement then the investor is not entitled to any distribution.

It is commented that there is no set rate of recovery in the alternative method and pre-liquidation withdrawals are effectively treated as voidable transactions, albeit they are not actually recovered. The equitable maxims as applied by Justice Wild in *Trans Capital (no. 4)* is not however referred to. In terms of pros, it is seen as straightforward to calculate the level of returns and targets investors who have suffered higher losses. The con identified is that it results in an uneven recovery across investors (p 54 – 56).

(d) The RT is also discussed. It is described as:

261. Distributions are then made first to those investors with the greatest percentage of loss. When all of those initial creditors reach a plateau with other creditors then all creditors with that level of loss are eligible to receive distributions in proportion to their remaining debt. This process will continue until all investors have suffered the same losses (measured in percentage terms) at which point the remaining assets would be distributed in proportion to each creditors remaining debt until the assets available to be distributed are exhausted.

A con of the RT demonstrated by MBIE's example at [263] is that the RT has the potential to concentrate recoveries in a small group of investors, leaving others receiving nothing. Pros are noted as again targeting investors who suffer the greatest losses and providing the most even distribution relative to other models (p 55- 56).

132. The addition of inflation to investor balances is also discussed albeit briefly in MBIE's paper (p 57 – 58).

133. MBIE state they have not formed a view as to which distribution model should be preferred for any legislative reform but reinforce that the five criteria they will measure any proposal against are certainty, predictability, principle, cost and fairness (p 58).

Dated at Wellington this 11th day of June 2018

P R W Chisnall / J D Haig
Amicus Curiae / Counsel assisting

Schedule "1"

On basis of $20k company assets, $10k trust assets

	Investor A	Investor B	Investor C	Investor D	Investor E	Investor F	Investor G	Investor H	Investor I	Investor J	
Contributions	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Withdrawals	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
NCB	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	(10,000.00)	(20,000.00)	
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00
Assume trust assets first											
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Maximum Distribution	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	25000
Pre-liquidation withdrawals of capital	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**2,500.00**	**2,400.00**	**2,100.00**	**1,500.00**	**1,000.00**	**500.00**	-	-	-	-	**10,000.00**
NCB											
Old NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	
New NCB Claim	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	5,000.00	-	-	-	50,000.00
Distribution Rate	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
Distribution NCB	**3,000.00**	**3,000.00**	**3,000.00**	**3,000.00**	**3,000.00**	**3,000.00**	**2,000.00**	-	-	-	**20,000.00**
Total distribution	**5,500.00**	**5,400.00**	**5,100.00**	**4,500.00**	**4,000.00**	**3,500.00**	**2,000.00**	-	-	-	**30,000.00**
Effective return	***55%***	***55%***	***55%***	***55%***	***55%***	***55%***	***70%***	***100%***	***200%***	***300%***	
Assume company assets first											
NCB											
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00
Distribution Rate	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Distribution NCB	**3,333.33**	**3,300.00**	**3,200.00**	**3,000.00**	**2,833.33**	**2,666.67**	**1,666.67**	-	-	-	**20,000.00**
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	56%	56%	56%	56%	56%	56%	56%	56%	56%	56%	56%
Maximum Distribution	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	5,555.56	55,555.55
Withdrawals (including NCB distribution)	(3,333.33)	(3,400.00)	(3,600.00)	(4,000.00)	(4,333.33)	(4,666.67)	(6,666.67)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**2,222.22**	**2,155.56**	**1,955.56**	**1,555.56**	**1,222.22**	**888.89**	-	-	-	-	**10,000.00**
Total distribution	**5,555.56**	**5,455.56**	**5,155.56**	**4,555.56**	**4,055.56**	**3,555.56**	**1,666.67**	-	-	-	**30,000.00**
Effective return	***56%***	***56%***	***56%***	***56%***	***56%***	***56%***	***67%***	***100%***	***200%***	***300%***	
Trust assets first	5,500.00	5,400.00	5,100.00	4,500.00	4,000.00	3,500.00	2,000.00	-	-	-	
Company assets first	5,555.56	5,455.56	5,155.56	4,555.56	4,055.56	3,555.56	1,666.67	-	-	-	
Variance	(55.55)	(55.55)	(55.55)	(55.55)	(55.55)	(55.55)	333.33	-	-	-	

On basis of $25k company assets , $5k trust assets

	Investor A	Investor B	Investor C	Investor D	Investor E	Investor F	Investor G	Investor H	Investor I	Investor J	
Contributions	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Withdrawals	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
NCB	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	(10,000.00)	(20,000.00)	
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00
Assume trust assets first											
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%
Maximum Distribution	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	1,600.00	16000
Pre-liquidation withdrawals of capital	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**1,600.00**	**1,500.00**	**1,200.00**	**600.00**	**100.00**	-	-	-	-	-	**5,000.00**
NCB											
Old NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	
New NCB Claim	8,400.00	8,400.00	8,400.00	8,400.00	8,400.00	8,000.00	5,000.00	-	-	-	55,000.00
Distribution Rate	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%
Distribution NCB	**3,818.18**	**3,818.18**	**3,818.18**	**3,818.18**	**3,818.18**	**3,636.36**	**2,272.73**	-	-	-	**25,000.00**
Total distribution	**5,418.18**	**5,318.18**	**5,018.18**	**4,418.18**	**3,918.18**	**3,636.36**	**2,272.73**	-	-	-	**30,000.00**
Effective return	***5,418.18***	***5,418.18***	***5,418.18***	***5,418.18***	***5,418.18***	***5,636.36***	***7,272.73***	***10,000.00***	***20,000.00***	***30,000.00***	
Assume company assets first											
NCB											
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00
Distribution Rate	42%	42%	42%	42%	42%	42%	42%	42%	42%	42%	42%
Distribution NCB	**4,166.67**	**4,125.00**	**4,000.00**	**3,750.00**	**3,541.67**	**3,333.33**	**2,083.33**	-	-	-	**25,000.00**
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	55%	55%	55%	55%	55%	55%	55%	55%	55%	55%	55%
Maximum Distribution	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	5,486.11	54,861.11
Withdrawals (including NCB distribution)	(4,166.67)	(4,225.00)	(4,400.00)	(4,750.00)	(5,041.67)	(5,333.33)	(7,083.33)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**1,319.44**	**1,261.11**	**1,086.11**	**736.11**	**444.44**	**152.78**	-	-	-	-	**5,000.00**
Total distribution	**5,486.11**	**5,386.11**	**5,086.11**	**4,486.11**	**3,986.11**	**3,486.11**	**2,083.33**	-	-	-	**30,000.00**
Effective return	***5,486.11***	***5,486.11***	***5,486.11***	***5,486.11***	***5,486.11***	***5,486.11***	***7,083.33***	***10,000.00***	***20,000.00***	***30,000.00***	
Trust assets first	5,418.18	5,318.18	5,018.18	4,418.18	3,918.18	3,636.36	2,272.73	-	-	-	
Company assets first	5,486.11	5,386.11	5,086.11	4,486.11	3,986.11	3,486.11	2,083.33	-	-	-	
Variance	(67.93)	(67.93)	(67.93)	(67.93)	(67.93)	150.25	189.39	-	-	-	

On basis of $15k company assets, $15k trust assets

	Investor A	Investor B	Investor C	Investor D	Investor E	Investor F	Investor G	Investor H	Investor I	Investor J	
Contributions	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Withdrawals	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
NCB	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	(10,000.00)	(20,000.00)	
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00

Assume trust assets first											
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Maximum Distribution	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	3,333.33	33333.33
Pre-liquidation withdrawals of capital	-	(100.00)	(400.00)	(1,000.00)	(1,500.00)	(2,000.00)	(5,000.00)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**3,333.33**	**3,233.33**	**2,933.33**	**2,333.33**	**1,833.33**	**1,333.33**	-	-	-	-	**15,000.00**
NCB											
Old NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	
New NCB Claim	6,666.67	6,666.67	6,666.67	6,666.67	6,666.67	6,666.67	5,000.00	-	-	-	45,000.00
Distribution Rate	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Distribution NCB	**2,222.22**	**2,222.22**	**2,222.22**	**2,222.22**	**2,222.22**	**2,222.22**	**1,666.67**	-	-	-	**15,000.00**
Total distribution	**5,555.56**	**5,455.56**	**5,155.56**	**4,555.56**	**4,055.56**	**3,555.56**	**1,666.67**	-	-	-	**30,000.00**
Effective return	***56%***	***56%***	***56%***	***56%***	***56%***	***56%***	***67%***	***100%***	***200%***	***300%***	

Assume company assets first											
NCB											
NCB Claim	10,000.00	9,900.00	9,600.00	9,000.00	8,500.00	8,000.00	5,000.00	-	-	-	60,000.00
Distribution Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Distribution NCB	**2,500.00**	**2,475.00**	**2,400.00**	**2,250.00**	**2,125.00**	**2,000.00**	**1,250.00**	-	-	-	**15,000.00**
Alternative											
Reference debt	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Maximum Distribution Rate	56%	56%	56%	56%	56%	56%	56%	56%	56%	56%	56%
Maximum Distribution	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	5,625.00	56,250.00
Withdrawals (including NCB distribution)	(2,500.00)	(2,575.00)	(2,800.00)	(3,250.00)	(3,625.00)	(4,000.00)	(6,250.00)	(10,000.00)	(20,000.00)	(30,000.00)	
Distribution Alternative	**3,125.00**	**3,050.00**	**2,825.00**	**2,375.00**	**2,000.00**	**1,625.00**	-	-	-	-	**15,000.00**
Total distribution	**5,625.00**	**5,525.00**	**5,225.00**	**4,625.00**	**4,125.00**	**3,625.00**	**1,250.00**	-	-	-	**30,000.00**
Effective return	***56%***	***56%***	***56%***	***56%***	***56%***	***56%***	***63%***	***100%***	***200%***	***300%***	

Trust assets first	5,555.56	5,455.56	5,155.56	4,555.56	4,055.56	3,555.56	1,666.67	-	-	-
Company assets first	5,625.00	5,525.00	5,225.00	4,625.00	4,125.00	3,625.00	1,250.00	-	-	-
Variance	(69.44)	(69.44)	(69.44)	(69.44)	(69.44)	(69.44)	416.67	-	-	-

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

TE KŌTI MATUA O AOTEAROA
TE WHANGANUI-Ā-TARA ROHE

CIV 2012-485-2591

UNDER	The Companies Act 1993 and the High Court Rules
IN THE MATTER OF	**ROSS ASSET MANAGEMENT LIMITED (IN LIQUIDATION) AND RELATED ENTITIES**
	JOHN HOWARD ROSS FISK AND DAVID JOHN BRIDGMAN as Liquidators of Ross Asset Management Limited (in Liquidation), Dagger Nominees Limited (in Liquidation), Bevis Marks Corporation Limited (in Liquidation), United Asset Management Limited (in Liquidation), McIntosh Asset Management Limited (in Liquidation), Mercury Asset Management Limited (in Liquidation), Ross Investments Management Limited (in Liquidation) Ross Investments Management Limited (in Liquidation) and Ross Unit Trusts Management Limited (in Liquidation)
	Applicants

SUBMISSIONS FOR EOIN DAVID FEHSENFELD

PRESENTED FOR FILING BY:

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MAY IT PLEASE THE COURT:

Introduction

1. Dr Fehsenfeld was the single largest investor in Ross Asset Management Limited ("RAM"). His introduction to the company and its principal David Ross, and the relationship that developed in which he was "cultivated" and systemically defrauded, is not untypical and began in the 1994.

2. By reason of the fact that he is the individual most affected in a consideration of differing distribution models, Dr Fehsenfeld has been given standing in this matter.

3. Dr Fehsenfeld is, in fact, the individual referred to "Investor A", as appearing at page 34 of Mr Fisk's affidavit of 11 December 2017. That records deposits by him of $7,800,004.74 and withdrawals of $2,185,040.76; a net difference of $5,614,963.98. These are CPI adjusted figures. (The difference between the figures as actually paid and withdrawn appears again in the schedule at page 21 of Mr Fisk's supplementary affidavit of 18 May.)

4. The Fraudster's modus operandi was one within which he selected and cultivated victims, inveigling himself into their confidence and often into their personal and family lives. Dr Fehsenfeld was one of these and was constantly implored to take advantage of "opportunities".

5. Material produced by the Liquidators shows Dr Fehsenfeld commencing his investments on 4 October 1994. The RAM records show five portfolio accounts. The schedule attached is a summary of payments to and withdrawals from RAM from the record provided by the Liquidators. (It is not CPI adjusted.)

6. The Court is asked to note that these figures are taken from the record the Liquidators have been able to extract. Dr Fehsenfeld (who is presently residing in Australia) has not been able to extract and analyse his own records against the many withdrawals and payments attributed to him in detail and some further enquiry will have to follow. However, for the purpose of this exercise it is clear that substantial deposits were made in the four years prior to liquidation against which there were no withdrawals.

Summary of Dr Fehsenfeld's submission as to the proposed Distribution

7. Dr Fehsenfeld's submission is that the "net contribution" model, as described by the Liquidator, is the only basis upon which distribution ought to be made whether under the Companies Act or in equity. This submission will develop points already made by the Liquidator; namely:

   - That such an approach is the only approach that reasonably complies with the Liquidator's duty in respect of company funds.
   - That the net contribution (or "pari passu" or "pro rata") distribution model is orthodox and consistent with expectations in all insolvencies, including those resulting from fraud and whether at "law" or in "equity".
   - That the alternative models are artificial, unwieldly and lead to uncertainty.
   - That comparison with United States insolvency cases may not be valid.
   - That in the facts of this case the proposed alternative models cause significant injustice.

8. As to the matter raised by Amicus as to "separate" funds, the analysis brought to the matter, while correct as far as it goes, is to

invite a distinction as to distribution of those funds on one of the two alternative distribution models, and if applied to Dr Fehsenfeld would deprive him of any portion of that fund, notwithstanding that he has almost certainly contributed towards it.

9. There is some doubt as to the actual quantum of withdrawals but, on the information presently available, it is undisputed that between October 2009[1] (the last withdrawal) and the date of liquidation, Dr Fehsenfeld provided cash to RAM of $2,729,763.60 against which there were no withdrawals.

10. There was said to be a withdrawal on 24 April 2008 across four portfolios totalling $1,052,074.21. (The total quantum of the withdrawal is in doubt.) The balance of the other withdrawals taken into account in the figure are spread between 1995 and 2003.

11. Thus, even on this cursory view, the effect of the alternative distribution model is glaring in that Dr Fehsenfeld will have made a recent contributions totalling $2,729,763.60 in cash into a fund from which, under either alterative model, he not only receives nothing himself, but effectively provides a benefit to others.

12. A further illustration of the effect of the proposed alternative models is shown when viewing the withdrawals themselves. His first withdrawal of $15,000.00 occurred on 20 October 1995. That transaction, more than seventeen years prior to the liquidation, counts against him in favour of those who may have joined the scheme much later, on the one hand, and, on the other hand, those who have been fortunate enough to have withdrawn capital retain it and contribute nothing.

[1] There are two withdrawals shown in October 2009; one of $15,393.75 in Portfolio 222 and the other of $212,818.38 in Portfolio 805. On the same day, however, there is a deposit in Portfolio 682 of $212,818.38. Thus, it appears almost certain that $212,818.38 was not withdrawn at all.

13. Finally, for the purposes of this overview, the significant injustice that would result from alternative distribution models is simply illustrated by the fact that a deduction from the existing contribution amount representing funds previously withdrawn ignores the almost certain fact that funds or capital withdrawn in the previous fifteen years has been reintroduced.

The Liquidators' and Amicus' submissions as to Distributions

14. It is not proposed to traverse the helpful and full submissions put forward by the Liquidators' Counsel and Counsel appointed to assist, as it relates to the analysis of those funds recovered by the Liquidators pursuing the Liquidators' clawback remedies.

15. Both submissions agree that these are company funds and that the orthodox application arising from Section 313 of the Companies Act results in an application of what is described as a net contribution or "pro-rata" distribution of those funds (approximately $19 million) to creditors, including Dr Fehsenfeld.

16. To the extent necessary, he adopts and agrees with those submissions and conclusions.[2]

17. Both Counsel recognise that there is a fund effectively held on trust for investors, as characterised differently to the funds that are properly seen as "assets of the company".[3]

18. For Dr Fehsenfeld it is submitted that on the facts of this case, pari passu or "net contributions" is also the only equitable method of achieving "***the least unfair result for the investors***" (as His

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[2] Submissions for Liquidators, paras 5.13 and 5.20 and Amicus at paras 37 and 54.
[3] Para. 5.67 Liquidators' submission.

Honour Justice Williams held in *Re International Investment Unit Trust*[4]).

19. As to whether or not funds are to be "pooled" and whether or not distribution of trust funds should be on a basis other than pro rata or net contributions, the suggested approach is that the equitable response to the distribution question rather defines the answer. If equity requires a pro rata distribution, it matters not whether there is one fund or two.

20. There are five essential points to develop.

    (i) Firstly, in our jurisprudence Parliament has enacted law applicable to creditor payments in both the Insolvency Act and Companies Act which attempts to restore some equality between the creditors of insolvent persons or entities who have suffered loss. While equity may aid the common law, it ought not defeat it. Should equity respond to a situation in which the law entitles one creditor to retain all of the capital withdrawn during the insolvency period to the disadvantage of other creditors by enabling a liquidator "in equity" to remediate that by denying another creditor any portion of his or her capital? To do so defeats the spirit of the law developed by Parliament for these very situations.

    (ii) Secondly, with one possible exception, the cases that have considered the point in New Zealand have all consistently concluded that where tracing is not realistic, equity calls for the equal distribution of "mixed funds" such as here, with one possible exception. The cases have been referred to by both Counsel and are respectively *Re International*

[4] *Re International Investment Unit Trust (in Statutory Management)* [2005] 1 NZLR 270 at para. 73.

Investment Unit Trust (in Statutory Management) [2005] 1 NZLR 270; *National Australia Bank NZ Limited v Tuck* [1995] NZCLC 66, 248; *Re Waipawa Finance Company Limited (in Liq.)* [2011] NZCCLR 14.

(iii) Thirdly, it seems to Counsel that there is a flaw in the proposed distribution models themselves, which is touched upon in paragraph 13 above, in that the money of investors like Dr Fehsenfeld is effectively double counted.

(iv) A second flaw in the models proposed, touched upon in paragraph 9 above, is that fresh deposits made to the company in the four years prior to its liquidation are disqualified as to any applicable dividend by reason of withdrawals as much as seventeen years prior to liquidations. This cannot be "equitable".

(v) It ought not be assumed that American cases lend themselves to comparison with New Zealand law or practice.

(i) The comparative relevance of insolvency rules under the Insolvency Act and Companies Act applicable to Trust Funds

21. Both the Insolvency Act and Companies Act have provisions laid down by Parliament applicable to an equalisation of "loss" between the victims of insolvency, whereby an assignee or liquidator may require restoration of funds paid out during a period of insolvency to the company for the benefit of the general body of creditors.

22. It would be an anomaly then if an insolvent company's property is held by reason of a statutory trust, where the primary equitable remedy of tracing is not possible, that it is required to distribute on a different basis. The effect is graphically illustrated by the *McIntosh* case itself. Mr McIntosh has retained all of his capital by

reason of his good fortunate in having withdrawn it. The Supreme Court, by a majority, has ruled that Mr McIntosh, in effect, gave value to the company. (In fact that that value was nothing other than in reality the ability to perpetuate fraud by giving his money to someone else unlawfully has made no difference). Someone who deposited $500,000.00 on the same day as Mr McIntosh, but drew nothing, will receive back a small percentage of his or her capital, and Mr McIntosh has retained 100 percent.

23. Equity cannot cure that, but to impose a rule whereby capital remaining in the company is to be taxed against "partial" withdrawals is to defeat the legal principle. One party who withdrew his capital is not penalised. Another party who withdrew part of his capital is penalised to 100 percent of his dividend entitlement.

(ii) **The prior Legal Cases**

24. As referred in (ii), the possible exception, as referred to by Amicus, is *Re Trans Capital Limited (in Liq.) (No. 4)* HC Wellington M84/99 22/5/2000 Wilde J, which is dealt with below.

25. As Amicus has correctly pointed out, the Court in that case effectively applied an alternative model, having determined that the Liquidator was the trustee of trust monies and characterised claims as "base claims" or "residual claims". (Base claims being calculated on the basis of investments less withdrawals, in the same manner as is proposed in the alternative model.)

26. To understand the case, some regard must be had to the facts, which were essentially that the affected creditor (Pacific Marina) had paid $600,000.00 to Trans Capital, but had not done so as an investor, rather as a deposit against a loan Trans Capital was to grant to it of $2.4 million for the purpose of construction of a

marina in Lyttleton Harbour. The $600,000.00 had been deposited with a (now disgraced) lawyer acting for Trans Capital, who had misapplied much of them. Pacific Marina had received $341,000.00 as part of the overall advances to be made under the loan contracts.

27. In theory, a $600,000.00 deposit remained. For Pacific Marina, it was argued that its receipt of the $341,000.00 was in its capacity as a "bona fide purchaser for value without notice". Therefore, the advance of $341,000.00 could not be clawed back and the creditor was entitled to a dividend based on the $600,000.00 deposit.

28. To remedy this, His Honour adopted a "base claim" value and, although it is not entirely clear on Counsel's reading of the Judgment, it would appear that through this approach what is effectively the alternative distribution model was adopted because it appeared to go on to stipulate that the withdrawal was treated as a distribution. (It is not entirely clear to this Counsel, but His Honour expressly approved an example put forward by Counsel at paragraph 35 of the Judgment, which seems to have this effect. The Judgment contains an order attached as a schedule, which, with respect, does seem ambiguous.)

29. Accepting, however, for the purpose of argument, that this is an application of an alternative distribution model, the facts were significantly different and for Dr Fehsenfeld it is simply submitted that the approach adopted by the Court in *Arena* and *Waipawa* is to be preferred.

30. The case further categorised creditors as categories "A" (those advantaged if funds were not deemed to be trust funds), "B" (those advantaged if trusts were found) (with tracing to follow) and "C" (those advantaged by "pooling").

31. The citation is for the fourth decision. There was a third decision in which the above creditor categories were identified.

(iii) **Both the ADM and Rising Tide models work an injustice on the facts and are "flawed"**

32. To hypothesise: On the ADM as proposed, an investor who had deposited $2 million at the early stage of the scheme, withdrew $1 million (say, to buy a house) and then reintroduced the $1 million after selling the house, has "invested" $3 million, but has "withdrawn" $1 million; he or she receives no dividend.

33. There is very little, if any, commentary upon this. To the extent that ADM's have been considered in New Zealand, and Judges have directed their minds to the matter, the prospect of funds being withdrawn and then reinvested does not seem to have been considered.[5]

34. Having raised this with the Liquidators, I am indebted to the diligence of the Liquidators' Counsel who have pointed to what commentary there is in the US case, *SEC v Huber*, referred to by both Counsel for the Liquidators and Amicus. It contains the following passage:

> *"We are given pause, however, by the situation of an investor who having withdrawn some money from the Ponzi scheme then reinvests it. Suppose he had initially invested $150,000 and then, shortly after withdrawing $50,000 he reinvested it, thus restoring his balance to $150,000, all of which he lost when the scheme collapsed. Under the rising tide method he would be credited with having invested $200,000 ($150,000 plus $50,000) and having recouped a quarter of that amount by his withdrawal, and thus would receive a reduced share of recovered assets compared to a*

[5] Just as Mr Fisk has done in his affidavit, Mander J put a hypothesis to himself at para. 32 of the Judgment in *Arena Capital*.

> *person who had invested $150,000 and lost it without any interim withdrawals. We can't see why those two investors should be treated differently, as would be obvious if the withdrawals and reinvestment had occurred on successive days. In cases of withdrawal followed by reinvestment, the investor's maximum balance in the Ponzi scheme ($150,000 in our example) should be treated as his investment; the withdrawals, having in effect been rescinded, should be ignored."*

35. Under the alternative distribution model or Rising Tide model, as described, if the hypothetical situation proposed by Mander J is considered, were client 1 to have reinvested his $2,000.00, his total contributions would be $7,000.00, yet he would be counted as having already received a $2,000.00 dividend.

36. Thus, it is plain that the point, as described above, has not been considered and it is submitted that the simple proposition described is enough to illustrate that neither the rising tide or ADM will, in fact, do equity on the facts of this case.

(iv) **"Fresh" Deposits**

37. As set out in paragraph 9 above, Dr Fehsenfeld is said to have withdrawn approximately $1 million in 2008. There was a very small net withdrawal in 2009 of approximately $15,000.00, after which he has introduced nearly $3 million without deduction or withdrawal. Dr Fehsenfeld's funds have either been given to other creditors or possibly formed part of the "trust" fund. It is by no means clear.

38. Whatever the circumstances, these are fresh funds and could not be possibly be tainted by bona fide capital withdrawals made many years earlier. To do so is inequitable and is tantamount to saying that he is denied all remedy because of the extent of the

effectiveness of the fraudster's actions in defeating the Liquidators and Investigators, thereby advantaging others. This is simply wrong thinking and cannot accord with anyone's view of equity.

(v) **The validity of US Comparisons**

39. New Zealand has its own well developed insolvency jurisprudence. The argument for alternative models is based almost entirely on consideration being given to Ponzi schemes in the US. US insolvency law is not thought to mirror New Zealand's. The cases referred to; particularly *Waipawa* and *Arena*, illustrate predictable, reasonable and equitable responses and should be applied.

Dated this 15th day of June 2018

D G Dewar
Solicitor/Counsel for Eoin Fehsenfeld

DR FEHSENFELD – PAYMENTS BY YEAR

	Deposits $	Withdrawals $	Net $
1994	166,022.00	Nil	166,022.00
1995	35,453.00	32,020.14	169,454.86
1996	65,390.00	Nil	234,844.86
1997	Nil	Nil	
1998	Nil	120,000.00	114,844.86
1999	Nil	50,000.00	64,844.86
2000	Nil	Nil	
2001	Nil	100,000.00	-35,155.14
2002	Nil	250,000.00	-285,155.14
2003	174,155.35	22,000.00	-132,999.79
2004	Nil	Nil	
2005	830,392.33	Nil	697,392.54
2006	1,842,088.85	Nil	2,539,481.39
2007	1,024,086.79	Nil	3,563,568.18
2008	Nil	1,092,074.21	2,471,493.97
2009 *	212,818.38	228,212.13	2,456,100.22
2010	1,450,198.00	Nil	3,906,298.22
2011	198,264.29	Nil	4,104,562.51
2012	868,716.84	Nil	4,973,279.35
Totals	6,867,585.83	1,894,306.48	4,973,279.35

In the High Court of New Zealand Wellington Registry **CIV 2012-485-2591**
I Te Kōti Matua o Aotearoa Te Whanganui-ā-Tara Rohe

Under the Companies Act 1993 and the High Court Rules
In the matter of Ross Asset Management Limited (in liquidation) and related entities

Between

John Howard Ross Fisk and David John Bridgman, as liquidators of Ross Asset Management Limited (in liquidation), Dagger Nominees Limited (in liquidation), Bevis Marks Corporation Limited (in liquidation), United Asset Management Limited (in liquidation), McIntosh Asset Management Limited (in liquidation), Mercury Asset Management Limited (in liquidation) Ross Investments Management Limited (in liquidation) and Ross Unit Trusts Management Limited (in liquidation)

Applicants

and

Eoin David Fehsenfeld,

Respondent

Submissions for the Applicants

18 May 2018
For hearing on **22 June 2018**
Judicial Officer: Associate Judge Johnston

BELL GULLY
BARRISTERS AND SOLICITORS

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May it please the Court:

1. Introduction

1.1 Ross Asset Management Limited (**RAM**) and its related companies were placed into liquidation on 17 December 2012. RAM was operating a Ponzi scheme.

1.2 At the time of its collapse, RAM purportedly held investments worth $449.6 million on behalf of over 860 investors (**Investors**). To date, only approximately $3.72 million of those investment assets have been located and realised.[1] Almost all investment assets purportedly held for Investors were a fiction.

1.3 The payments received by Investors as the purported "profits" on their investment were mostly funded by new deposits from other Investors or the sale of shares other than those supposedly held for that Investor in their portfolio.

1.4 The Liquidators have, to date, also received approximately $18.5 million in settlement payments from such Investors in relation to payments by RAM to them.[2]

1.5 The Liquidators currently hold total funds of approximately $18.8 million.[3]

1.6 RAM's liquidation is on-going. However, the Liquidators consider that they are now in a position to make an interim distribution of $17.5 million.[4] They seek directions to facilitate this.

1.7 Given that RAM's operations were a Ponzi, the distribution of its assets raises a number of complex and novel issues. The most significant

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[1] Affidavit of John Howard Ross Fisk sworn 11 December 2017 (**First Fisk Affidavit**), para 1.3.

[2] Affidavit of John Howard Ross Fisk sworn 18 May 2018 (**Second Fisk Affidavit**), para 7(y).

[3] Second Fisk Affidavit, para 6.

[4] Second Fisk Affidavit, para 4.

issue in this Application is how to distribute the assets between the various groups of Creditors and Investors in RAM.

1.8 The Liquidators' analysis shows that 639 Investors paid RAM more than they received from RAM (after an adjustment for the Consumer Price Index (**CPI**)) (**Shortfall Investors**). Their claims total $124,709,390.34 (calculated on the basis, for each Shortfall Investor, of total amount paid to RAM, less total amount received by RAM, each amount being adjusted for CPI).[5]

2. Summary of issues and directions sought

2.1 The Court's overarching task in respect of this application is aptly summarised by Williams J in *Re International Investment Unit Trusts* [2005] 1 NZLR 270:[6]

> To meet, as far as it can now be met, their common misfortune, what is required is a search for the least unfair result for the investors, bearing in mind that regrettably, no method of distribution will result in perfect justice for all.

2.2 The issues in this application can be separated into three categories as follows:

Orders as to pooling and pools

2.3 The Liquidators seek directions that the assets of RAM and its related entity, Dagger Nominees Limited (in liquidation) (**Dagger**), be pooled and the liquidation of the two companies proceed as if they are one company.

(a) The Liquidators do not expect this direction to be contentious and it is supported by counsel assisting the court. The two companies were in effect run as one, and both were parties to the standard investment management agreement with all Investors.

[5] First Fisk Affidavit, para 5.4.

[6] *Re International Investment Unit Trusts* [2005] 1 NZLR 270 at [73].

(b) Dagger has no creditors of its own (save for Investors). Therefore, no party is prejudiced by this order.

2.4 The Liquidators seek a direction that there should be only one common pool of assets for distribution for both general unsecured creditors and Investors rather than two pools of assets (a trust pool and a general pool of assets) with Investors (only) having a claim on the trust pool and both general unsecured (non-Investor) creditors (**Creditors**) and Investors having a claim in the general pool. The Liquidators seek this direction on the basis that:

(a) Creditors total less than $70,000.[7] It would be uneconomic to seek to distinguish between them and Investors for the purpose of distribution.

(b) However, the one common pool direction could become the focus of greater attention if the Court considered it were constrained by the provisions of the Companies Act 1993 (the **CA**) in relation to its choice of distribution models (see below).

Orders as to the basis of distribution

2.5 The basis for the distribution of the assets now held by the Liquidators is the key issue.

2.6 The Liquidators have put forward two alternative distribution models (which are described in the First Fisk Affidavit and summarised in Part Four below):[8]

(a) The **Net Contributions Model** which is largely based on the usual approach to distributions to creditors; i.e. the amount owing to them as at the date of liquidation. The Liquidators also seek a direction that distributions only be made to Shortfall Investors.[9] To be clear, this would preclude distributions to Investors on the

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7 First Fisk Affidavit, para 1.5(b).

8 See Fisk Affidavit, paras 9.13 – 9.37.

9 See Application for Directions, order 1(c)(ii).

basis of a contingent claim against RAM quantified, for example, on the basis of a lost opportunity to earn investment returns.

(b) The **Alternative Model** which seeks to take into account pre-liquidation payments by RAM to Shortfall Investors to achieve what is, on one view of it, a fairer overall outcome amongst Shortfall Investors.

2.7 The two models present quite different outcomes for Investors.

2.8 Counsel assisting the court has proposed a further distribution model, the **Rising Tide Model** which also takes into account pre-liquidation payments by RAM in a manner similar to the Alternative Model. The Liquidators consider that the Rising Tide Model produces the same result as the Alternative Model for Investors.[10]

2.9 There is a preliminary legal issue as to whether the Court has the jurisdiction under the CA to order that company assets can be distributed in a manner other than the one based on the Net Contributions Model.

2.10 If this Court were to determine that it did not have the jurisdiction to order that company assets can be distributed pursuant to the Alternative Model or the Rising Tide Model (or otherwise), the one pool or two pools issue explained at paragraph 2.4 above becomes significant. This is because a further issue would then arise as to whether a two pool approach could enable the Court to distribute the company assets (i.e. the general pool) pursuant to the Net Contributions Model, but the trust assets (i.e. the trust pool) pursuant to a different model and if so, whether the Court should make such an order.

2.11 The Liquidators also seek directions:

(a) that Investor contributions and withdrawals be adjusted for CPI for the purpose of calculating distributions. Counsel assisting the

[10] Second Fisk Affidavit, paras 13, 15 and 22.

court has recommended that this issue be substantively argued at the hearing; and

(b) confirming the correct treatment of transfers or purported transfers of value between RAM portfolios for the purpose of distribution. This direction is not expected to be contentious and is supported by counsel assisting the court.

Ancillary orders

2.12 The Liquidators seek orders designed to progress and expedite the liquidation, including payment of the Liquidators' costs from the common pool of assets, an alternative procedure to the standard proof of debt process and a process for dealing with unclaimed distributions. These orders are not expected to be contentious.

2.13 The Liquidators consider that the directions sought are consistent with their principal duty to realise and distribute the assets held in the Ross Group liquidation in a reasonable and efficient manner.[11]

Roadmap of submissions

2.14 The body of these submissions deals with orders which may be contentious. The submissions as to the other orders are detailed in schedules to these submissions.

2.15 These submissions have the following parts:

(a) Relevant Factual Background.

(b) Overview of the three proposed distribution models.

(c) Whether the Court can order a distributions model other than the Net Contributions Model.

(d) The Most Appropriate Distributions Model.

(e) Adjustments for CPI.

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[11] Companies Act 1993, s 253.

(f) Conclusion.

(g) Schedule One: List of orders sought.

(h) Schedule Two: Pooling orders and one pool or two.

(i) Schedule Three: Common features of the distributions models.

(j) Schedule Four: Ancillary Orders.

3. Relevant factual background

3.1 The relevant factual background is detailed in the affidavits of John Howard Ross Fisk, sworn 11 December 2017 (the **First Fisk Affidavit**) and 18 May 2018 (the **Second Fisk Affidavit**).

3.2 Since the early 1990s RAM marketed itself as offering investment services to its clients. RAM's sole director was Mr David Ross. Mr Ross had sole responsibility for all (supposed) funds management, research and investment decisions made by him on behalf of clients or by RAM.[12]

3.3 Ross Group investors typically entered into an agreement with RAM and a related party, Dagger Nominees Limited (**Dagger**), when placing their investments with RAM (the **Management Agreement**).[13]

3.4 The Management Agreement provided that shares were to be legally owned by Dagger, beneficially owned by the respective investors and managed by RAM. Any cash in an investor's portfolio was to be held in a bank account in the name of that investor.[14]

3.5 Investors were led to believe that if they transferred money or shares to RAM, this was in turn transferred to Dagger who would hold those shares and cash on their behalf. Any cash withdrawals that the

[12] First Fisk Affidavit, para 3.1.

[13] First Fisk Affidavit, para 3.2.

[14] First Fisk Affidavit, para 3.3.

investors wished to make would be received from RAM following the sale of shares by Dagger.[15]

3.6 In exchange for providing these services RAM was entitled to receive various management fees and transaction fees. However, in reality, these fees were not paid.[16]

3.7 Investors were provided with quarterly reports for each of their portfolios which purported to record transactions within their portfolio. However, the reports were fictitious.[17]

How the Ross Group actually operated

3.8 In reality investor monies were not dealt with as investors had been led to believe. In particular:

(a) Cash or shares were transferred by investors to RAM or, occasionally, a broker used by RAM. Rather than being immediately transferred to Dagger and kept separately, on trust, for the respective investors, they became part of a diminishing pool of shares and cash owned by the Ross Group.[18]

(b) The pool of assets was used to pay the operating expenses of RAM, personal drawings by David Ross and payments to investors and share purchases.[19]

(c) In substance RAM operated one bank account in its own name through which such payments and deposits were made. This main bank account had significant fluctuations and was occasionally in overdraft.[20]

(d) If funds were obtained from investor deposits, these "new" investor funds were intermingled with other monies received by

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15 First Fisk Affidavit, para 3.4.

16 First Fisk Affidavit, paras 3.5 – 3.6.

17 First Fisk Affidavit, paras 3.7 and 3.12.

18 First Fisk Affidavit, para 3.9.

19 First Fisk Affidavit, para 3.9.

20 First Fisk Affidavit, paras 3.10 and 6.6.

RAM, such as the proceeds of sale of shares or dividends. These intermingled funds were then used for trade creditor payments, wages, the purchase of shares and payments to investors.[21]

(e) If there were insufficient funds available then shares owned by any of the companies within the Ross Group were sold and the proceeds paid to RAM to enable RAM to meet payments. The shares actually sold to pay monies to investors did not usually match the shares which RAM reported it was selling in its quarterly reports to investors.[22]

3.9 The effect of the above arrangements was that RAM was running a Ponzi scheme which was dependent on new investors investing money to pay prior investors. In fact, investor deposits were mostly used to repay previous investors, rather than to purchase shares.[23]

3.10 Mr Ross admitted, through the Agreed Summary of Facts in the criminal proceedings brought by the Serious Fraud Office, that he had since at least June 2000:[24]

(a) deliberately or purposefully dealt with investor funds otherwise than in accordance with the agreed terms by using investor funds to repay other investors' investments and to fund the operations of RAM; and

(b) was running a Ponzi scheme.

3.11 The June 2000 date was the focus of the criminal charges as RAM changed its computer system at that date. It did not have computer records available prior to that time.[25] However, evidence suggests the

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[21] First Fisk Affidavit, paras 3.9 and 3.11.

[22] First Fisk Affidavit, paras 3.11 – 3.12.

[23] First Fisk Affidavit, para 3.13.

[24] First Fisk Affidavit, para 3.16 and exhibit pages 92 – 99 at [28] – [29].

[25] First Fisk Affidavit, paras 4.3 – 4.4.

Ponzi was well entrenched by June 2000, and was likely in existence as early as the early 1990s.[26] In particular:[27]

(a) As at June 2000, approximately 60% of shares by value were recorded by RAM as being held by "Bevis Marks". Bevis Marks was a fictitious broker Mr Ross used to record fictitious shareholdings. Accordingly, as at June 2000, it is likely that at least 60% of the shareholdings (by value) RAM reported as holding for investors were fictitious.

(b) The Liquidators have "tracked back" in some cases when shares recorded as held by the fictitious broker as at June 2000 were reported by RAM as first purchased. The Liquidators have tracked back Bevis Marks shares as being reportedly acquired as early as 1997.

(c) RAM's hardcopy records show that the intermingling of investors' funds, which is a key aspect of the Ponzi, was occurring at least as early as 1996.

(d) Since the early 1990s, ANZ Nominee bank statements for investors are inconsistent with what the Liquidators would expect to see if cash held by RAM or Dagger on behalf of the investor was being held separately, as required by the terms of the Management Agreement.

3.12 Accordingly, the Liquidators believe that RAM had been running a Ponzi since the 1990s.[28] As explained below, the long running nature of the scheme has given rise to a number of novel legal and practical issues.

3.13 The scale of the Ponzi is unprecedented in New Zealand. At the time of RAM's receivership, it was purportedly holding 958 individual investment portfolios for over 860 individual investors. (There had been a total of 1,720 total portfolios purportedly held, but some of those

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[26] First Fisk Affidavit, para 3.17.

[27] First Fisk Affidavit, paras 4.3 to 4.11.

[28] First Fisk Affidavit, para 4.11

had been "closed" prior to the receivership.)[29] The volume of transactions undertaken by RAM through its bank accounts in any given month were significant. The volume of share transactions reported by RAM in any given month were also significant, although many of these transactions may well have been fictitious.[30]

4. Overview of the three proposed distribution models

4.1 As outlined above, there are three proposed distribution models: the Net Contributions Model, the Alternative Model and the Rising Tide Model.

4.2 The key difference between these models is how pre-liquidation withdrawals by an Investor are treated.

4.3 Before considering the differences between these models, it is important to identify the three common key features.

(a) First, no model would involve the tracing of particular investor assets, due to the significant costs and practical difficulties associated with such an exercise.

(b) Second, only Shortfall Investors would be eligible for distribution payments. Investors who, at the time of RAM's liquidation, had already been paid more by RAM than they had contributed (**Overpaid Investors**) would not receive any distribution.

(c) Third, claims would be calculated based on contributions (payments or transfers of shares) made by or on behalf of the Investor to RAM, less payments made by RAM to, or on behalf of, the Investor. That is, claims would not take into account any purported "profits" earned on an Investor's RAM investment.

The reasons for these three common features is explained in detail in Schedule Three; the jurisdiction to order a distributions model based on the second and third of the common features is discussed below.

[29] First Fisk Affidavit, para 4.18.

[30] First Fisk Affidavit, paras 4.19 to 4.20.

4.4 The issue of a CPI adjustment is addressed in Part 7 of these submissions. If a CPI adjustment is to be applied, it will be applied equally to any of the three models, as explained in the First Fisk Affidavit. For ease of explanation, the explanations below ignore any CPI Adjustment.

Jurisdiction to order the common key features

4.5 Investors may have claims for damages against RAM outside of one which simply seeks their net contributions balance. In particular, a damages claim for the lost opportunity to make an investment return. Such a damages claim is an admissible claim pursuant to section 303(1) of the CA.

4.6 However, the reality of RAM's liquidation is that:

(a) Shortfall Investors will only receive a fraction of their lost capital contributions. The current expected dividend (based on the CPI adjusted net contributions model) is 14 cents in the dollar.[31]

(b) There is a finite pool of money available for distribution to investors. Any return to Investors in respect of a damages claim for the loss of an opportunity to make an investment return will reduce the return available to investors on their lost capital contributions. The Liquidators consider that the fairest approach is that lost capital contributions be paid in priority to other contingent claims against RAM.

(c) To require the Liquidators to consider claims other than simply on a net contribution balance basis will be time consuming and complex. The Second Fisk Affidavit details some of these complexities at paragraphs 46 to 54. The Liquidators consider that it will result in a distributions process which is time consuming and fraught. It will add further complexity, increase investor confusion about their expectations in the distributions process, and in turn will increase the costs of the liquidation.

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31 Second Fisk Affidavit, para 32(b).

(d) It will also have an immediate effect on the interim distribution proposed. The Liquidators are currently proposing to make an interim distribution from $17.5 million of funds. This distribution fund assumes total claims of $124,709,390.34 (net contribution of claims for Shortfall Investors adjusted for CPI).[32] Requiring the Liquidators to consider other potential claims means that there is an unknown value of claims which the Liquidators have not, and indeed currently cannot, quantify. Accordingly, in the absence of the order sought excluding such claims from the distribution model, the Liquidators would need to delay paying out an interim distribution until they had a better assessment of the likely value of such claims.[33] This would be in no-one's interests.

4.7 Section 284 of the CA provides the Court with a wide discretion to make orders necessary for a liquidation to proceed in a pragmatic manner and have granted orders which achieve a similar result.

4.8 In *Re Kiwi International Airlines Limited (in liquidation)*[34] the Liquidators sought orders relieving them of their duty to account to unsecured creditors, where the distribution would be less than one cent in the dollar at best, and there were unresolved issues which could cost all of the available funds to resolve.

4.9 The Court held:

(a) The duty under section 253 of the CA (to realise and distribute the assets in a reasonable and efficient manner) does not require the liquidators to take all usual steps regardless of the likely outcome. The duty is to take what steps are reasonable and efficient towards the end purpose of distribution.[35]

(b) The starting point must be that the unsecured creditors should be treated equally. However, common sense must also be applied

[32] Second Fisk Affidavit, para 53.

[33] Second Fisk Affidavit, para 53.

[34] *Re Kiwi International Airlines Limited (in liquidation)* HC Auckland CIV-2005-404-7051, 26 July 2006.

[35] *Re Kiwi International Airlines Limited (in liquidation)* at [15].

in unusual cases, rather than slavish adherence to that starting point.[36]

(c) An insolvent liquidation invariably creates difficulty and hardship. Resolution frequently requires "a certain arbitrariness of result".[37]

(d) Given the circumstances of that case; being a large group of creditors, claims far greater than the comparatively small realised surplus and unresolved practical difficulties facing any distribution, there were realistically only two options available – adopt the liquidators' proposal or require all unsecured creditors to complete a process which had all the prospects of becoming an exercise in futility for most if not all of the creditors.[38]

Accordingly, the Court granted the order relieving the liquidators of their duty to account to unsecured creditors and ordering them to pay the remaining funds into the Crown Liquidation Surplus Account, on the basis that it was the "least unfair result for the creditors as a whole."[39]

4.10 In *Re HIH Casualty and General Insurance (NZ) Limited*[40] the Court achieved a similar result by a different route. In *Re HIH* there were policy holders who could claim against either HIH (in liquidation) or QBE, a solvent insurer who had assumed liability for a number of policies. The Liquidators sought directions that:[41]

(a) the claims of such policyholders be deemed to not be a claim against HIH for the purpose of section 303 of the CA; or

(b) alternatively, that for the purpose of any distribution, that such a claim by those policyholders be valued at zero and that the liquidators were not required to make any provisions for those claims.

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[36] At [23].

[37] At [31].

[38] At [32].

[39] At [33].

[40] *Re HIH Casualty and General Insurance (NZ) Limited* HC Auckland CIV-2003-404-2838, 17 December 2003.

[41] *Re HIH* at [7].

4.11 The Court stated, that while it was not necessary to decide the point, its preliminary view was that the power under s 284 did not extend to declaring that a claim under a contract was not a "claim" for the purpose of s 303 of the CA. It considered that such an order was an alteration of contractual rights of a third party, not a direction to the liquidator.[42] However, the Court granted the direction that such claims would be valued at zero for the purpose of a distribution in the liquidation, noting that were sound commercial reasons for giving this direction.[43]

4.12 This direction was given in reliance on s 284 of the CA. An equivalent order could have been made under s 307(1)(b) of the CA which provides:

> If a claim is subject to a contingency, or is for damages, or, if for some other reason, the amount of the claim is not certain, the liquidator may –
>
> (b) refer the matter to the court for a decision on the amount of the claim.

4.13 Notably, the Court in *Re Kiwi International Airlines Limited* distinguished *Re HIH* on the basis that there were sufficient funds to meet all potential claims under the policies, due to QBE's assumption of those policies, meaning there were not the practical or economic difficulties facing the liquidators in *Re Kiwi International Airlines Limited.*[44]

4.14 Accordingly, the Court can make the orders that net contribution claims will be paid in priority to any other claims Investors may have against RAM or Dagger. It can make these orders by way of any of the following:

(a) Pursuant to the general power under section 284, to direct that either:

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[42] *Re HIH* at [17]. The Courts have repeated this concern about using section 284 to curtail contractual rights in *obiter* statements in *McGreal Floor Coverings Limited (in liquidation) v McGreal* [2014] NZHC 2884 and *Madsen-Ries v Greenhill* [2016] NZHC 3188.

[43] *Re HIH* at [17].

[44] *Re Kiwi International Airlines Limited* at [18].

(i) the Liquidators:

A. can value any claims lodged by an Investor on any basis other than a negative net contributions balance (as adjusted for CPI if so ordered) as having a value of zero; and

B. are not required to make any provisions for those claims; or

(ii) the Liquidators only be required to make a distribution in respect of any claim lodged by an Investor on any basis other than a negative net contributions balance (as adjusted for CPI if so ordered) when claims by Investors on the basis of a negative net contributions balance (as adjusted for CPI if so ordered) have been paid in full.

(b) Pursuant to section 307(1)(b), valuing these claims at zero.

4.15 This approach to such claims is consistent with the approach the Court has taken in similar Ponzi liquidations (although the distribution of assets in these instances were not governed by the CA). In particular:

(a) In *Arena*, the Court held "As between innocent beneficiaries a division of assets based on the contribution of each investor is to be viewed as the only "rationale mode of distribution" in order to achieve substantial justice between the parties."[45] The Court adopted the Net Contributions Model in that case.

(b) In *Re Waipawa*, the distribution was based on payments in and payments out, as adjusted for the constant dollar approach. In that case, the Court noted that given the fictitious nature of the purported "interest" on investments, if the liquidators used the funds to pay "interest" it would be tantamount to furthering the fraud.[46]

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[45] *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [17].

[46] *Re Waipawa Finance Company Limited (in liq)* [2011] NZCCLR 14 (HC) at [30].

(c) It is also consistent with overseas authority. In particular, it is consistent with the approach taken in the Madoff litigation. In that litigation, investors argued that the Trustee should not quantify claims based on the net contributions method, but rather the last statement method, based on the securities which were reported by Madoff to investors as held for them. However the US Court of Appeals found that if the Trustee did adopt an approach other than the net contribution method, "the whim of the defrauder would have controlled the process that is supposed to unwind the fraud".[47]

The Net Contributions Model

4.16 The Net Contributions Model is a more orthodox approach to distributions in a liquidation. If focuses on the amount owed by RAM to the Shortfall Investor as at the date of liquidation. It calculates the claim by taking into account all deposits and withdrawals made by the Investor and calculating a running account balance (also known as the **Net Contributions Balance**). This figure becomes the Reference Debt for that Investor. The calculation for that Investor would then become:

Reference Debt x Rate (being the amount available for distribution ÷ sum of all Reference Debts) = Distribution.

4.17 This model does not treat Investors differently, based on pre-liquidation withdrawals. The focus is purely on the amount of the Net Contributions Balance as at the date of RAM's liquidation.

4.18 The Net Contributions Model can be seen unfairly to prefer those Investors who received payments prior to the collapse of RAM. By failing to take into account pre-liquidation payments, those Investors who received such payments will ultimately receive a higher overall recovery of their investment than those who did not receive pre-liquidation payments. See example Investors W and Y at paras 9.16 to 9.18 in the First Fisk Affidavit.

[47] *In re Bernard L Madoff Investment Securities LLC* 654 F 3d 229 (2d Cir 2011) at 241.

4.19 The Alternative and Rising Tide Models seek to address that concern by taking into account payments received by an Investor from RAM when calculating the distribution to an Investor.

Alternative Model

4.20 The first step in the Alternative Model is to calculate a "provisional" Reference Debt for each Investor which is the total amount the Investor contributed to RAM. Any withdrawals are not considered at this stage.

4.21 A provisional distribution rate is applied to the Reference Debts.

4.22 This allows a provisional gross entitlement to be calculated for each Investor. This provisional gross entitlement figure for each Investor is then compared to the total of all payments made by RAM to that Investor:

(a) If the payments are less than the provisional gross entitlement then the balance becomes the Investor's distribution entitlement.

(b) If the payments are greater than the provisional gross entitlement then the Investor is not entitled to any distribution.

4.23 There is an obvious relationship between the distribution rate, the amount of the distribution and whether or not an Investor is entitled to a distribution. So iterations of the model are run with different rates of distribution until the position is achieved that the amount available for distribution is distributed.

4.24 Ultimately distribution under this model is more focussed on achieving an overall rate of recovery of an Investors' RAM investment as a whole. There is no uniform rate (% or cents on the dollar) applied to the Net Contributions Balance. Investors who have not withdrawn any funds would be entitled to a distribution in the liquidation at the full provisional distribution rate. Those who had withdrawn some funds but less than their provisional gross entitlement under this Model would receive a lower effective distribution rate in the liquidation (as their pre-liquidation payments from RAM are taken into account). See example Investors W and Z at paras 9.26 to 9.27 in the First Fisk Affidavit.

Rising Tide Model

4.25 The Rising Tide Model is similar to the Alternative Model.

4.26 The starting point is to establish the percentage of loss suffered by each Investor. The Investors with the largest percentage of losses are paid first, with a view to the distribution bringing Investors up to a reduced but more equalised percentage of loss across RAM Investors as a group. This approach is carried out incrementally, with the highest percentage of loss reducing (or the "tide" rising) with each increment. Once all Investors are at the same loss tier, the assets will be distributed rateably across all Investors.

4.27 Consider the example in paragraphs 17 to 19 of the Second Fisk Affidavit.

(a) Four Investors suffer losses of their capital contributions of 80%, 60%, 100% and 96%.

(b) The first increment distributes enough funds to bring all Investors to 96% loss, meaning only the third Investor receives an allocation of funds in that increment. Following that interim allocation, the losses suffered by the Investors are 80%, 60%, 96% and 96% respectively.

(c) The second increment allocates enough funds to bring all Investors to the next threshold of loss, 80%, meaning only the third and fourth Investors receive an allocation of funds in that increment. Following the second interim allocation of funds, the losses suffered by the Investors are 80%, 60%, 80% and 80%.

(d) This incremental approach is repeated until either:

(i) all Investors reach the same loss threshold, at which point the remaining funds are distributed rateably; or

(ii) the funds have been entirely distributed.

4.28 While this approach adopts the net contributions balance as its starting point (in order to calculate the percentage of loss), it is strikingly similar

to the Alternative Model. Like the Alternative Model, it focuses on achieving a (on one view) more equal overall recovery rate amongst Investors. In particular, whether an Investor receives a distribution and if so, the level of that distribution, takes into account the level of their pre-liquidation withdrawals.

4.29 The Liquidators have carried out an analysis of both the Rising Tide Model and the Alternative Model and confirm that they appear to produce the same result for Investors. This is explained at paragraphs 17 to 22 in the Second Fisk Affidavit.

4.30 The Liquidators' confirmation accords with a consideration of the Rising Tide model from a theoretical perspective. The Rising Tide model was described by the US Seventh Circuit Appellate Court in *SEC v Huber* as follows:[48]

> Under the rising tide model, withdrawals are considered part of the distribution received by an investor and so are subtracted from the amount of receivership assets to which he would be entitled had there been no withdrawals. (When there are no withdrawals, rising tide yields the same distribution of receivership assets as net loss).

4.31 This description could equally be applied to describe the Alternative Model. The Alternative Model adopts a different starting point and route to the Rising Tide Model. But they are both premised on the same principles and will ultimately achieve the same result.

4.32 The Liquidators prefer the Alternative Model over the Rising Tide Model for two reasons:[49]

(a) The Alternative Model can be more easily explained to Investors and Investors can check the Liquidators' calculations. In contrast, under the Rising Tide Model it will be exceptionally difficult to explain to an Investor the specific calculation for their distribution. The Liquidators expect that the lack of transparency under the

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48 *Securities and Exchange Commission v Huber* 702 F 3d 903 (7th Cir 2012) at 905.

49 Second Fisk Affidavit, paras 24 – 27.

Rising Tide Model may be a source of frustration and confusion for some Investors.

(b) The costs of conducting the Rising Tide model analysis will invariably be higher than that for the Alternative Model. This is simply because there are more calculations as part of this model, which would need to be checked before any distributions were paid.

5. Can the Court order a distributions model other than the Net Contributions Model?

5.1 The first legal issue is whether the Court has jurisdiction to order a distributions model other than the Net Contributions Model (being the orthodox approach).

5.2 "Claim" for the purpose of part 16 of the CA is defined through sections 303 and 306, as follows:

(a) Section 303(1) of the CA provides that:

> …a debt or liability, present or future, certain or contingent, whether it is an ascertained debt or a liability for damages, may be admitted as a claim against a company in liquidation.

(b) Section 306(1) of the CA provides:

> The amount of the claim must be ascertained as at the date and time of commencement of the liquidation.

5.3 Section 307 of the CA further provides:

> (1) If a claim is subject to a contingency, or is for damages, or, if for some other reason, the amount of the claim is not certain, the liquidators may:
>
> (a) make an estimate of the amount of the claim; or
>
> (b) refer the matter to the court for a decision on the amount of the claim.

(2) On the application of the liquidator, or of a claimant who is aggrieved by an estimate made by the liquidator, the court shall determine the amount of the claim as it sees fit.

5.4 Crucially, section 313 of the CA provides (emphasis added):

(1) After paying preferential claims in accordance with section 312, the liquidator **must** apply the assets of the company in satisfaction of **all other claims**.

(2) The claims referred to in subsection (1) rank equally amongst themselves and must be paid in full, unless the assets are insufficient to meet them, in which case **payment shall abate rateably among all claims**.

5.5 These provisions are mandatory. The liquidator does not have a discretion to pay claims out of the company assets in the manner he/she considers is just and equitable. Following payment of preferential claims, the assets of the company **must** be applied:

(a) in satisfaction of **all other claims**; and

(b) where the assets of the company are insufficient to pay all claims in full (as is clearly the case here), payment shall abate rateably among all claims.

5.6 This gives rise to four issues:

(a) First, does section 313 of the CA mean the assets of the company cannot be applied as proposed by the Alternative Model or the Rising Tide Model?

(b) Second, if so, do these provisions apply to assets held by the company on trust for Investors?

(c) Third, if those provisions do not apply to assets held on trust, what assets are the company's assets, as opposed to assets held on trust for Investors?

(d) Finally, how should the assets held on trust be applied?

Alternative Model and Rising Tide Model are inconsistent with section 313 of the CA

5.7 There are two characteristics of the Alternative Model and the Rising Tide Model which are inconsistent with section 313.

(a) First, these models do not purport to apply the assets of the company in satisfaction of all claims. No payments will be made in respect of a number of claims.

(b) Second, claims will not be paid rateably. The nature of these models is that the rate of recovery on a claim will differ between Investors.

5.8 The definitions of "rateably" and "claim" for the purposes of the CA are fundamental to these points.

5.9 "Rateably" is not defined in the CA. However, the Court has generally interpreted it to be synonymous with the *pari passu* principle.

(a) In *Stotter v Equiticorp* the Court held:[50]

> First, the way in which an insolvent's estate is to be distributed among the general body of unsecured creditors begins with the fundamental principle that claims rank equally among themselves and abate rateably in the event of a deficiency: see s 313(1) of the Companies Act 1993 (the pari passu principle). All creditors suffer in an insolvent liquidation. The presumption is that the burden should be spread rateably between them.

(b) This is consistent with the way in which that term has been applied by other jurisdictions. For example, see *Foskett v McKeown*.[51]

(c) The commentary in both *Heath and Whale on Insolvency* and *The Law of Insolvency in New Zealand* also identify section 313 as a statutory codification of the pari passu principle.[52]

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[50] *Stotter v Equiticorp Australia Ltd (in liquidation)* [2002] 2 NZLR 686 (HC) at [36].

[51] *Foskett v McKeown* [2001] 1 AC 102 (HL) at 132.

5.10 The very nature of the Alternative Model and the Rising Tide Model is that:

(a) Investors will not receive the same rate of return on their net contributions balance; and

(b) some Investors will not receive any return on their net contributions balance.

5.11 Consider for example Investors A to E in the Second Fisk Affidavit (all figures below are adjusted for CPI).

(a) Under the Net Contributions Model, all Investors will receive 14.04 cents in the $ on their net contributions balance. That is:

(i) payments will be made to satisfy (in part) **all** claims; and

(ii) all claims will rank equally and all Investors will share rateably in the fund.

(b) In contrast, under the Alternative Model:

(i) Investors A and B will not receive any payment towards their claims in the liquidation; and

(ii) while Investors C, D and E will receive a distribution in the liquidation, their rates of recovery on their net contributions balances vary, as follows:

- Investor C will receive a distribution of $51,351.05 against a net contribution balance of $318,419.44, being a recovery rate of 16.13 cents in the $.

- Investor D will receive a distribution of $140,058.62 against a net contribution balance of $627,085.40, being a recovery rate of 22.33 cents in the $.

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[52] Paul Heath and Michael Whale *Heath and Whale on Insolvency* (online looseleaf ed, LexisNexis) at [20.37]; Lynne Taylor and Gran Slevin *The Law of Insolvency in New Zealand* (Thomson Reuters, Wellington, 2016) at [29.1].

- Investor E will receive a distribution of $515,988.43 against a net contribution balance of $2,417,120.27, being a recovery rate of 21.35 cents in the $.

5.12 Accordingly:

(a) the available funds would be applied in (partial) satisfaction of some claims only; and

(b) Investors do not share rateably in the funds.

5.13 Of course, the purpose of the Alternative Model and Rising Tide Model is to achieve greater fairness between Investors who received pre-liquidation withdrawals and those who did not. Accordingly, it might be argued that the approach of those models is not inconsistent with the overarching principles of *pari passu*. In particular, the Alternative Model and the Rising Tide Model would see all Investors obtain, at least, a recovery of 22.34 cents in the $ on their capital contributions to RAM, based on the cumulative effect of their pre-liquidation withdrawals and their distribution in RAM's liquidation. Accordingly, if the Court were to take the total capital contributions as the "Claim" in the liquidation, the gains and losses in the RAM scheme are borne by Investors rateably.

5.14 However, this approach is inconsistent with:

(a) the wording of section 313 of the CA;

(b) the overall scheme of Part 16 of the CA, which deals with pre-liquidation payments through the voidable transaction provisions;[53] and

(c) the definition of "claim" for the purpose of the CA.

5.15 As set out above, "claim" is defined in sections 303 and 306 of the CA. Those definitions were discussed in *Stotter v Equiticorp*, where the Court held that:[54]

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[53] See *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [38].

> … a creditor's proof is limited to that sum for which the liquidation debtor would have been liable, assessed as at the date of the liquidation. That proposition is given statutory force in s 306(1) of the Companies Act which provides that "The amount of a claim must be ascertained as at the date and time of the commencement of the liquidation."
>
> … [T]he sum for which a creditor proves cannot exceed that sum for which the creditor could have obtained judgment as at the date of the liquidation.

5.16 Consider, for example, Investor A in the Second Fisk Affidavit. He invested $7,800,004.74 in RAM. He withdrew $2,185,040.76. Accordingly, his net contribution as at the date of the liquidation was $5,614,963.98 (all figures adjusted for CPI). His "claim" has to be ascertained as at the date and time of commencement of the liquidation. Accordingly, this must be $5,614,963.98. It cannot be the Reference Debt under the Rising Tide and Alternative Models of $7,800,004.74, as this fails to take into account the payments RAM made to him prior to its liquidation.

5.17 In summary, the terminology in section 313 of the CA is mandatory – the Liquidator must apply the assets of the company (post payment of preferential creditors) in a way which:

(a) is in satisfaction of **all claims**; and

(b) where the assets of the company are insufficient to pay all claims in full (as is clearly the case here), payment shall abate rateably among all claims (i.e. *pari passu*).

5.18 The Alternative and Rising Tide Models do not apply the assets of the company in this way.

5.19 The Liquidator has no discretion in this. Similarly, there is no obvious provision in the CA which allows the Court to permit the Liquidator to deviate from the mandatory provisions in section 313.

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[54] *Stotter v Equiticorp Australia Ltd (in Liquidation)* [2002] 2 NZLR 686 (HC) at [38] and [40].

5.20 Accordingly, section 313 of the CA means that the assets of the company cannot be distributed in accordance with the Alternative Model and Rising Tide Model.

Does section 313 apply to assets held by the company on trust?

5.21 Where funds or assets are held on trust for Investors, they are not "assets of the company" and are not available in the liquidation of the company.[55] Accordingly, section 313 does not apply to the distribution of assets held on trust for Investors.

5.22 The correct approach to distribution of assets in equity is to adopt the rules which will achieve equity as between the beneficiaries, depending on the context.[56]

5.23 However, the starting point is, generally, for equity between beneficiaries. As Lord Millett held in *Foskett v McKeown:*[57]

> Innocent contributors, however, must be treated equally inter se. Where the beneficiary's claim is in competition with the claims of other innocent contributors, there is no basis upon which any of the claims can be subordinated to any of the others. Where the fund is deficient, the beneficiary is not entitled to enforce a lien for his contribution; all must share rateably in the fund.

5.24 Accordingly, the Court should adopt the same approach to distribution of trust funds as is required to company assets, and distribute the funds rateably amongst all beneficiaries.

5.25 The equity as it applied to this case is discussed further in Part Six below.

Assets of the company vs assets held on trust for Investors

5.26 Given the submissions above that section 313:

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[55] *Re Ararimu Holdings Limited* [1989] 3 NZLR 487 (HC) at 504 and *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [44].

[56] See *Eaton v LDC Finance Limited (in rec)* [2012] NZHC 1105 at [59] to [61] and *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [17].

[57] [2001] 1 AC 102 (HL) at 132.

(a) requires that the assets of the company be distributed in accordance with the Net Contributions Model; but

(b) does not provide for a mandatory distribution model for assets held by the company on trust;

it is necessary to consider what assets are held by the Liquidators and which are company assets as against assets held on trust.

5.27 The Second Fisk Affidavit details the assets held by the Ross Group at paragraphs 7 to 9. Some are clearly company assets, some are clearly assets held on trust and some fall into an uncertain category.

5.28 It is well established that where a trustee wrongfully uses trust money to provide part of the cost of acquiring an asset, the beneficiary is entitled, at his option, to claim a proportionate share of the asset or to enforce a lien upon it to secure his personal claim for the amount of the misapplied funds. It does not matter whether the trustee mixed the trust money with his own in a single fund before using it to acquire the asset.[58]

5.29 As explained in the First Fisk Affidavit, investor funds were intermingled in RAM's bank accounts, in a manner which means a particular investors funds were no longer individually identifiable. While those funds cannot be traced to any particular investor, they can be traced to the investor group more generally. Accordingly, where assets were purchased with funds from the intermingled trust funds, the investors will have an equitable proprietary right to those assets, in a share proportionate to the proportion paid for by the intermingled investors' funds.

5.30 Investors will have paid monies into RAM's bank accounts at different times. This gives rise to two issues:

(a) First, it would be impossible to try to ascertain a particular Investor's proportionate share in a particular shareholding

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[58] *Foskett v McKeown* [2001] 1 AC 102 (HL) at 124.

purchased from the intermingled Investors' funds at any given time.

(b) Second, it is possible that an Investor deposited funds into the intermingled pool of funds after a particular shareholding was purchased from those funds.

5.31 However, this does not preclude the Investors having an equitable proprietary right to the shares held by RAM or Dagger, purchased with the intermingled trust assets. As the Courts have previously acknowledged, the availability of equitable remedies ought to depend upon the substance of the transaction in question and not upon the strict order in which associated events happened. Accordingly, the Court can take a pragmatic approach to the Investors' equitable proprietary interest in the assets held by RAM and Dagger.[59]

5.32 Based on the principles above, the funds held by the Liquidators can be allocated as follows:[60]

Assets held on trust for Investors

(a) *Net share realisations of $3,023,480.23*

The shares held by RAM and Dagger and the Arria shares held by the DRG Ross Family Trust as at the liquidation were very likely purchased from the intermingled pool of investor funds. Accordingly, the Court should find the Investors would have an equitable proprietary interest in those sale proceeds; i.e. they are held on trust for Investors.

(b) *Dividends on shares of $115,962.56*

As above, the relevant shares were very likely purchased from the intermingled pool of investor funds. Accordingly, the Court should find that the Investors have an equitable proprietary

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59 See *Priest v Ross Asset Management Limited (in liquidation)* [2016] NZHC 1803, (2016) 4 NZTR 26-016 at [168]

60 Second Fisk Affidavit, para 7.

interest in the dividends earned on those shares; i.e. they are held on trust for Investors.

(c) *Cash at Bank $61,811.65*

As detailed at paragraphs 3.9 – 3.11 of the First Fisk Affidavit, the funds held by RAM and Dagger in their bank accounts were generally either:

(i) the result of intermingled investor deposits, which were supposed to be held on trust for Investors; or

(ii) the proceeds of the sale of shares, where the shares were either supposed to be held on trust for an Investor or alternatively, were purchased with funds from the intermingled pool of assets.

Accordingly, the Court should find that the Investors have an equitable proprietary interest in the funds held by RAM and Dagger in their bank accounts; i.e. they are held on trust for Investors.

(d) *Net sale proceeds and rental from property owned by Mr Ross or related family trusts (other than the family home) of $894,312.85*

Mr Ross and Mrs Ross agreed that two properties owned by family trusts were tainted property as they had been purchased with funds from RAM or funds which had passed through RAM's 00 Account. Accordingly, the Court should find that the Investors will have an equitable proprietary interest in these sale proceeds; i.e. they are held on trust for Investors.

Company assets

(e) *Management Fees of $27,303.92*

As detailed in paragraph 7(k) of the Second Fisk Affidavit, these fees were recovered by the Liquidators on shares or the sale proceeds of shares returned to Investors in the liquidation who could establish a valid proprietary claim to those shares. They

were amounts RAM was entitled to receive, as income, under the various management agreements with those Investors on shares which were not, in fact, misappropriated by RAM. Therefore, these fees are company assets.

(f) *Net proceeds of office furniture sales $7,716.40*

This is the proceeds of the sale of assets owned by RAM. It is simply not clear when they were purchased and how the purchase was funded. As there is no evidence to suggest their purchase was funded by investors' funds, these would be company assets.

(g) *Miscellaneous receipts of $621.60*

The Liquidators received $621.60 from investors, relating to the costs of recovering information for those investors. Accordingly, this would be company assets.

Assets where the categorisation as company assets or held on trust is not clear or is mixed

(h) *Recoveries from clawback claims: $19,122,249.38*

The status of these funds is complex and is discussed below.

(i) *Reparations from David Ross of $1,087,707.76*

The reparations from David Ross fall into two distinct categories:

(i) Proceeds of the sale of shares which Mr Ross claimed were his or his family's personal shares. The Liquidators have not carried out a tracing analysis to establish how the purchase of these shares were funded as such an exercise would be time consuming and costly. However, they consider these shares may have been funded by misappropriated investor funds.[61]

[61] Second Fisk Affidavit, para 7(q).

(ii) Sale proceeds from household furniture, paintings and from Mr and Mrs Ross' former residence. There is no evidence to suggest that these furnishings, paintings or the residence were purchased using misappropriated investor funds.

In each case, the funds were received by the Liquidators as reparation for claims the Liquidators of the Ross Group had against:

(iii) Mr and Mrs Ross arising from a current account debt of approximately $1.9 million owing by them to various companies in the Ross Group; and

(iv) Mr Ross personally, arising from his misappropriation of investor funds.

The Liquidators consider that the current account debt is necessarily linked, as a practical matter, to the misappropriation of investor funds. As explained in the Second Fisk Affidavit, the Ross Group had no genuine income to fund the current account advances to Mr and Mrs Ross. Accordingly, those advances were in all likelihood funded from misappropriated investor funds.[62]

The status of these assets as either company assets or assets held on trust for investors is discussed at paragraphs 5.65 and 5.66 below.

(j) *Interest of $457,876.31*

Whether interest earned is a company asset or funds held on trust will ultimately depend on the legal ownership of the funds on which that interest was earned.

Of the amount above, $154,047.00 is interest on the recoveries of clawback claims.[63]

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62 Second Fisk Affidavit, para 7(s).

63 Second Fisk Affidavit, para 7(p).

If one assumes that the funds comprising company assets above were applied first to pay the costs of the liquidation (as discussed in Schedule Four below), then the interest of $303,380.29 (i.e. excluding interest earned on clawback recoveries) would have been predominantly earned on assets in which the Investors had an equitable proprietary interest.

Clawback recoveries: assets held on trust or company asset?

5.33 Most of the funds held by the Liquidators are the result of settlements (or in one case, a judgment sum) of actual or threatened clawback proceedings against Investors who received payments from RAM prior to its liquidation.

5.34 The clawback claims on which the Liquidators relied are pursuant to:

(a) Sections 345 to 348 of the Property Law Act 2007 (the prejudicial disposition provisions of the **PLA**). These sections permit the Liquidators (or any creditor prejudiced by the disposition in issue) to clawback payments made by RAM which were made either:

(i) with intent to prejudice creditors, in that they were made with intent to hinder, delay or defeat creditors of RAM in the exercise of any right of recourse in respect of the property; and/or

(ii) without RAM receiving reasonably equivalent value in exchange; and/or

(b) Sections 292 and 294 of the Companies Act 1993 (the voidable transactions provisions of the CA). These sections permit the Liquidators to clawback payments made by RAM where the payments were made during the specified period (as defined in the CA) at a time where RAM was unable to pay its due debts and enabled the recipient Investor to receive more towards the satisfaction of a debt owed by RAM than they would have received in RAM's liquidation. Section 295 provides that the order for compensation must be in favour of the company.

5.35 The recoveries from clawback claims were received following the decisions in the High Court, Court of Appeal and/or Supreme Court in the proceeding of *McIntosh v Fisk*.

5.36 Mr McIntosh was a former investor in RAM. He had paid RAM $500,000.00 for investment purposes in 2007. He made no withdrawals from RAM until 2011 at which time he was paid $954,047.62 by RAM, purportedly being returns on investments RAM and Dagger held for him in his investment portfolio. The Liquidators challenged all payments made by RAM to Mr McIntosh pursuant the prejudicial disposition provisions of the PLA and the voidable transactions provisions of the CA. The High Court, Court of Appeal and Supreme Court all held that:[64]

(a) the payments made by RAM to Mr McIntosh could be clawed back pursuant to both the prejudicial disposition provisions of the PLA and the voidable transaction provisions of the CA; but

(b) that Mr McIntosh had a value defence to the extent of the capital contributions paid by him to RAM.

5.37 On this basis, Mr McIntosh was required to repay the difference between the payments received from RAM and the payment he made to RAM, being $454,047.62 (plus interest).

5.38 The issue of beneficial ownership of clawback recoveries is not straightforward. While the Liquidators consider that the funds paid out by RAM to investors who are subject to clawback claims were ultimately funded by misappropriated trust assets, this does not mean that recoveries from a clawback claim are likewise an asset held on trust. There is no evidence that any funds paid by former Investors to the Liquidators or RAM in respect of clawback claims are traceable (in a conventional, FIFO sense) to the funds they received from RAM.

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[64] *Fisk v McIntosh* [2015] NZHC 1403, (2015) 11 NZCLC 98-033 at [59], [74], [93] and [151]-[152]; *McIntosh v Fisk* [2016] NZCA 74, [2016] 2 NZLR 783 at [39] and [52]; *McIntosh v Fisk* [2017] NZSC 78, [2017] 1 NZLR 863 at [41], [65] and [136]. Justice Miller (CA) and Justice Glazebrook (SC) dissented; they would have permitted the plaintiffs to claw back all payments made by RAM to Mr McIntosh.

Further, there is caselaw which indicates that such recoveries are held by the liquidators for the benefit of all Investors and Creditors.

Re Hibiscus

5.39 In *Re Hibiscus Coast Marine Centre Limited (in liquidation)*[65] the liquidators had received a payment from Westpac, pursuant to a judgment ordering it to make that payment, on the basis that a pre-liquidation payment by the company to Westpac was a voidable transaction. The issue in *Hibiscus* was how the liquidators were to distribute the funds representing the judgment sum. That is, were the liquidators required to pay those funds to the secured creditor or for the benefit of all general creditors?

5.40 The secured creditor argued that by virtue of its debenture over the company's assets, the funds comprising the voidable payment were subject to the secured creditor's charge at the time of payment. Accordingly, it argued that the payment of the judgment sum was simply repayment to the company of the funds paid out and therefore were likewise subject to the secured creditor's debenture.

5.41 The Court held that the judgment sum was to be paid out for the benefit of general creditors, not the secured creditor. In particular Casey J held:[66]

(a) There was a long line of authority to the effect that the doctrine of fraudulent preference was "entirely for the purpose of distribution among the creditors generally; not for the benefit of any single creditor".

(b) Amounts recovered by a liquidator from a voidable transaction were ultimately amounts recovered through the exercise of a statutory right of the liquidator and the liquidator therefore holds what is recovered for the benefit of all creditors, subject to the rights of any secured creditor impressed on the property before it

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65 *Re Hibiscus Coast Marine Centre Limited (in liquidation)* (1986) 3 NZCLC 99,615 (HC).

66 *Re Hibiscus Coast Marine Centre Limited (in liquidation)* (1986) 3 NZCLC 99,615 (HC) at 99,618.

comes into his/her hands, following the exercise of that statutory right.

(c) Where a disposition is to be set aside, the Court can order:

(i) transfer of the specific property; or

(ii) payment of such sum as the Court thinks proper, not exceeding the value of the property as at the date of the disposition.

(d) In the voidable transaction judgment in *Hibiscus,* the court had ordered the latter – the judgment ordered a payment to the liquidators, not the return of the specific property (i.e. return of the specific money paid to Westpac). This meant the money was paid to the liquidators in their own right and not to the company.

(e) Accordingly, the Court was unable to identify that the payment made to the liquidators was the same money paid to Westpac.

5.42 *Hibiscus* has been consistently cited as the authority for the principle that sums recovered under the voidable transaction provisions of the CA are for the benefit of general creditors.[67] This is a sound principle. The rationale for the regime of voidable transactions is to ensure equal distribution among creditors generally on the basis of the section 313 *pari passu* statutory direction. It would be anomalous if the fruits from those statutory provisions were applied on some other basis.

5.43 There is no reason to take a different approach to recoveries made in respect of a clawback claim pursuant to the PLA claim, for the same reasons as identified by Casey J in *Hibiscus.*

5.44 Counsel assisting the Court has correctly stated that the provisions of the CA have changed since *Hibiscus* was decided.[68] At the time of

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[67] See for example *Strategic Finance Limited v Bridgman* [2013] NZCA 357, [2013] 3 NZLR 650 and *National Bank of New Zealand Limited v Nellies* HC Dunedin M93/00, 14 March 2001.

[68] First memorandum of *amicus curiae* as to directions and orders of the Court dated 13 December 2018, dated 16 March 2018 (**Memorandum of counsel assisting the Court**) at [26].

Hibiscus the equivalent section to section 295 of the CA provided that recoveries under voidable transactions were paid directly to the liquidator. In 2007 section 295 of the CA was amended to provide that the voidable transaction recoveries would be paid to the company. However, this change in wording does not change the principles as applied in *Hibiscus.* In particular:

(a) First, the decision in *Hibiscus* was premised on two grounds:

(i) that the recoveries were held by the liquidator in their own right, not the company; and

(ii) that where funds are received pursuant to a court order to make a payment to the liquidators – not an order for the return of the specific monies paid to the creditor – the funds received are not the same funds as those paid out.

The change in wording in 2007 to require voidable transaction recoveries to be paid to the company, rather than the liquidator, has no relevance to the second point. Where a court orders simply that payment be made to the company pursuant to the voidable transaction provisions, rather than the return of the specific funds paid out, the payment made is not the same funds as those initially paid out.

(b) Second, as noted above, the entire premise of the voidable transaction regime is to ensure that creditors share equally in the company's assets. It would be entirely inconsistent with this principle for the proceeds of voidable transaction claims to be distributed in any other way. If Parliament was intending such a radical change, one would expect it to be effected in a more obvious manner than simply providing that such recoveries are to now be paid to the company in liquidation, rather than the liquidators.

5.45 The courts generally appear to be striving to ensure that the proceeds of voidable transaction provisions are used for the benefit of all creditors, not just some creditors or secured creditors. This is apparent

not only from *Hibiscus* and cases that have since followed *Hibiscus*, but also the Australian approach.

5.46 Under the Australian Corporations Act 2001 (and its predecessor, the Corporations Law 1989), recoveries from voidable transaction claims are paid directly to the company. In *Elfic Limited v Macks*[69] the Court of Appeal of Queensland held:

> There is nothing in the provisions of the Corporations Law to suggest that moneys recovered under s 565 of the Corporations Law [transactions void against the liquidator] are to be held by a liquidator on terms different to those on which the liquidator holds the general assets of the company.

The Court went onto find that recoveries under section 588FF (court orders in respect of voidable transactions; substantially similar to section 295 of the CA) were likewise property of the company.[70]

5.47 The issue is even more clear cut in this instance:

(a) Of the recoveries from clawback claims, only one Investor paid funds pursuant to a judgment – Mr McIntosh, pursuant to the decision in *McIntosh v Fisk* [2017] NZSC 78. The Supreme Court upheld the High Court decision requiring Mr McIntosh to "pay to the liquidators the sum of $454,047.62."[71] There is no suggestion in the court order that it was requiring the specific funds paid to Mr McIntosh to be returned to RAM – it was accepted that those funds had been applied to other purposes by Mr McIntosh. Accordingly, on the basis of *Hibiscus*, the funds paid by Mr McIntosh to RAM are not the same funds which RAM paid out to Mr McIntosh.

(b) This is relevant because it means that although Mr McIntosh was paid from misappropriated trust funds, the funds paid to the liquidators by Mr McIntosh were not the misappropriated trust funds he received. It was reasonable compensation, paid

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69 *Elfic Limited v Macks* [2001] QCA 219, [2001] 162 FLR 41 at 58.

70 *Elfic* at 59. See also *Kratzmann Pty Limited v Tucker* (1968) 123 CLR 295 (HCA).

71 *Fisk v McIntosh* [2015] NZHC 1403, (2015) 11 NZCLC 98-033 at [152].

pursuant to the liquidators exercising a statutory right. Accordingly, those funds are held for the benefit of all creditors pursuant to *Hibiscus* above.

(c) All other recoveries from clawback claims came pursuant to settlements with Investors. Each of those settlements was agreed:[72]

(i) following the Liquidators threatening to exercise their statutory right to challenge various payments by RAM to the investor as a prejudicial disposition under the PLA and, where applicable, the voidable transaction provisions of the CA, and in some cases actually commencing proceedings against the Investor; and

(ii) on the basis that the Investor did not accept any liability for such claims to RAM, Dagger or the Liquidators.

(d) Accordingly, in the case of settlement payments where no liability is admitted by the Investor, it is even more difficult to argue that the settlement sums paid were the return of misappropriated trust assets. It was simply the payment of money by an Investor to RAM to avoid a disputed claim progressing to a court hearing.

5.48 For completeness, generally, the Liquidators cannot distinguish whether each clawback recovery paid to them or RAM resulted from claims pursuant to the CA or the PLA. This is because the various settlement agreements generally make no distinction between the two claims and the court in *McIntosh* found for the Liquidators pursuant to both claims. However, there will be some settlements entered into, where there was no CA claim against the investor (i.e. no pre-liquidation payments were made within the “specified period” as defined in the CA).[73] To determine the value of settlements falling within this category would require a review of all settlements entered into to date.

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72 Second Fisk Affidavit, para 7(y).

73 Second Fisk Affidavit, para 7(y)(iii).

5.49 Counsel assisting the court has indicated that he intends to consider the application of both backwards tracing and remedial constructive trusts to the characterisation of recoveries from clawbacks; namely whether those funds are properly characterised as trust funds rather than funds of the company.[74] Counsel for the Liquidators intend to address these issues, in substance, in reply. However, for the purpose of advancing submissions, these submissions outline some of the issues with the application of these doctrines to the Ross Group liquidation.

Backwards tracing

5.50 Backwards tracing allows a court to take a substance over form approach to tracing and allow a proprietary remedy, even though the traditional tracing rules would preclude relief.

5.51 The leading case is *Brazil v Durant.*[75] In *Brazil* a person had received USD10.5 million as bribes and funnelled those payments overseas through bank accounts in the name of the defendants. It was accepted on appeal that USD 7.7 million of the bribes could be traced through to the defendants' bank accounts. However, they argued that the remaining bribes could not be traced because:

(a) some of the bribes were paid into the intermediary's account after the intermediary had made payment of funds to the defendants; and

(b) the intermediary's account was a mixed fund and drawings were made on the account before payment to the defendants' account, meaning some of the funds paid to the defendants' bank account must have come from other sources.

[74] See Memorandum of counsel assisting the Court.

[75] *The Federal Republic of Brazil v Durant International Corp* [2015] UKPC 35.

5.52 The Privy Council permitted "backwards tracing" to find that the full sum of the bribes could be traced to the defendants' bank accounts. It focused on a 'substance over form' approach[76] and held:[77]

> …the claimant has to establish a coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund.

5.53 The Courts' focus was on ensuring that the law could adapt to sophisticated money laundering operations rather than expanding the remedy of tracing to enable beneficiaries' claims to take priority over ordinary unsecured creditors.

(a) The lower Court observed that to find otherwise would enable any sophisticated fraudster "to defeat an otherwise effective tracing claim simply by manipulating the sequence in which credits and debits were made to his account."[78]

(b) Likewise, the Privy Council held:[79]

> The development of increasingly sophisticated and elaborate methods of money laundering, often involving a web of credits and debits between intermediaries, makes it particularly important that a court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect. If the court is satisfied that the various steps are part of a coordinated scheme, it should not matter that, either as a deliberate part of the choreography or possibly because of the incidents of the banking system, a debit appears in the bank account of an intermediary before a reciprocal credit entry.…the availability of equitable remedies ought to depend on the substance of the transaction in question and not upon the strict order in which associated events occur.

76 *Brazil v Durant* at [38].

77 *Brazil v Durant* at [40].

78 *Brazil v Durant* at [13].

79 *Brazil v Durant* at [38].

(c) The Court also cautioned against expanding the equitable rules beyond what was strictly required, stating:[80]

> The courts should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties. If a trustee on the verge of bankruptcy uses trust funds to pay off an unsecured creditor to whom he is personally indebted, in the absence of special circumstances it is hard to see why the beneficiaries' claim should take precedence over those of the general body of unsecured creditors.

5.54 The case of *Brazil* is quite different to the RAM facts. This case does not concern reconciling slight differences in temporal tracing to recognise the substantive transaction. Rather, applying backwards tracing to this instance would require the Court to find that, for example, a payment to an investor of misappropriated trust funds in 2010 could be traced to a settlement payment by that investor made to avoid threatened court proceedings, without any admission of liability, in 2017. This is a significant stretch from the application of the backwards tracing doctrine in *Brazil*.

5.55 Additionally, finding the necessary "coordination" would require the Court to overrule *Hibiscus* above, for at least those settlement payments made where there was a claim pursuant to the voidable transaction provisions of the CA. This in turn would have significant ramifications on Parliament's prescribed *pari passu* regime, as set out in the CA.

5.56 The Court should not rely on the doctrine of backwards tracing to supplement section 313 of the CA.

Remedial constructive trusts

5.57 Counsel assisting the Court has also suggested that a remedial constructive trust could be imposed on the recoveries from clawbacks,

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80 *Brazil v Durant* at [33].

so that they were not assets of the company.[81] However, for the reasons explained below:

(a) it is not clear that remedial constructive trusts are a part of New Zealand law;

(b) there is not the requisite unconscionability to justify the imposition of a remedial constructive trust; and

(c) even if there were (which is not accepted), to introduce the remedy into the area of insolvency would be fundamentally at odds with the approach the Court has taken previously, and, as above, Parliament's prescribed *pari passu* regime.

5.58 In the case of *Fortex Group v MacIntosh*,[82] the Court of Appeal considered whether to impose a remedial constructive trust over company assets, in order to give employees priority over secured and unsecured creditors for superannuation contributions paid into the employer's overdrawn bank account.

5.59 The Court expressed some doubt as to whether remedial constructive trusts were a part of New Zealand law and deliberately sidestepped making such a finding. However, its judgment went on to detail some of the parameters of the remedy, if it were a part of New Zealand law.[83] (Notably, in 2013 the Court of Appeal in *Strategic Finance Limited v Bridgman* likewise sidestepped determining that issue, noting that whether such a remedy existed was still a matter of unresolved controversy).[84]

5.60 The Court held:[85]

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81 Memorandum of counsel assisting the Court, para 29.

82 *Fortex Group v MacIntosh* [1998] 3 NZLR 171 (CA).

83 *Fortex Group v MacIntosh* at 173 (per Tipping, Gault & Keith JJ) and 182 (per Blanchard J).

84 *Strategic Finance Limited v Bridgman* [2013] NZCA 357, [2013] 3 NZLR 650 at [122] and [125] to [126].

85 *Fortex Group v MacIntosh* at 175.

> But before the Court can contemplate declaring that assets owned in law by A should, by way of remedy, be held by A on trust for B, there must be some principled basis for doing so, both vis-à-vis A and vis-à-vis any other person who has a proper interest in the subject matter which would be affected by the imposition of the trust. … In order to defeat, pro tanto, the secured creditors' rights at law under their security by the imposition of a remedial constructive trust, the plaintiffs must be able to point to something which can be said to make it unconscionable – contrary to good conscience – for the secured creditors to rely on their rights at law. If such can be shown, equity may restrain the exerciser of those rights to the extent necessary to afford the plaintiffs appropriate relief.

5.61 In *Fortex Group v MacIntosh*,[86] the Court emphasised that as it was the secured creditors who would be prevented from enforcing their security if the remedial constructive trust was imposed, it was their conscience that was in issue – not that of the employer. The Court found there was nothing affecting the conscience of the secured creditors at all, let alone to the extent that they should be deprived of their contractual rights to exercise their security.[87]

5.62 A similar issue arises in this instance. If a remedial constructive trust were imposed, the parties prevented from exercising their legal rights to claim against the assets of the company will be RAM's ordinary (trade) creditors. Accordingly, the Court would need to find that the conscience of those creditors (and not that of RAM's) was impugned, such to justify equity intervening to prevent them from claiming a share in the clawback recoveries. However, there is simply no suggestion of anything affecting their conscience, such that they should be prevented from claiming against those assets.

5.63 Even if there could be such a suggestion (which is not accepted), the Courts have previously indicated that if the remedy of remedial constructive trusts does exist, the Courts should be very hesitant to allow it into the area of insolvency. In particular, the Court of Appeal has twice cautioned that such an introduction could open the door to

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[86] *Fortex Group v MacIntosh* [1998] 3 NZLR 171 (CA).

[87] *Fortex Group v MacIntosh* at 178-179.

significant uncertainty in insolvency, with the additional costs and protracted litigation that would go with such uncertainty:

(a) In *Fortex Group v MacIntosh,* Blanchard J commented that caution should be exercised "in proceeding to do anything which would disturb the settled pattern of distribution in an insolvency."[88]

(b) In *Strategic Finance Limited*, the Court noted that the chief objection to the remedy is that the basis of "unconscionability is too open-ended and offends against settled insolvency rules on too loose a basis by according priority via a constructive trust".[89]

5.64 Accordingly, there is no basis to impose a remedial constructive trust over the clawback recoveries, at the expense of the (non-Investor) Creditors. Additionally, to do so would:

(a) significantly expand the scope of the remedy; and

(b) introduce a significant element of uncertainty into the settled principles of insolvency.

Reparations from Mr Ross and related parties

5.65 While the analysis above addressed the correct categorisation of clawback recoveries, the same principles should apply to the reparations received from Mr Ross and related parties as settlement of claims against those parties arising from the misappropriation of investor funds. That is:

(a) Some of the funds received as reparation were clearly not "tainted" by misappropriated investor funds, being the proceeds of sale of assets Mr Ross and related parties owned prior to RAM's incorporation (i.e. proceeds of sale of the former residence, the furnishings and paintings). Accordingly, these

[88] *Fortex* at 182.

[89] *Strategic Finance Limited (in receivership & liquidation) v Bridgman* [2013] NZCA 357 at [124].

funds are clearly not the same funds as those misappropriated from investors.

(b) Some of the funds received as reparation may have been funded by investor funds, even if only indirectly (being the proceeds of sale of shares Mr Ross claimed were owned in his personal capacity).

(c) The reparation was made in respect of claims which ultimately arose from the misappropriation of investor funds.

(d) However, the claims which caused the reparation payments to be made, were ultimately claims the Liquidators could have used their statutory powers to pursue.

5.66 Accordingly, the reparations should therefore be treated as company assets in the same way as the clawback recoveries.

5.67 On this basis, the assets held by the Liquidators are held as follows:

(a) $4,398,947.58 are assets held on trust for Investors;

(b) $20,245,599.06 are assets of the company.

6. The most appropriate Distributions Model

6.1 This Court will need to consider this issue if it has the jurisdiction to order a distributions model other than the Net Contributions Model for all or some assets (presumably the “trust assets”) held by the Liquidators.

6.2 As explained above, the key difference between the Net Contributions Model and both the Alternative Model and the Rising Tide Model is their approach to pre-liquidation withdrawals. Both the Alternative Model and the Rising Tide Model take into account pre-liquidation withdrawals when determining the distribution to an Investor. The Net Contributions Model does not.

6.3 The Liquidators appreciate why some Investors consider that a model which takes into account pre-liquidation withdrawals produces a fairer result. Both the Alternative Model and the Rising Tide Model ultimately seek to ensure that those Investors who withdrew some (but not all) of their funds contributed to RAM prior to the liquidation do not receive a distribution, which enables them to receive an even greater return on their RAM investment, at the expense of those who did not withdraw any funds from RAM.

6.4 Consider the example Investors W and Y in the First Fisk Affidavit (paragraphs 9.16 to 9.19).

(a) Both investors invest the same amount ($5,000) with RAM on the same day.

(b) Investor W withdraws $2,000 on 1 January 2012. Investor Y makes no pre-liquidation withdrawals.

(c) Assuming a 10 cent in the dollar distribution and an adjustment for CPI, under the Net Contributions Model:

(i) Investor W's total recovery of his/her RAM investment will be $2,312.23 (being the $2,000 withdrawn prior to the liquidation adjusted for CPI, plus a distribution of $292.82).

(ii) Investor Y's total recovery of his/her RAM investment will be a distribution in the liquidation of $514.16.

(d) Under the Alternative Model, Investor W would not receive a distribution in the liquidation due to the level of his/her pre-liquidation. The amounts which would otherwise become payable to Investor W are effectively added back into the pool to increase the rate of distribution for other investors, including Investor Y.

6.5 That is, the investors made the same investment, but under the Net Contributions Model, Investor W receives a much higher overall recovery, simply due to an accident of timing: he/she withdrew funds from RAM before its collapse.

6.6 However, this is not a novel distinction which arises only in a Ponzi scheme. In a liquidation of an insolvent company generally, there will invariably be creditors who were fortunate enough to be paid prior to the collapse of a debtor company, which ultimately means (assuming the creditor can establish a value defence) they will recover a greater proportion of their debt than those who were not paid pre-liquidation. There is no compelling policy reason to try to treat the liquidation of a Ponzi differently.

6.7 Additionally, the perceived "fairness" is not universal. It only applies to persons who have a claim in the liquidation (being Shortfall Investors). These models would have no ability to clawback capital payments (or indeed payments of fictitious profits) from Overpaid Investors, despite them receiving an overall rate of recovery on their RAM investment of at least 100%.

6.8 In *McIntosh v Fisk*, the Supreme Court held that an investor would have a "value" defence to a claim to clawback pre-liquidation payments up to the value of their capital contributions to RAM (and subject to establishing the good faith and without knowledge elements of the defence).[90] The impact of this decision is that the Liquidators could not successfully challenge pre-liquidation withdrawals up to the level of the investor's capital contributions, unless the investor knew, or ought to have known, at the time of receipt that something was amiss at RAM.

6.9 In contrast, the Alternative Model and Rising Tide Model would allow the Liquidators to take into account any pre-liquidation withdrawals when determining whether the Investor is eligible for a distribution and if so, the quantum of that distribution. They would achieve de facto what the Supreme Court has denied de jure.

6.10 For example, an Investor who received pre-liquidation payments from RAM totalling 105% of their capital contribution would be treated in a different way to an Investor who received pre-liquidation payments from RAM totalling 95% of their capital contribution. The former's pre-liquidation payments up to the level of their capital contributions are

[90] *McIntosh v Fisk* [2017] NZSC 78; [2017] 1 NZLR 863 at [136].

(subject to good faith and knowledge) unimpeachable. The latter's pre-liquidation payments can be effectively set-off against any distribution they would otherwise be entitled to receive in the liquidation.

6.11 This approach is also inconsistent with the fundamental premise of the calculation of creditors' claims in liquidations. As explained at paragraphs 5.2 to 5.5 above it is inconsistent with:

(a) the usual approach of valuing "claims" as at the date of the liquidation; and

(b) the overarching premise in a liquidation that all creditors share equally in the remaining assets.

6.12 Finally, the reality of a Ponzi (and indeed any insolvent liquidation) is that there is simply not enough money to pay all claims. Accordingly, a model which increases the distribution for some investors, invariably takes those amounts redistributed from other investors.

6.13 The Second Fisk Affidavit provides a comparison of the impact of the Net Contributions Model and the Alternative Model on the investor pool as a whole. As this illustrates (and comparing both models as adjusted for CPI):[91]

(a) 247 Investors will be worse off under the Alternative Model, compared with the Net Contributions Model. The average negative impact for these investors is $24,230.86.

(b) Of these 247 investors, 205 Investors who would receive a distribution in the liquidation under the Net Contributions Model will not receive any distribution under the Alternative Model.

(c) In contrast, 392 Investors will be better off under the Alternative Model than under the Net Contributions Model. The average positive impact for these investors is $15,267.91.

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[91] Second Fisk Affidavit, para 45.

(d) There are some significant outliers:[92]

(i) 89 Investors will be between $10,001 and $50,000 worse off under the Alternative Model.

(ii) 18 Investors will be between $50,001 and $100,000 worse off under the Alternative Model.

(iii) Nine Investors will be between $100,001 and $500,000 worse off under the Alternative Model.

(iv) One Investor (Mr Fehsenfeld) will be $788,279.64 worse off under the Alternative Model. Under the Alternative Model, Mr Fehsenfeld is not eligible for any distribution.

6.14 On the other hand:[93]

(a) 145 Investors will be between $10,001 and $50,000 better off under the Alternative Model.

(b) 18 Investors will be between $50,001 and $100,000 better off under the Alternative Model.

(c) Four Investors will be between $100,001 and $500,000 better off under the Alternative Model.

6.15 Because these issues are not novel to Ponzi schemes, adopting the Alternative Model could introduce a level of uncertainty into company liquidations. This would be at odds with the approach the Courts have taken to insolvency law generally – see for example *Fortex* and *Strategic Finance* referred to at paragraph 5.63 above. It would also give rise to an issue as to when a failed company has become a Ponzi. This could be a difficult issue.

6.16 Finally, the Net Contributions Model is consistent with the approach the Court has taken in respect of liquidations of other Ponzi operators. See

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[92] Second Fisk Affidavit, para 45.

[93] Second Fisk Affidavit, para 45.

for example, *Re International Investment Unit Trust*, *Arena* and *Re Waipawa*.[94]

6.17 In particular, in *Arena* the Alternative Model was proposed as a model for distribution. The Court rejected that model in favour of the Net Contributions Model noting (amongst other matters) that the Alternative Model:[95]

(a) had an apparent "equity" at first blush, but that impression was not supported upon further analysis of the model, given the large negative impact it had on a smaller group of investors;

(b) inherently required a different treatment of pre-liquidation returns of capital across categories of investors and was inconsistent with the law's present treatment of such payments;

(c) led to disparate treatment of pre-liquidation capital payments between Shortfall Investors and Overpaid Investors which could not be easily reconciled with the overarching apparent intention of the model, being the recovery and redistribution of pre-liquidation capital returns; and

(d) was inconsistent with the law as it relates to the calculation of creditors' claims in the liquidation, being the amount creditors could have sued for as at the date of the liquidation.

6.18 Accordingly, the Liquidators submit that in all the circumstances, the Net Contributions Model is the most appropriate – and indeed the fairest – model.

6.19 If the Court were minded to order either of the Alternative Model or the Rising Tide Model, the question then becomes which model to order. They will, ultimately, produce the same result for Investors.[96] However,

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[94] *Re International Investment Unit Trust* [2005] 1 NZLR 270 (HC); *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973; *Re Waipawa Finance Company Limited (in liq)* [2011] NZCCLR 14 (HC).

[95] *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [34] – [40].

[96] Second Fisk Affidavit, paras 20 and 24.

there are two key differences between the two models: transparency for Investors and cost.

6.20 The Alternative Model can be more readily explained to Investors and Investors will be able to cross-check the Liquidators' calculations. Once the Liquidators provide to an Investor their transaction summary (i.e. a list of contributions to RAM and withdrawals from RAM, as adjusted for CPI if so ordered), the "Maximum Distribution Rate" and the funds available for distribution, an Investor can calculate their own distribution. This will provide them with greater visibility and understanding of the distribution process. Due to the number of calculations which go into each iteration of the Rising Tide Model, it will be impossible (or at least very difficult, time consuming and costly) to walk an Investor through their specific calculation for their distribution.

6.21 This is apparent from the Second Fisk Affidavit. The Rising Tide Model needed to be explained by reference to a simplified example, rather than the actual anonymised Investors A to E, who were used to explain the Net Contributions Model and the Alternative Model. The process simply has too many calculations within each iteration and too many iterations, to concisely explain for Investors A to E.[97]

6.22 This lack of visibility of the distributions process is expected to cause frustration and confusion for Investors.[98]

7. Consumer Price Index adjustment

7.1 Ponzi schemes can collapse quickly. The issue of an adjustment for inflation or time value of money or otherwise may not normally arise as such an adjustment would generally have an insignificant impact on investor claims.

7.2 The position is starkly different in the case of RAM. RAM had been accepting investor deposits since the early 1990s and was in likelihood a Ponzi from that time.[99] The issue in this part of the Application is

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[97] Second Fisk Affidavit, para 26.

[98] Second Fisk Affidavit, para 26.

[99] First Fisk Affidavit, paras 3.1 and 3.17.

whether an adjustment should be made to reflect that, for example, $1,000 invested in 1995 is not the same as $1,000 invested in 2011.

7.3 The Liquidators consider it is appropriate to make such an adjustment and therefore propose to adjust Investors' contributions and withdrawals for CPI up to the date of the liquidation for the purpose of calculating each Investors' claim in the liquidation.

7.4 The impact of such an adjustment will be material – particularly for early Investors who did not withdraw a significant portion of their capital contributions prior to RAM's collapse.

7.5 By way of illustration, consider Investors F and G (real, but anonymised, RAM Investors) in the Second Fisk Affidavit:[100]

(a) Investor F contributed $3,117,047.06 to RAM, almost all of which was contributed between November 2000 and May 2001. Once those contributions are adjusted for CPI, the value of his/her contributions is $4,186,463.93.

(b) That is, Investor F's contributions of approximately $3 million in 2000 and 2001 are equivalent to an investor contributing $4 million in 2012.

(c) Similarly, Investor G contributed $313,935.35 to RAM in a single contribution in 2001. Once this contribution is adjusted for CPI, the value of Investor G's contributions is $417,714.98. Investor G's deposit of $300,000 in 2001 is equivalent to an investor depositing $400,000 in 2012.

7.6 The Liquidators consider that such an adjustment is appropriate in order to treat Investors equally.

7.7 Such an adjustment can make a significant difference to these early Investors. In particular, the effect of an adjustment is as follows:[101]

(a) $623,689.92 of funds are redistributed between Investors.

[100] Second Fisk Affidavit, paras 40 – 42.

[101] Second Fisk Affidavit, paras 36 – 37.

(b) 188 Investors will be positively affected by such an adjustment, with the average positive impact being $3,317.50.

(c) 15 Investors are better off by between $10,001 and $50,000, and one investor is better off by $61,036.17.

7.8 Applying this to Investors F and G:[102]

(a) Investor F would receive a distribution of $227,802.51 under the Net Contributions Model if a CPI adjustment is applied; his/her distribution reduces to $172,918.63 if an adjustment is not applied.

(b) Investor G would receive a distribution of $58,642.62 under the Net Contributions Model if a CPI adjustment is applied; and $51,848.18 if the adjustment is not applied.

7.9 Of course, the funds available in the liquidation are limited and therefore the Liquidators acknowledge that the increased distribution for these early Investors is at the expense of later Investors.

7.10 This Court has previously adopted a similar adjustment in *Re Waipawa.*[103]

7.11 *Re Waipawa* involved a Ponzi scheme which operated for over 20 years. The Court was required to determine the most equitable way in which to distribute the funds to investors, pursuant to the Securities Act 1978. It held that the funds were to be distributed on a *pari passu* basis, adopting a constant dollar approach.[104]

7.12 The Court in *Re Waipawa* acknowledged that the pool of funds for distribution was limited and that any adjustment in favour of a particular class of investor would inevitably have an effect on the other investors.

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[102] Second Fisk Affidavit, para 39.

[103] *Re Waipawa Finance Company Limited (in liq)* [2011] NZCCLR 14 (HC).

[104] At [57] – [60].

Despite this, it considered that a constant dollar adjustment was required in order to treat early and late investors equally.[105]

7.13 The Court in *Waipawa* quoted from the submissions of the United States Securities Exchange Commission (**SEC**) in a submission to Congress on compensation in the Madoff Ponzi scheme, in support of a proposal to convert each dollar invested into a "time equivalent or constant dollar". The Court quoted the following passage:[106]

> The constant-dollar approach is rooted in the classic economic concept of the time value of money and will result in greater fairness across different generations of Madoff investors – in effect, treating early investors and later investors alike in terms of the real economic value of their investments.

7.14 The Court then held:[107]

> The inequality this approach is designed to "cure" is the assumption that $100 invested in 1987 is the same "value" as $100 invested in 2007. Given the effects of inflation over time then that cannot be so. In this sense, therefore, such an adjustment to the $100 invested, depending on the timing of the investment, does reduce the unfairness of a *pari passu* scheme.

7.15 The Court rejected the suggestion that the constant dollar approach "rewarded" early investors at the expense of later investors, noting that the intention of such an approach was to equalise the position as between early and later investors rather than reward risk.[108]

7.16 Counsel assisting the Court has correctly stated that in *In re Bernard L Madoff Investment Securities* (***Madoff***),[109] the United States Court of Appeals ultimately ordered that for the purpose of distributing the assets in the Madoff Ponzi, no adjustment to investor contributions and

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105 At [55] – [57].

106 *Re Waipawa* at [40]. However, the SEC made a similar argument before the Second Circuit United States Courts of Appeals in *In re Bernard L Madoff Investment Securities LLC* 779 F 3d 74 (2d Cir 2015) which was rejected as being "novel, inconsistent with its positions in other cases, and ultimately unpersuasive" at 83.

107 *Re Waipawa* at [44].

108 *Re Waipawa* at [55].

109 *In re Bernard L Madoff Investment Securities LLC* 779 F 3d 74 (2d Cir 2015).

withdrawals should be made for inflation, time value of money or the like. (The SEC in that case supported an adjustment for inflation on the basis quoted in paragraph 7.13 above.)

7.17 The Second Circuit Court of Appeals ultimately found that the terms of the Securities Investor Protection Act (**SIPA**) did not permit any inflation or interest adjustment to "net equity" claims (i.e. the net contributions balance) for customer property.[110]

7.18 It is apparent that the Second Circuit Court of Appeals' decision is based predominantly on the specific terms of SIPA. In particular it held:[111]

(a) SIPA was designed to return customer property to customers, based on their "net equities" being the sum which would have been owing by the debtor to a customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of the customer, minus the indebtedness of the customer to the debtor on the filing date.

(b) SIPA's definition of net equity does not mention the possibility of an inflation adjustment. This is despite the fact that other (unrelated) provisions of SIPA do mention such a possibility.

(c) This silence of SIPA on an inflation adjustment to net equity was not surprising. SIPA's purpose was to remedy broker dealer insolvencies by promptly returning customer property to customers, avoiding customer assets being tied up during a liquidation. It was not necessarily established to remedy broker-dealer fraud.

(d) SIPA's specific purpose is a theme repeated throughout the Court's judgment. In particular, the Court emphasised that SIPA's role was limited to defending investors from a broker-dealer's failure to perform its custodial role, but does not otherwise shield investors from loss. It simply restores them to

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110 *Madoff* at 83.

111 *Madoff* at 77 – 80.

their position but for the liquidation. It does not provide for any compensation for lost use of securities or cash while the liquidation is pending.

(e) The Court considered that to allow for a CPI adjustment would shift the focus of SIPA from the proportional distribution of customer property actually held by the broker to the restoration to customers of the value of the property that they originally invested.

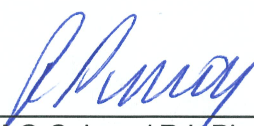
7.19 The US Courts have not applied the *Madoff* decision to liquidations outside of SIPA. See for example *SEC v Amerindo Investment Advisors Inc*[112] where the Court found that a CPI adjustment could be applied to claims in a liquidation under the Securities Act 1933 and the Securities Exchange Act 1934 and that the *Madoff* decision above did not apply as it was not a liquidation under SIPA. (Although, the liquidators in that case had already recovered sufficient funds to pay the full value of claims on a net contribution basis; the issue was whether to distribute additional funds on a pro rata basis or based on a CPI adjustment.)

7.20 The Liquidators intend to expand on these submissions in reply, following the submissions of counsel assisting the court on this issue.

[112] *SEC v Amerindo Investment Advisors Inc* USDC SDNY, 14 July 2017.

8. Conclusion

8.1 There is a significant disparity between the claims of Investors and the assets available for distribution. In such circumstances, perfect justice simply cannot be achieved. The directions sought by the Liquidators produce the least unfair result for Investors and Creditors, while enabling a difficult and lengthy liquidation to be concluded in the most efficient manner.



M G Colson / R L Pinny
Counsel for the Applicant Liquidators

18 May 2018

Schedule One: Orders sought

1. The Liquidators are seeking the orders set out below (change from Application is in red).

2. That the assets of Ross Asset Management Limited (in liquidation) (**RAM**) and Dagger Nominees Limited (in liquidation) (**Dagger**) be pooled for the purposes of the liquidation and the liquidations of these two companies proceed as if they were one company (the **pooling order**).

3. That all recovered assets of RAM and Dagger, after costs, be treated as forming one common pool of assets for distribution, available to both the general unsecured creditors of RAM and Dagger (the **Creditors**) and investors in RAM at the time of its liquidation (the **Investors**).

4. That the common pool of assets be distributed on the following basis:

   (a) there will be no tracing of particular Investors' assets;

   (b) any Investor who received payments from RAM (adjusted for the Consumer Price Index (**CPI**) with a reference date of 17 December 2012, being the date of liquidation) which exceeded their contributions to RAM (adjusted for CPI with a reference date of 17 December 2012) is not entitled to any distribution in the liquidation of any of the companies comprising the Ross Group;

   (c) that in respect of any purported transfers between investment portfolios purportedly held by Investors:

      (i) such purported transfers be recognised by the Liquidators only to the extent of any positive net contributions balance in respect of the transferring portfolio at the date of transfer;

      (ii) contributions balances be calculated by deducting from any contributions made by an Investor to RAM any payments made by RAM to that Investor (both contributions and payments being adjusted for CPI with a reference date of 17 December 2012 being the date of liquidation);

(d) if because of extraordinary circumstances the direction on inter-portfolio transfers at paragraph (c) above is unjust or ineffective in relation to a specific portfolio or portfolios then:

(i) the Liquidators may apply a reasonable and logical alternative methodology; but

(ii) where such an alternative methodology is adopted:

(A) the Liquidators will write to the Investor (by email, if an email address is held, failing which by post) detailing:

- why the Liquidators consider the usual approach to inter-portfolio transfers is unjust or ineffective;

- the Liquidators alternative methodology applied; and

- the Investors' right to apply to challenge the method as per (B) below; and

(B) leave is granted to the affected Investors to apply to the Court within this proceeding if they wish to challenge the Liquidators' decision in respect of that particular purported inter-portfolio transfer within one calendar month of receiving the Liquidators' notice as per order XX(d)(ii)(A) above; and

5. As to the appropriate method of distribution of those pooled assets to all Creditors and Investors, being the Net Contributions Model (as described in the affidavit of John Howard Ross Fisk sworn 11 December 2017) or the Alternative Model (as described in the affidavit of John Howard Ross Fisk filed with this application) or the Rising Tide Model as described in the article attached to the memorandum of counsel assisting the court dated 16 March 2018.

6. That the Liquidators are entitled to deduct their costs and expenses in the liquidation from the common pool of assets;

7. That for the purpose of a claim form for Investors who are entitled to receive a distribution in the liquidation of RAM and Dagger:

(a) the Liquidators will provide to each such Investor a statement:

(i) summarising their transactions with RAM; and

(ii) stating their claim in the liquidation based on the distribution model determined by this Court as applicable;

(the **Transaction Summary**); and

(b) once the Investor signs the Transaction Summary, the signed Transaction Summary is deemed to be the requisite claim form for the purpose of the Companies Act Liquidation Regulations 1994 (the **Liquidation Regulations**) and section 304 of the Companies Act 1993;

(c) if the Investor wishes to object to the Transaction Summary, they must do so in writing, detailing the grounds for the objection, no later than:

(i) 20 working days after the Transaction Summary was sent to them, if it was sent by email;

(ii) 25 working days after the Transaction Summary was sent to the Investor, if it was sent by post to an address in New Zealand; and

(iii) 40 working days after the Transaction Summary was sent to the Investor, if it was sent by post to an address outside of New Zealand;

(d) the Liquidator must make a decision in relation to a written objection within 20 working days and this decision is deemed to be the admission or rejection of the claim (in whole or in part) for the purposes of section 284 of the Companies Act 1993;

8. That where:

(a) an Investor has not signed the Transaction Summary for a period of six months after it was issued by the Liquidators and has not provided a written objection in accordance with paragraph 7(c) above; or

(b) the Liquidators have been unable to locate an Investor for the purpose of providing the Transaction Summary;

that Investor's distribution (as set out in the Transaction Summary) shall be:

(c) deemed to be Unclaimed Money for the purpose of the Unclaimed Money Act 1971; and

(d) paid to the Commissioner of Inland Revenue in accordance with section 4(3) of the Unclaimed Money Act 1971;

9. That leave to apply for further directions is reserved.

Schedule Two: Orders relating to the appropriate pool of assets

1. This schedule addresses two orders sought:

   (a) that the assets of RAM and Dagger be pooled and the liquidation of the two companies proceed as if they are one company; and

   (b) that there should be only one pool of assets for distribution for both general unsecured Creditors and Investors in RAM, rather than two pools of assets.

Legal principles behind pooling

2. Section 271(1)(b) of the CA provides that on the application of a liquidator, the court, if satisfied that it is just and equitable to do so, may order that where two or more related companies are in liquidation, the liquidations in respect of each company must proceed together as if they were one company to the extent that the court so orders and subject to such terms and conditions as the court imposes.

3. Section 2(3) of the CA provides that a company is related to another company if:

   (a) the other company is its holding company or subsidiary;

   (b) more than half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, are held by the other company (whether directly or indirectly, but other than in a fiduciary capacity); or

   (c) more than half of the issued shares, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, are held by members of the other (whether directly or indirectly, but other than in a fiduciary capacity); or

(d) the business of the companies have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable; or

(e) there is another company to which both companies are related.

4. In this Application, the Liquidators rely on (d) above, that the businesses of RAM and Dagger were so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable.

5. Section 272(2) of the CA provides that when deciding whether it is just and equitable to make an order under s 271(1)(b), the Court must have regard to the following matters:

(a) the extent to which any of the companies took part in the management of any of the other companies;

(b) the conduct of any of the companies towards the creditors of any of the other companies;

(c) the extent to which the circumstances that gave rise to the liquidation of any of the companies are attributable to the actions of any of the other companies;

(d) the extent to which the businesses of the companies have been combined; and

(e) such other matters as the court thinks fit.

6. Pooling orders cut across the fundamental principles of the CA, by diluting the separate legal personality of each entity concerned. However, the pooling order exception is intended to give the Court the broadest discretion to effect a result which accords with the common notions of fairness in all the circumstances, bearing in mind the cardinal

principle underlying in solvency administration – that there should be equality among creditors of the same standing.[113]

7. The Court of Appeal recently held that s 271 required the Court to balance two policy considerations:[114]

   (a) The first is respect for the separate corporate identity of the companies in liquidation. Inherent in this rationale is that the companies concerned will be separate commercial entities.

   (b) The second is avoiding the mischief that can result from an overly strict application of separate corporate identity. In particular, where the company is a mere façade, the "corporate veil" does not shield that façade from the operators of the business which is carried on in its name.

Application to the facts

8. Dagger and RAM were related companies for the purpose of s 271(1)(b) of the CA. In particular, and for the reasons detailed below, the businesses of the companies were so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable (as per s 2(3)(d) of the CA):

   (a) David Ross had effective control of both of RAM and Dagger. He was the sole director of both RAM and Dagger.[115] He also held 100% of the shares in Dagger and 50% of the shares in RAM (with the remaining 50% were owned by his wife, Mrs Jillian Ross).[116]

   (b) Mr Ross had sole responsibility for the operations of RAM and Dagger, including all decisions on funds management, research

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[113] See *Re Home Loans Fund (NZ) Limited* (1983) 1 NZCLC 95,073 at 98,583-98, 584 quoted in *Re Dalhoff and King Holdings Limited (in liquidation)* [1991] 2 NZLR 296 (HC) at 308.

[114] *Steel & Tube Holdings Limited v Lewis Holdings Limited* [2016] NZCA 366, (2016) 11 NZCLC 98-045 at [27].

[115] First Fisk Affidavit, paras 3.1 and 3.18.

[116] First Fisk Affidavit, exhibits page 25.

and investment. He was supported by two administrative assistants who were employed by RAM.[117]

(c) RAM's and Dagger's operations were inextricably intertwined. RAM marketed itself as offering investments services to clients. Dagger was the nominee company which would legally own the investments for RAM's clients, while RAM would manage those investments. That is, Dagger's sole business was to hold investments as nominee, for RAM's investment operations.[118]

(d) RAM investors typically entered into a Management Agreement with both RAM and Dagger. This Management Agreement, and their dealings with RAM and Dagger lead investors to believe that:[119]

(i) If they transferred money or shares to RAM, this was in turn transferred to Dagger.

(ii) Dagger would then hold those shares and cash as trustee on the investors' behalf.

(iii) Any cash withdrawals would be paid to investors by RAM, following the sale of shares held for that investor by Dagger.

(e) In fact, RAM and Dagger did not operate in this way. Generally, shares and cash were not transferred to Dagger to be held separately on trust for investors. Instead, investor assets became part of an intermingled pool of shares and cash held by RAM, Dagger and other related entities. From that pool, the operating expenses of RAM, personal drawings by David Ross and payments to investors and share purchases were met.[120]

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[117] First Fisk Affidavit, para 3.1.

[118] First Fisk Affidavit, paras 3.3 – 3.4, 3.18.

[119] First Fisk Affidavit, paras 3.2 – 3.4.

[120] First Fisk Affidavit, para 3.9.

(f) Mr Ross and RAM's two administrative assistants effectively treated Dagger as if it were simply a division of RAM. When instructions were given by them in respect of Dagger, these instructions were simply effected through RAM. Dagger had no employees of its own, nor its own letterhead. Dagger had no trade creditors in its own name.[121] It was effectively a puppet of RAM's, devoid of capacity to conduct its own affairs.[122]

(g) The only expenses Dagger incurred were broker fees and bank account fees in respect of bank account and broker accounts held in its own name.[123]

(h) While Dagger did have bank accounts in its own name, the funds in those accounts generally comprised the sale of shares, which were then paid into RAM's 00 Account to become part of the intermingled pool of assets applied for a number of purposes, including payment of RAM's operating expenses. Significant amounts of funds were transferred from Dagger's bank accounts to RAM's bank accounts, with amounts in recent years being:[124]

(i) in the financial year to 31 March 2011: $2,381,609.73;

(ii) in the financial year to 31 March 2012: $5,849,069.17; and

(iii) in the financial year to 6 November 2012: $2,511,950.64.

(i) These figures can be contrasted with the Investor withdrawals from RAM for each of those years. In particular, Investor withdrawals were:[125]

(i) in the financial year to 31 March 2011: $38,258,320.88;

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[121] First Fisk Affidavit, para 3.18.

[122] See *Steel & Tube Holdings Limited v Lewis Holdings Limited* [2016] NZCA 366 for a similar example of a "puppet company", where pooling orders were granted.

[123] First Fisk Affidavit, paras 3.18, 3.21 and 7.2.

[124] First Fisk Affidavit, paras 3.19 – 3.20.

[125] First Fisk Affidavit, exhibits page 110.

(ii) in the financial year to 31 March 2012: $27,254,224.68;; and

(iii) in the financial year to 6 November 2012: $16,043,354.52.

(j) Despite the terms of the Management Agreement providing that any shares held for investors were to be held by Dagger, shares purchased were ultimately held by RAM also.[126]

9. Applying these factors to the mandatory considerations in s 272(2) of the CA:

(a) *the extent to which any of the companies took part in the management of any of the other companies:*

With the exception of the express terms of the Management Agreements (which were ignored by RAM and Dagger), Dagger effectively operated as simply another facet of RAM.

(b) *the conduct of any of the companies towards the creditors of any of the other companies:*

RAM's approach to treating Dagger as an extension of itself extended into Dagger's finances. As outlined above, funds were transferred from Dagger's accounts to RAM's 00 account, to be applied to a range of expenditure, including RAM's operating costs.

Additionally, it is likely that the apparent involvement of Dagger in RAM's operations gave Investors some sense of security for their investments. The Management Agreement specifically provided that it was Dagger's role in RAM's operations, to hold cash and investments separately for Investors – to avoid intermingling of investors' cash and shares. RAM Investors are now creditors of RAM because, amongst other reasons, Dagger did not comply with its obligations under the Management Agreement.

[126] First Fisk Affidavit, para 3.9.

(c) *the extent to which the circumstances that gave rise to the liquidation of any of the companies are attributable to the actions of any of the other companies:*

RAM's operations as a Ponzi is the reason both companies are in liquidation. As Dagger was effectively run as a facet of RAM, Daggers' liquidation can be entirely attributed to the actions of RAM. In *Re Dalhoff* it was held when granting a pooling order "as a matter of fact…the companies stood or fell together…the failure of one involved the failure of others."[127] This is equally apparent from the way in which RAM and Dagger operated.

The core features of the Ponzi, being the misappropriation of Investor funds upon deposit into RAM's accounts, the intermingling of Investor funds in RAM's accounts, the fictitious reporting of investments and profits to Investors and the payments made to Investors which were not the proceeds of shares held for those Investors were all carried out by RAM.

(d) *the extent to which the businesses of the companies have been combined:*

As above, Dagger was effectively run as simply another facet of RAM.

(e) *such other matters as the court thinks fit:*

There are two other relevant matters for the Court to consider:

(i) No party is adversely affected by the order sought.

(ii) It would be impossible for the liquidations to proceed separately.

These points are explained further below.

[127] *Re Dalhoff and King Holdings Limited (in liquidation)* [1991] 2 NZLR 296 (HC) at 305.

No party adversely affected by the orders

10. Significantly:[128]

    (a) counsel assisting the Court supports the pooling orders sought; and

    (b) no Investor or Creditor has indicated any opposition to the Liquidators or counsel assisting the Court to the pooling orders sought.

11. Dagger has no creditors of its own (save for Investors). Accordingly, no party will be adversely affected by the orders sought. The practical impact of these orders is to make $1,130,208.61 available for Investors (and, subject to the submissions below, Creditors also).

It would be impossible for the liquidations to proceed separately

12. The Liquidators currently hold funds totalling $1,130,208.61 on behalf of Dagger. This is primarily the proceeds of sale of shares held by Dagger at the time of its receivership. The Liquidators consider that these shares were almost certainly purchased using Investors' misappropriated funds.[129]

13. As Dagger was a party to the Management Agreement with Investors, Investors will have claims against Dagger for, at least, a breach of the terms of the Management Agreements. However, the Liquidators consider that it would be impossible to divide Investor claims between RAM and Dagger.[130] This would involve attempting to trace Investors' deposits and share transfers through RAM and Dagger. For the reasons outlined at paragraphs 4 to 14 of Schedule Three, this simply cannot be done. Even if it could be done (which is not accepted), such a task would be very time-consuming, expensive and fraught with uncertainty. Given the current expected dividend of 14 cents in the $, it

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[128] See Memorandum of counsel assisting the Court, para 37(a) and Joint memorandum of counsel for the Applicants and counsel assisting the court in advance of conference on 9 April 2018, dated 6 April 2018 at paras 20 – 21.

[129] First Fisk Affidavit, paras 6.15 and 7.2(h).

[130] First Fisk Affidavit, para 7.2(g).

cannot be in the interests of Creditors and Investors to require the Liquidators to pursue such a fraught (and expensive) exercise.[131]

Are the orders just and equitable?

14. The ultimate question for this Court on this application is whether, in all the circumstances, it is just and equitable to grant the pooling orders sought.

15. As the Court held in *Dalhoff*:[132]

> To separate [the companies] now would be to belatedly recognise a legal separation which has never in fact operated. It would be to prefer some creditors over others and to do so fortuitously since there does not seem to have been any principle on which the activities of the company were divided … Justice and equity are terms which would normally involve equality of treatments taking into account all the surrounding circumstances.

16. Although authorities on pooling orders will generally be very fact specific, there is one decision which has similar characteristics to this. In *Re Pacifica Syndicates (NZ) Limited (in liquidation),*[133] the Court considered an application for a pooling order under the former s 315B of the CA 1955. The Court summarised the background to the application as:[134]

> Thanks to the scandalous mismanagement of the affairs of two companies, the liquidator was faced with a tangled web of inter-related transactions, and substantial claims by members of the public whose investments in the companies' projects had been misapplied and lost.

17. The companies' operations involved the application of investors' money into the purchase of exotic cattle – in one scheme by Pacific Syndicates as trustee for the investors and in the other by the investors

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[131] For Courts granting pooling orders based on similar practical concerns about the forensic accounting required to separate the companies' affairs, see, for example, *Re Dalhoff and King Holdings Limited (in liquidation)* [1991] 2 NZLR 296 (HC).

[132] *Re Dalhoff* at 309.

[133] *Re Pacifica Syndicates (NZ) Limited (in liquidation)* (1989) 4 NZCLC 64,757 (HC).

[134] At 64,758.

themselves. The liquidator sought an order pooling the assets of both companies in the liquidations.

18. Hardie Boys J held:[135]

> There are a number of reasons for making an order in the present case. First, there is the pooling of investors' funds in the one account. Secondly, there is the complex and possibly arguable situation of inter-company debt. Thirdly, and related to it, is the intertwined liability of the companies to investors in the cattle schemes, and the fact that they at the liquidator's invitation proved against Continental Cattle, but not against Pacific Syndicates. Fourthly, there is the impossibility of dividing the Cattle Syndicates fund between the two companies. …Sixthly, the investigating accountant has expressed the view that it would be equitable to allocate any final dividend pro rata between all creditors of both companies. If the liquidator were permitted to do this, this protracted liquidation would be brought to a prompt conclusion without further expenditure on what are likely to be futile accounting and legal exercises.

19. Each of those reasons is present in this case. Accordingly, the Court should adopt the same approach.

20. In any event, even if the liquidations were to progress separately (and leaving to one side the practical difficulties discussed above), the ultimate result would be that either:

    (a) the only claims in Dagger's liquidation would be claims by Investors, meaning the funds are returned to Investors anyway; or

    (b) if Investors did not have claims against Dagger (but only had claims against RAM) then the monies held by Dagger would be distributed to its shareholder – being the bankrupt estate of Mr David Ross. RAM is the largest creditor in the bankruptcy, so any distribution from Dagger's liquidation to the bankrupt estate would be returned to RAM by the Official Assignee. Accordingly, the funds will ultimately be returned to RAM, for the benefit of Investors, albeit it in a more indirect route.

[135] At 64,767 – 64,768.

21. In summary:

   (a) It is consistent with the overarching principle of equality of treatment of similarly affected creditors that the assets of Dagger be made available to all affected Investors (and Creditors).

   (b) If the liquidations are required to proceed separately, the Liquidators will need to incur further and significant time and cost on the (likely impossible) task of separating the companies' affairs. That is in no-one's interests.

One pool or two pools

22. The second order is that there be one common pool of assets for both Investors and Creditors.

23. As is detailed in the Second Fisk Affidavit, there will be some assets which are clearly assets derived from the funds deposited by Investors and misappropriated by RAM. These assets will therefore be held by the Liquidators on trust for the Investors. An obvious example of this is the proceeds of the sale of shares purchased with misappropriated trust funds. There will also be assets which are derived from the company's other sources of funds which are not able to be traced back to the Investors' deposits. These assets will be company assets. Again, an obvious example is the management fees paid to the Liquidators on shares subject to proprietary claims. There are also some assets for which it is not clear into which pool they fall.

24. Ordinarily, if there are two classes of assets the orthodox approach would be to have separate pools of assets, one containing trust assets available to Investors and the other consisting of general assets available to Creditors. However, in this case, the exercise of creating two separate pools of assets for distribution would cause unnecessary cost to the ultimate disadvantage of Investors.

25. Even if tracing could occur for transactions after March 2006,[136] given the extensive time over which RAM operated and the volume of

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[136] This would simply be impossible prior to March 2006 due to the inadequacies of RAM's records; see First Fisk Affidavit, para 9.8.

reported transactions, the cost involved in such an exercise would be wholly disproportionate. The Creditors (i.e. non-Investor creditors) in RAM's liquidation total 26 with claims totalling less than $70,000.[137] That is a fraction of the total claim value – assuming an overall distributions rate of 14.04 cents in the $, the return to Creditors from the $17,500,000 available for distribution is less than $10,000 (or 0.0006%). This means the likely cost of categorising the assets and maintaining two separate pools vastly outweigh any benefit to Investors and Creditors.[138]

26. A similar approach was adopted by the Court in *Arena* where similar practical issues arose. The Court found that it was in the investors' financial interests that there be one common pool of assets and that this approach was the most cost-efficient and pragmatic model to adopt.[139]

27. No objection has been taken to this approach by any Investor or Creditor. Counsel assisting the court supports this approach, subject to the issue outlined in paragraph 2.4 above.

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137 First Fisk Affidavit, para 1.5(b).

138 First Fisk Affidavit, paras 8.6 – 8.10.

139 *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [15].

Schedule Three: Common features of the Distributions Models

1. The three distribution models are put forward on the basis of the following common features:

   (a) There would be no tracing of particular Investor assets.

   (b) Investor claims would be calculated based on contributions made to RAM (cash or transfer of shares) less payments made by RAM. That is, claims would not take into account any purported "profits" earned on any Investor's purported RAM investment.

   (c) Only Shortfall Investors would receive a distribution in RAM's liquidation – Overpaid Investors would not receive any distribution.

   The reasons for these features are explained below.

2. The Liquidators also seek that the Court confirm its approach to dealing with inter-portfolio transfers or purported transfers of value. That approach is explained below. It is proposed that approach would be applied in any of the three distribution models.

3. Each of these proposed orders are supported by counsel assisting the court.[140]

No tracing

4. The Liquidators accept that the starting point for distribution of a mixed fund is that where tracing can be done, there should be tracing.[141] Accordingly, where Investors have been able to trace into shareholdings held by RAM or Dagger as at the date of their receiverships, the Liquidators have sought and obtained court orders allowing them to transfer those shares or pay the proceeds of the sale of those shares to the investors who could establish a proprietary claim.

[140] Memorandum of counsel assisting the Court, para 37(c).

[141] *Re Waipawa Finance Company Limited (in liq)* [2011] NZCCLR 14 (HC) at [14].

However, those instances have been relatively few in number. For the reasons detailed below, RAM's operations mean tracing is either impossible or unreliable, fraught and likely to be very time consuming. The Court have long recognised that where tracing required an enormous effort for unreliable results, justice will require pooling.[142]

5. The starting point for distribution of a mixed fund is *Clayton's Case* which involves a "first in, first out" (FIFO) method of distribution.[143] However, although this is widely recognised to be the correct starting point, it has been the subject of adverse comment for a long time.[144] The Courts have in recent times emphasised that this approach has fallen into disfavour, noting that it may be departed from even by a "slight counterweight".[145]

6. Historically, the Courts have sought to distinguish *Clayton's Case* based on one of two grounds:

   (a) The first is that as *Clayton's Case* is a presumed intention, it must give way to a contrary intention or circumstances which point to a contrary conclusion.[146]

   (b) Second, where it is not practical to trace investors' funds or where such an exercise will involve enormous effort unlikely to produce a reliable result, the application of the rule should be rejected and the Court should give such directions as are necessary to do substantial justice between the parties.[147]

7. In the case of RAM, *Clayton's Case* can be distinguished based on either ground.

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[142] *Re Registered Securities Limited (in liquidation)* [1991] 1 NZLR 545 (CA) at 555.

[143] *Devaynes v Noble* (1816) 1 Mer 572, 35 ER 781 (Ch) (***Clayton's Case***).

[144] For a discussion of the earlier criticisms of *Clayton's Case* see *Re International Investment Unit Trust* [2005] 1 NZLR 270 (HC) at [50] – [57].

[145] *Re International Investment Unit Trust* at [57]; *Vero Liability Insurance Limited v Heartland Bank Limited* [2015] NZCA 288 at [100], *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [17].

[146] *Re Registered Securities Limited (in liquidation)* at 553.

[147] *Re Registered Securities Limited (in liquidation)* at 555, *Graham & Jackson v Arena Capital Limited (in liquidation)* [2016] NZHC 194 at [48] and *Graham & Jackson v Arena Capital Limited (in liquidation)* [2017] NZHC 973 at [17].

8. Investors had expected their investments (deposits and shares) to be held on trust, separately from that of other RAM investors and applied so as to yield returns. They did not expect their funds to be pooled or withdrawn to satisfy the repayment demands of other investors or drawings of Mr Ross or to pay RAM's operational expenses. Their presumed intention, if they had known their investments were to be pooled, must have been to share losses equally. It would be inconsistent with that common intention to apply a FIFO analysis. Such an approach invariably favours later investors over earlier investors, which cannot have been the presumed intention.

9. The Court in *Barlow Clowes* distinguished *Clayton's Case* for a similar reason stating:[148]

> The investors did not expect that their money would be kept in a bank account or used for the purchase of a yacht, or of anything other than gilts…
>
> As soon as the money of two or more investors was mixed together it became part of a common fund that was diminished only when it was used other than for the purchase of gilts. Such investors cannot be presumed to have intended that losses incurred would be borne other than rateably. All the money was paid into a fund, which already was, or which became, depleted. When paid into the fund it ceased to be earmarked or identifiable as the money of individual investors. They did not expect to incur any loss, but when they found that they had done so they would have had no reason to expect that they would be repaid other than pari passu with other investors whose money was held in the same way.

10. Similarly, in *Re Waipawa* the Court held that *Clayton's Case* should not be applied, as it could not have been investors' intentions that the latest investors be paid in full, at the expense of earlier investors.[149]

11. Additionally, it is simply not practical to trace Investors' funds, as required for a FIFO analysis. In particular:

    (a) RAM's inadequate records mean tracing simply cannot be done prior to March 2006.

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[148] *Barlow Clowes International Limited (in liq) v Vaughan* [1992] 4 All ER (CA) at 46.

[149] *Re Waipawa* at [23].

(b) To do so after March 2006:

(i) would be a very complex, time consuming and expensive task. Given the limited funds available, it is not in the Investors' and Creditors' interests to carry out such an exercise. Nor is it consistent with the ultimate purpose to distribute the funds in a reasonable and efficient manner; and

(ii) would also, in effect, treat transactions between the early 1990s to March 2006 in a different manner to those after March 2006, where there is no valid basis for such a distinction amongst Investors.

12. As is detailed in the First Fisk Affidavit, tracing on a FIFO basis simply cannot be done prior to March 2006. This is because:[150]

(a) The Liquidators only hold RAM's bank statements for its main account, the 00 Account from March 2006. They also hold limited statements from various brokers used by RAM and, in the case of some brokers, no statements at all.

(b) RAM's earliest computer records are from June 2000. Prior to that date, the Liquidators would be reliant on incomplete hardcopy records only.

(c) RAM's records simply cannot be relied upon as being accurate. Many of the transactions recorded on the RAM Investor Database were fictitious, meaning tracing using RAM's records is unlikely to be accurate.

Notably of the over 860 Investors at RAM's receivership, 463 of those Investors first invested with RAM prior to March 2006.[151] Accordingly, it would be impossible to trace the investments of at least 54% of affected Investors.

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[150] First Fisk Affidavit paras 4.12 – 4.14.

[151] First Fisk Affidavit, para 9.8(a).

13. While third party records (and in particular RAM's bank statements) are available from March 2006, attempting to trace Investors' funds would be a hugely complex, time consuming and costly task.

(a) A key feature of RAM's operation is the volume of transactions. There was a large number of transactions occurring through RAM's 00 Account at any time. This is particularly so at the beginning or end of the month. The First Fisk Affidavit gives two example days: 2 July 2007 and 30 June 2010. On each of these days there were 55 transactions through the 00 Account.[152] This snapshot gives an indication of the volume of transactions that would be required to be "traced" through RAM's 00 Account and beyond. There would also invariably be difficulties and disputes regarding which Investors' deposits into the intermingled pool could be traced to a particular purchase of shares, which were funded from the intermingled "pool" of funds.

(b) Additionally, it was not uncommon for a broker, under RAM's instruction, to purchase shares using the proceeds of the sale of shares it had previously acquired on RAM's behalf, meaning those proceeds were not ultimately paid into any bank account of RAM. The Liquidators do not have full broker statements to track all of these transactions.[153]

14. Accordingly, any tracing exercise post March 2006 would be incomplete, uncertain, fraught with disputes, time consuming and expensive. In a liquidation where the current dividend is only 14 cents in the $, it is not in the Investors' interests to engage in such an exercise, nor is it consistent with the overarching duty to distribute assets in a reasonable and efficient manner.

Contribution basis

15. The Liquidators propose that distribution will be based on an Investors' contributions to RAM and pre-liquidation payments from RAM. This means:

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[152] First Fisk Affidavit, para 4.19.

[153] First Fisk Affidavit, para 9.8.

(c) no purported "profits" would be taken into account when calculating Investors' claims; and

(d) Overpaid Investors would not receive any distribution in the liquidation.

16. In all the circumstances, the Liquidators consider this is the fairest approach to distribution. They recognise that Overpaid Investors may still have claims against RAM arising from the misappropriation of their investments, which would mean they were still a creditor of RAM. However, there is ultimately only a very limited pool of assets to distribute amongst significant claims. Shortfall Investors will recover only a fraction of their net contribution which was misappropriated by RAM.

17. Recognising claims in respect of "fictitious profits", lost opportunity or the like would ultimately diminish the pool of assets for those who will not recover their capital contributions in full. It is also consistent with the approach taken by the Supreme Court in *McIntosh v Fisk*, which held that payments of "fictitious profits" could be clawed back, subject to available defences.[154]

18. As detailed at paragraphs 4.6 (c) and (d) above, to require the Liquidators to consider claims other than simply on a net contribution balance basis (e.g. claims for damages or purported profits) will be time consuming and complex. The Liquidators consider that it will result in a distributions process which is time consuming and fraught. It will add further complexity, increase investor confusion about their expectations in the distributions process and in turn will increase the costs of the liquidation. It will also have an immediate effect on the interim distribution proposed.

[154] See *McIntosh v Fisk* [2017] NZSC 78.

Inter-portfolio transfers

19. RAM permitted Investors to transfer "value" from their RAM investment portfolio to another Investor's RAM investment portfolio. For example:[155]

    (a) A jointly held portfolio might be split into individual portfolios, with one investor retaining the original portfolio and half the value being transferred to establish a new portfolio in the name of the other investor.

    (b) A parent might "transfer" a specified amount or specified shareholdings (which did not in fact exist) to establish a RAM portfolio in their child's name.

    (c) An investor might "transfer" a specified amount or specified shareholdings (which did not in fact exist) to establish a portfolio in the name of a related trust.

20. However, as RAM was operating a Ponzi scheme, the reported transfers were almost inevitably a fiction as the assets "transferred" did not exist; or existed only in part.

21. The Liquidators' general approach to inter-portfolio transfers in the context of assessing clawback claims has been to recognise the transfer as a transfer of value only to the extent of any positive net contributions balance in the transferring portfolio's account.

22. That is:[156]

    (a) where the transferring portfolio already had a negative net contributions balance at the time of transfer (i.e. the transferring investor had already been paid by RAM more than they had contributed) the Liquidators have not recognised any transfer on the basis that the transferring portfolio had no "value" to transfer;

[155] First Fisk Affidavit, para 10.1.

[156] First Fisk Affidavit, para 10.4.

(b) otherwise the Liquidators have recognised the transfer as a valid transfer of value only up to the value of the positive net contributions balance existing at the time of the transfer.

23. There have been (a very limited number of) exceptions to the Liquidators' general approach where the particular circumstances meant that the Liquidators considered a different approach was required to achieve the fairest result. An example of such a situation is given at para 10.6 of the First Fisk Affidavit.

24. The Liquidators seek an order confirming that their general approach to inter-portfolio transfers is correct when calculating Investor claims for the purpose of distribution, but with a carve out that where they consider their general approach would lead to a result which is unjust or ineffective as applied to a particular portfolio or portfolios, that:[157]

(a) the Liquidators may apply a reasonable and logical alternative methodology; but

(b) where such an alternative methodology is adopted, leave is granted to the affected Investors to apply to the Court within this proceeding if they wish to challenge the Liquidators' decision in respect of that particular purported inter-portfolio transfer

25. No Investor has raised any objection to this proposed direction. Counsel assisting the court supports this proposed direction, save that Mr Chisnall proposed that an order should address service on the affected investors with a clearly set out timetable to file any challenge.[158]

26. In light of Mr Chisnall's comments, the Liquidators propose that the order provide for the following additional details:

(a) where Liquidators have adopted an alternative methodology to the treatment of inter-portfolio transfers, the Liquidators will write

[157] First Fisk Affidavit, para 10.8.

[158] Memorandum of counsel assisting the Court, para 37(c)(iv).

to the Investor (by email, if an email address is held, failing which by post) detailing:

(i) why the Liquidators consider the usual approach to inter-portfolio transfers is unjust or ineffective;

(ii) the Liquidators alternative methodology applied; and

(iii) the Investors' right to apply to challenge the method.

Schedule Four: Ancillary orders

1. This application seeks three ancillary orders, as follows:

   (a) confirmation that the Liquidators are entitled to deduct their costs and expenses in the liquidation from the common pool of assets;

   (b) orders sought to streamline the process for lodging a claim form in the liquidation of RAM and Dagger; and

   (c) orders as to how to manage distributions where the entitled Investor cannot be contacted to arrange payment of their distribution.

Costs

2. The Liquidators seek orders regarding the deduction of their costs and expenses in the liquidation from the common pool of assets.

3. The original liquidation orders set the Liquidators' remuneration. Liquidation costs (largely liquidators' fees and legal fees) have been regularly reported to the Liquidation Committee and to investors generally (by virtue of the liquidators' reports). They have been paid on a monthly basis from the funds held by the Liquidators.

4. Section 278 of the CA provides that the expenses and remuneration of the liquidator are payable out of the assets of the company. Assets held on trust for Investors are not the assets of the company.

5. The Court however has an inherent jurisdiction to allow payment of expenses to liquidators out of trust assets to meet the costs of trust administration. *Re Ararimu Holdings* summarised the principles applying to that jurisdiction as follows:[159]

   (a) The priority of the CA is such that that the liquidators' costs are to be met out of the whole of the assets of the company first, and those costs will include the remuneration for the whole of the liquidators' services in winding up the affairs of the company

[159] *Re Ararimu Holdings Limited* [1989] 3 NZLR 487 at 504.

whether relating to the company's own property or in relation to the trust property held or administered by it.

(b) In the event of a deficiency, then in the exercise of the Court's inherent jurisdiction to protect trust property, the liquidator may be remunerated out of the "trust" property to the extent to which their services related to the preservation and proper disposal thereof but not further.

(c) Such remuneration should be borne pro rata by all investors who had money or investments in the hands of the company at the commencement of the winding up.

6. If the Court orders that there should be one pool of trust and company assets, the principles in *Ararimu* will not be able to be readily applied. Accordingly, the Court's inherent jurisdiction should be exercised to allow payment of the Liquidators' expenses out of the common pool. Such an order is consistent with the approach the Court has taken in similar instances of liquidators' costs in relation to a Ponzi operator which involves trust and company assets – see for example, *Arena*, *Re International Investment Unit Trust (in stat man)* and *Re Waipawa*.

7. However, if the Court adopts the "two pools" approach, then on the basis of *Ararimu* the costs of the liquidation should be deemed to have paid from the company assets first with any shortfall to come from the trust assets. There would be no shortfall if, as above, the proceeds of clawback claims are held to be company assets and not trust assets.

Claim forms

8. The Liquidators seek orders intended to streamline the claim form process.

9. The Liquidators expect that the standard claim form as prescribed by the Companies Act Liquidation Regulations will be problematic.

10. The quantum of each Investors' claim will depend on three factors:

(a) their transactions with RAM (contributions and payments);

(b) which distributions model this Court orders will apply; and

(c) the effect of a CPI adjustment (if so ordered by this Court) on Investors' claims.

11. Most Investors will only know their transactions with RAM (at best). They will not be able to carry out their own CPI adjustment (and in any event, this would need to be checked by the Liquidators to ensure calculations were consistent for all Investors). Even if a CPI adjustment is not ordered, Investors may well be unable to carry out their own distributions calculation. (They certainly will not have sufficient information to be able to calculate their own distribution under the Rising Tide Model).

12. The Liquidators will need to explain the effect of the Court's orders in this application to Investors. Accordingly, sending Investors a blank claim form to fill out will invariably cause confusion and be time intensive for the Liquidators as they, and PwC staff, need to instruct Investors individually on how to fill out the claim form and then check all these forms. This process will be costly.[160]

13. The Liquidators' proposed process will significantly expedite the distribution process. It provides that:[161]

(a) the Liquidators will write to Investors entitled to a distribution summarising their transactions with RAM (contributions to RAM and payments from RAM, as adjusted for CPI if so ordered) and stating their claim in the liquidation based on the model proposed by this Court (the **Transaction Summary**);

(b) the Investor can then accept the Transaction Summary by signing it and returning it to the Liquidators, at which time it is deemed to be the requisite claim form for the purpose of section 304 of the CA and the Liquidation Regulations;

[160] First Fisk Affidavit, paras 11.18 and 11.19.

[161] First Fisk Affidavit, para 11.20.

(c) alternatively, the Investor can object to the Transaction Summary in writing, detailing the grounds for the objection within:

(i) 20 working days after the Transaction Summary was sent to them, if sent by email; or

(ii) 30 working days after the Transaction Summary was sent to them, if sent by post to a New Zealand address; or

(iii) 40 working days after the Transaction Summary was sent to them, if sent by post to an address outside of New Zealand.

(d) If the Investor objects, the Liquidator must make a decision in relation to a written objection within 20 working days and this decision is deemed to be the admission or rejection of the claim (in whole or in part) for the purpose of section 284 of the CA.

(e) The Investor can then challenge the Liquidators' decision in the usual way.

14. The Liquidators consider this to be the most efficient, expeditious and cost-effective way to receive claim forms from Investors,[162] while still providing the Liquidators with the usual protections within a liquidation and preserving the right for Investors to challenge the Liquidators' assessment of their claim and resulting distribution.

Distributions not claimed

15. Given the significant number of Investors and Creditors in the Ross Group liquidations (59 for whom the Liquidators do not have any contact details) the Liquidators are conscious that there may be some Investors who cannot be located to be provided with a Transaction Summary or their distribution. The Liquidators therefore seek orders which would enable them to wind up the liquidation promptly, without needing to incur significant cost attempting to locate these Investors.[163]

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[162] First Fisk Affidavit, para 11.20.

[163] First Fisk Affidavit, paras 11.13 and 11.21.

16. Unclaimed monies in a liquidation are dealt with at s 316 of the CA. Section 316(1) provides that:

> Money representing unclaimed assets of a company standing to the credit of a liquidator shall, after completion of the liquidation, be paid to Public Trust.

17. This section gives rise to two issues:

    (a) First, whether it applies to assets held by the Liquidators on trust for Investors.

    (b) Second, whether the Liquidators are required to try to trace or otherwise locate Investors for payment.

18. The Liquidators submit that in the absence of a court order, s 316 does not apply to assets held by the Liquidators on trust. This is because s 316 expressly refers to "unclaimed assets of a company". Trust assets are not assets of a company and are therefore not available in the liquidation to creditors.

19. This means, *prima facie*, unclaimed distributions for Investors – either from the "trust pool" or the common pool of assets – will not fall within s 316 above and must fall under the Unclaimed Money Act 1971.

20. The position under the Unclaimed Money Act 1971 is that the Liquidators would be required to retain the distribution for either:

    (a) six years, following the date on which the money became payable;[164] or

    (b) as RAM has ceased to carry on business, for a period of at least six months following the cessation of its business.[165]

21. The Liquidators therefore seek to clarify the position on unclaimed distributions in RAM's liquidation. They seek a direction that where an Investor has not signed the Transaction Summary within six months

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[164] Unclaimed Money Act 1971, s 4(1)(e).

[165] Unclaimed Money Act 1971, s 4(3).

after it was issued (and has not provided a written objection to the Transaction Summary) or where the Investor cannot be located to be provided with a Transaction Summary, their distribution be treated as unclaimed monies and paid to the Commissioner of Inland Revenue, pursuant to section 4(3) of the Unclaimed Money Act 1971.

22. Alternatively, the Court could order that section 316 of the CA will apply to any distribution otherwise payable to an Investor, where the Investor has not signed the Transaction Summary within six months after it was issued (and has not provided a written objection to the Transaction Summary) or where the Investor cannot be located to be provided with a Transaction Summary. From the Liquidators' perspective, either order achieves the same result.

23. The orders sought are just and equitable. The liquidation of RAM has been the subject of significant media coverage over the previous six years. Therefore, for those Investors for whom the Liquidators currently do not have any contact details, it cannot be assumed that such details will be located in the near future.

24. If the orders sought are not granted, there is a risk that a very small number of Investors who cannot be located may prevent the liquidation of the Ross Group being concluded promptly and efficiently.