

Untangling a Ponzi scheme – New Zealand Supreme Court gives final word on claw back

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9 August 2017

In *McIntosh v Fisk* [2017] NZSC 78, the New Zealand Supreme Court had to consider whether the liquidators of a Ponzi scheme were entitled to recover from an investor a payment that the investor had received shortly before the appointment of the liquidators.

In 2007, Mr McIntosh (McIntosh) invested \$500,000 with Ross Asset Management Ltd (RAM). RAM was to hold the money on trust for McIntosh and use it to purchase securities as McIntosh's agent. All of RAM's investors, including McIntosh, were led to believe that their portfolios were increasing in value. In 2011, McIntosh cashed up his portfolio and received \$954,047 from RAM. This sum represented the original \$500,000 invested by McIntosh together with \$454,047 of (fictitious) profit.

In reality, RAM was operating as a Ponzi scheme. McIntosh's \$500,000 had become part of a pool of cash and securities, which RAM used to pay out other investors. In 2012, liquidators were appointed to RAM. The liquidators subsequently sought repayment from McIntosh of the full \$954,047 on the basis that the payment was an insolvent transaction. The High Court, Court of Appeal and now Supreme Court have all held that the liquidators were entitled to claw back the fictitious profits paid out to McIntosh but that McIntosh was allowed to retain his original investment of \$500,000.

Legal framework

In New Zealand, the Companies Act 1993 and Property Law Act 2007 contain regimes for liquidators to recover certain payments made by a company to a creditor in certain periods prior to liquidation. Both Acts essentially provide a creditor with a defence if the creditor:

- Did not know, or ought to know, that the company was (or would be insolvent) at the time of the payment
- Received the payment in good faith
- Either gave value for the payment or altered their position in reliance on the payment.

The Supreme Court had little difficulty concluding that the liquidators had established all of the elements under the Companies Act and the Property Law Act for recovering the \$954,047. The most contentious issue was whether McIntosh had a defence to the liquidators' claim and, if so, whether he was entitled to retain the full amount of \$954,047 or only his initial investment of \$500,000.

McIntosh had acted in good faith and there was no reason for him to suspect that the payment made to him by RAM was an insolvent payment. The key issue requiring determination was whether McIntosh gave value or altered his position in reliance on the payment such that he had a defence to the liquidators' claim.

The giving of value

When considering the giving of value, the Supreme Court relied on its earlier decision in *Allied Concrete Ltd v Meltzer* [2015] NZSC 7, which dealt with the meaning of "gave value". In that case, the Court held that the phrase could include value given when the debt was initially incurred or value arising from the reduction or extinguishment of a liability to the creditor incurred by the debtor company because of an earlier transaction. Accordingly, if McIntosh gave value at the time he invested his \$500,000 with RAM, this would remain value for a later repayment. However, the value given had to be "real and substantial", and not simply value sufficient to constitute consideration in contract terms.

The majority found that, despite never parting with beneficial ownership of the \$500,000, McIntosh gave value once RAM misappropriated McIntosh's funds. Once RAM misappropriated the \$500,000, it became indebted to McIntosh for that amount. The fact that, after receipt, RAM acted fraudulently in a way that destroyed the value of what had been provided did not undermine the nature of the value given.

However, McIntosh could not prove that he had given value for the fictitious profit of \$454,047. In particular, RAM had no contractual obligation to pay any profit to McIntosh and so the payment of the profits did not discharge any liability RAM owed to McIntosh. Although the *Allied Concrete* principles only required that value be "real and substantial" the Court could see no

sustainable basis for finding that the payment of the \$500,000 gave value for the fictitious profit of \$454,047.

One Judge (Glazebrook J) agreed that McIntosh was not entitled to retain the fictitious profit of \$454,047 but went further and also held that McIntosh should not be entitled to retain his original investment of \$500,000. Her Honour considered that McIntosh did not give value for the \$500,000 because:

- McIntosh did not intend to provide the money for RAM to use for its own benefit. McIntosh expected that the money would be held on trust and used to purchase securities for his benefit
- Though there was a clear breach of trust when RAM misappropriated the money, the trust relationship continued. Accordingly, RAM had only bare legal title to the funds and this did not amount to valuable consideration
- The only "value" provided by the \$500,000 was that it allowed RAM to continue to perpetuate the ongoing fraud. This could be contrasted with actual value provided by trade creditors through the supply of goods and services.

Change of position

McIntosh also could not make out a change of position defence in relation to the payments he received from RAM. McIntosh attempted to argue that he had made the decision to proceed with a new property development in reliance on receiving the payments. However, the Court found that his intention had always been to proceed with the new property development and that his position had not changed in reliance on the RAM payments.

Conclusion

This case provides New Zealand with a final ruling on how the concept of giving value applies in the context of a fraud. However, insolvency law in New Zealand is currently under review. As part of the review, it has been noted that insolvency law was never intended or designed to address fraud (and nor should it be) and it has been suggested that the relevant legislation could be amended to aid the recovery of funds from Ponzi scheme investors in similar circumstances.

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