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MINIMISING WINNERS TO GIVE MORE TO LOSERS: AN ANALYSIS OF NEW ZEALAND'S VOIDABLE TRANSACTION REGIME IN LIGHT OF *FISK V MCINTOSH*

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Abstract

Fisk v McIntosh brings light to pertinent issues within New Zealand's voidable transaction regime, an integral component of the country's insolvency law framework. The case concerns a payment received by an innocent investor upon exiting a Ponzi scheme. The scheme's liquidator has claimed the entirety of the payment as a voidable transaction under the Companies Act 1993. The High Court and Court of Appeal held that the sum of the original investment can be retained, but any profits must be returned. This paper analyses the Courts' interpretation of the defence provision under the voidable transaction regime and discusses the true meaning of "value" under the Act. The tension between upholding commercial confidence and treating unsecured creditors equally is highlighted. It is argued that courts must give priority to commercial confidence and fairness to individual creditors over a remorseless application of parity-based logic wherever a payment has a preferential effect. It concludes that in order to maintain clarity in New Zealand's company law and ensure its purpose is upheld, creditors should remain entitled to keep payments received in good faith, for which they provided real and substantial value.

Key Words

Fisk v McIntosh, Companies Act, voidable transaction, liquidation, Ponzi.

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I Introduction

Fisk v McIntosh is a test case arising from a company liquidator's attempt to claw back payments from an innocent investor of Ross Asset Management, New Zealand's largest Ponzi scheme.[1] This paper will consider the current legal framework for liquidation under the Companies Act 1993, in particular the s 296(3) defence under the voidable transaction regime.[2] It will analyse how the Court in *Fisk v McIntosh*[3] misinterpreted the regime in light of the factual background of the case, a situation which does not fit squarely into New Zealand's company law.

Part one will outline the relevant parts of the voidable transaction regime and the facts of *Fisk v McIntosh.* Part two will critique the Courts' interpretation of the s 296(3) defence and their analysis of whether the defendant gave value for the payment he received. It will argue that the Courts should have interpreted the term "value" to mean real and substantial value as opposed to equivalent value, the former being in line with previous case law, and parliamentary purpose. This part will consider the practical implications of having a requirement of equivalent value compared to one of real and substantial value, finding the latter to be not only more workable, but also in harmony with the policy and purpose of the Act.

Part three will consider the competing policy principles behind the differing interpretations – those of *pari passu* distribution and commercial confidence. The voidable transaction regime was intended to function as an exception to the general rule of commercial confidence.[4] It has since been interpreted in such a way by the Courts that creditors *keeping* their money has become more of an exception. This paper will argue that widening the defence and allowing for a broad interpretation of "real and substantial" value will realign the regime with its purpose by allowing innocent creditors to keep their money where they

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[1] *Fisk v McIntosh* [2015] NZHC 1403.

[2] Companies Act 1993.

[3] And subsequent appeal: *McIntosh v Fisk* [2015] NZCA 74.

[4] Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at [696].

have provided significant value for it. Despite the fact that this may not be in accordance with *pari passu* distribution, it is justified on the basis that it provides greater certainty in commercial transactions.[5]

This paper relies on the acceptance of three points. First, that value under s 296(3) means real and substantial value, as opposed to equivalent value. Secondly, that without a requirement of equivalence, a single transaction cannot be assessed as two separate payments, and thirdly, that an investment of $500,000 must be real and substantial use of money value.

The overanalysis of the voidable transaction regime in *Fisk v McIntosh* is a testament to the statement that "hard cases make bad law". The complication of the case by the Courts has led to the term "value" being misinterpreted in order to realise a "fairer" outcome for a larger number of creditors, where there is nothing under the law to justify such a result. This case has obscured the clarity of the Companies Act by creating exceptions and implementing a strained interpretation that was never intended by Parliament, but has been designed by judges to achieve what they believe is justice in the particular case.[6]

II Voidable transaction regime

Under s 292(1) of the Companies Act an "insolvent transaction" is voidable by the liquidator if it was entered into within the specified period[7] of two years before the commencement of the liquidation.[8]

An *insolvent transaction* is a transaction by a company that—

(a) is entered into at a time when the company is unable to pay its due debts; and

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[5] Spencer A Winters "The Law of Ponzi Payouts" (2012) 111 MLR 119 at 119.

[6] Hon Justice Paul Heath "Hard Cases and Bad Law" (paper presented to University of Waikato, October 2008).

[7] Companies Act, 292(1).

[8] Section 297(3)(b).

> (b) enables another person to receive more towards satisfaction of a debt owed by the company than that person would be likely to receive in the company's liquidation.[9]

Section 296 provides a defence to any voidable transaction, allowing a creditor to set aside a liquidator's claim to claw back payments under the regime.[10] Under s 296(3), a court must not order the recovery of a company's property (or its equivalent value) if the person receiving the property; a) acted in good faith; b) had no reasonable grounds to suspect and did not suspect that the debtor company was, or could become insolvent, and c) either *gave value for the payment* or altered his or her position in the reasonably held belief that the payment was valid and would not be set aside.[11]

This paper will focus on the first alternative defence under s 296(3)(c) – the issue of whether value was given in exchange for the payment received. Value is not defined anywhere in the Act and courts have continuously grappled with its interpretation for the purpose of s 296(3)(c).[12] The requirements of the defence will be considered in detail, with a particular focus on what constitutes value.

It is notable that payments made up to six years before liquidation can also be challenged under s 348 of the Property Law Act 2007.[13] The preconditions to recovery are essentially the same under both Acts, albeit with slight variations in wording, and a different specified period.[14] Section 296(3) of the Companies Act applies to clawback actions under any enactment.[15] Although claims were made in the alternative, the Courts' focused their analysis on the Companies Act, noting that any findings as to whether the defence applied would be true for both enactments. This paper will do the same.

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[9] Companies Act, s 292(2).

[10] Section 296.

[11] Section 296(3).

[12] Jean Sarah Watson "*Towards a Coherent Voidable Preference Regime for New Zealand*" (LLM Thesis, University of Toronto, 2014) at 31.

[13] Property Law Act 2007, s 348.

[14] *Fisk v McIntosh*, above n 1, at [32].

[15] Section 296(3).

III Ponzi Schemes

Payments out of a Ponzi scheme in the two years prior to the scheme's liquidation are voidable transactions under the Companies Act.[16] The scheme's liquidator can apply to claw back payments made by the scheme in the two-year period before the liquidation in order to increase the pool of assets available to the scheme's unsecured creditors.

Nothing in the legislation suggests that the liquidation of Ponzi schemes should be treated differently from any other instance of insolvency. The Companies Act was enacted to simplify the law by finding uniform solutions based on the substance, rather than the form, of the particular case.[17] The Act is intended to apply equally to all insolvency cases.

IV Fisk v McIntosh

A Ross Asset Management Limited

Fisk v McIntosh is the first of three test cases arising from the liquidation of Ross Asset Management Limited (RAM). RAM was an investment business operated by David Ross. The business purported to invest clients' money in shares and other investments.[18] The legal structure of the arrangement was that each investor entered a management deed with RAM as manager and a separate company owned by RAM as nominee.[19] Investors were given quarterly statements that reported healthy returns on their investments,[20] but this was all a facade.[21] Ross did not operate his business in accordance with the contract.[22] He was

[16] *Fisk v McIntosh*, above n1, at [51].
[17] David Brown and Tom Telfer *Personal and Corporate Insolvency Legislation* (2nd ed, LexisNexis NZ Limited, Wellington, 2013) at 110.
[18] *Fisk v McIntosh*, above n 1, at [1].
[19] At [3].
[20] At [1].
[21] At [2].
[22] At [7].

operating a Ponzi scheme under which investors' funds were misappropriated and applied for other purposes. [23] Instead of transferring investors' shares to the separate company to be held on trust, the assets entered a pool of shares held by Ross Group companies. From that pool, RAM paid the operating expenses of the company, Ross's personal drawings, investors requesting repayment, and for the few share purchases actually made.[24] The Ross Group entered liquidation in late 2012 when it became clear that most of the assets supposedly held for investors did not exist and that their funds were never invested in the securities reported to them.[25] At liquidation, the company's liabilities exceeded its assets by approximately $100 million.[26]

The result of this case will determine the fate of former investors who withdrew their investments up to two years (or six years for payment challenged under the Property Law Act) before the liquidation, as well as that of the unsecured creditors who will take out of a relatively small (or growing) pool, depending on the success and quantum of the liquidator's clawbacks.

B Particular facts

John Fisk (RAM's liquidator) is seeking to recover $954,047 paid out to Hamish McIntosh, an innocent investor of RAM, under the voidable transaction regime.[27] McIntosh withdrew his funds from RAM in November 2011.[28] Fisk claims that McIntosh received more money than he would have received had he not exited the scheme before liquidation and that the funds recovered will be property of other investors, not RAM.[29] McIntosh is seeking to keep the full amount on the basis of the s 296 defence.

[23] At [2].
[24] At [9].
[25] At [2].
[26] At [24–26].
[27] *Fisk v McIntosh,* above n 1, at [19].
[28] At [16].
[29] At [22].

McIntosh deposited $500,000 with RAM in April 2007 to establish an international equity portfolio under a formal contract with RAM. According to a report received by McIntosh, the money was used to commence a profitable share portfolio.[30] In November 2011, at McIntosh's request, RAM paid McIntosh $954,047. The payment was made in six instalments.[31] The investment report following payment said that eight share parcels were sold to realise the amount paid to McIntosh. Fisk's evidence is that none of the shares existed.[32] Monies paid to McIntosh were actually derived from sales of other shares and securities, not those reportedly held by McIntosh, from intercompany transfers, from accounts of companies within the Ross Group and just under $250,000 from deposits paid by other investors.[33]

It is common ground between the parties that McIntosh acted in good faith, having no reason to suspect that RAM was, at all relevant times, a Ponzi scheme.

C Procedural history

Mackenzie J in the High Court found that the payment made to McIntosh could be divided for the purpose of assessing what constitutes value. He found that McIntosh could keep the $500,000 he originally invested with RAM but had to return the "fictitious profits" of $454,047.[34]

The majority in the Court of Appeal agreed that McIntosh could retain the $500,000 investment because the consideration for the $500,000 was not only real and substantial, but "quantifiable and equivalent."[35] The Court held that the liquidators are entitled to recover $454,047 because McIntosh gave no value for that amount.[36]

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[30] At [13].
[31] At [13].
[32] At [17].
[33] At [18].
[34] *Fisk v McIntosh*, above n 1, at [82]-[83].
[35] *McIntosh v Fish* [2015] NZCA 74 at [38].
[36] At [52].

Miller J (dissenting) held that the entire payment of $954,047 should be returned. He disagreed with the majority and Mackenzie J that the case of *Allied Concrete v Meltzer,*[37] governed this case.[38]

V Allied Concrete

Allied Concrete concerned insolvent companies that had made payments to entities supplying goods and services on credit. Payments were made under 60 or 90 day credit arrangements for goods supplied prior to submission of invoices.[39] The primary issue in *Allied Concrete* was whether value for the purpose of s 296(3)(c) means new value given at, or after the receipt of payment from the debtor company, or whether it can also encompass value given at the time the antecedent debt was created. [40] The Court found that value does not require proof of new value given when or after a payment is received. [41] It extends back to an earlier time.[42] Value given at the time of the original transaction when the antecedent debt was created is sufficient to engage the defence under s 296(3)(c).[43] Creditors need then only to prove that they acted in good faith, with no suspicion of insolvency, in order to defeat a voidable transaction claim.

Mackenzie J restated the essence of the decision as being that: [44]

> "where a payment discharges an obligation arising from a situation in which value has been provided to the company, the need for value can be met, even though there is not a contemporaneous exchange of moneys' worth at the time the challenged payment is made."

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[37] *Allied Concrete v Meltzer* [2013] NZSC 51.
[38] *McIntosh v Fish*, above n 33, at [98].
[39] At [22].
[40] *Allied Concrete v Meltzer*, above n 35, at [3].
[41] At [130].
[42] At [130].
[43] At [130].
[44] *Fisk v McIntosh*, above n 1, at [73].

McIntosh provided $500,000 value upon entry into the contract with RAM. *Allied Concrete* provided a platform for this prior payment to engage the defence, leaving only the question of whether the sum is real and substantial to satisfy the requirements of s 296(3)(c).

The Court in *Allied Concrete* found that value means "real and substantial" value.[45] This means value that is not "merely nominal or trivial", is more than the contractual notion of consideration,[46] but is not necessarily "full" value. [47] Value is to be measured at the time that it was given by the creditor, rather than at the time the challenged payment is received. The majority in *Allied Concrete* observed that sufficiency of consideration was unlikely to arise in routine commercial transactions between unrelated parties at arm's length, but that in a typical transaction, it is expected that the value given would always be real and substantial.[48] McIntosh and RAM had an arm's length relationship. From McIntosh's perspective, it was no different from any situation whereby an investor deposits money with a fund manager or investment broker. This contract was routine for the industry.

VI Value given according to McIntosh

Counsel for *McIntosh* argued that he provided value for the payment in four substantial ways:[49]

a) The original investment of $500,000;
b) The benefit to RAM of the use of the money for four years, (and the corresponding detriment to McIntosh of his deprivation of it) otherwise known as the time value of money;
c) His promise to pay management fees; and

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[45] *Allied Concrete v Meltzer*, above n 35, at [76].
[46] At [76].
[47] *Trustee of the Property of the Bankrupt v Abbot [In re Abbott]* [1983] 3 WLR 86 (Ch).
at 57 cited in *Allied Concrete v Meltzer,* above n 35, at [76].
[48] *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* [2011] NSWCA 109 at [162] cited in *Allied Concrete v Meltzer*, above n 32, at [76].
[49] *Fisk v McIntosh*, above n 1, at [65].

d) The discharge of RAM’s debt to McIntosh on repayment.

The Courts found that the only relevant value was McIntosh’s original investment of $500,000 into RAM and this could only constitute value for $500,000 of the $954,047 he received.

VII Assessment as a single transaction

The Courts divided the payment into two elements for the purpose of the value assessment. In order to find that only the original $500,000 could be clawed back, Mackenzie J assessed the total $954,047 separately as principal investment, and “fictitious profits”, holding that value was provided only for the former.[50] The Court of Appeal upheld this distinct application of the defence to the two elements of the payment,[51] but like the High Court, did not allude to any authority enabling it to assess whether value was provided in this way.

The Courts divided the payment in order to achieve equivalence of value, and to provide a “fairer” outcome to the general pool of unsecured creditors.[52] Splitting a single transaction into two payments in order to achieve equivalence is not permitted under New Zealand law.[53] It is not in line with the reality of the situation, nor with what either party believed to have happened at the time. This paper will argue that the payment should be assessed as a single transaction for which value either was, or was not, provided. The transaction should be viewed as a whole,[54] as in essence, it was. The judgment describes this as the “all or nothing” approach.[55] A similar payment from a non-Ponzi company would be assessed as a single sum. This transaction should not be treated any differently on the basis of the scheme from which it came.

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[50] *Fisk v McIntosh*, above n 1, at [88].
[51] *McIntosh v Fish*, above n 33, at [17].
[52] *Fisk v McIntosh*, above n 1, at [92].
[53] At [84].
[54] Brown and Telfer, above n 16, at 110.
[55] *Fisk v McIntosh*, above n 1, at [87].

McIntosh's counsel argued that the payment was in substance one transaction – a single payment in response to one full closure.[56] Mackenzie J rejected this point, saying that though the payout from RAM *was* a single transaction, it was not effected by one single payment, but six payments to McIntosh over a one month period.[57] Following this reasoning, it makes more sense to assess the transaction as six separate payments, as it actually happened, as opposed to two. The Court admitted that it must look at the substance of the payment, but found this to contain two elements – original investment and fictitious profits. The payment did not contain two elements from the point of view of McIntosh or RAM. It was one payment of what was owed to McIntosh according to his investment statement.

Fisk's counsel raised an alternative argument. They sought to rely on the payment in six separate amounts, each to be treated as an individual transaction.[58] Both Courts rejected this approach, finding it "artificial to attempt to allocate value to individual payments where all were made in response to [McIntosh's] withdrawal notice."[59] This shows a use of contradictory reasoning in order to get to their desired outcome. The rejections makes little sense when considering that they accepted the assessment as *two* separate payments, when it was a singular payment of $954,047 that was made in response to McIntosh's withdrawal notice. It was never split in two by RAM. Following this reasoning, the "all or nothing" approach should have been taken because that reflects reality and is therefore the least "artificial" method of assessment. A finding that RAM presented the principal and profits as separate components is both contractually and factually wrong.

VIII Courts' interpretation of value

The Court of Appeal suggested that under the Act, value means "equivalent value".[60] An interpretation necessitating an inquiry into equivalence of value in order to achieve the

[56] At [85].
[57] At [85].
[58] *McIntosh v Fish*, above n 33, at [50].
[59] At [51].
[60] *Fisk v McIntosh*, above n 1, at [85]–[86].

objective of fairness[61] allowed the Court to assess RAM's payment to McIntosh as two elements. There is no basis to support this finding. Following *Allied Concrete,* a correct interpretation of the section requires only "real and substantial" value.[62] The Supreme Court never mentioned "equivalence" as a requirement under the defence.

A requirement of equivalent value is inconsistent with *Allied Concrete,* as well as the wording of s 296(3)(c), which contains no such qualification. A purpose of the 2006 reforms to the Companies Act was "the simplification of the law", which Parliament found was "no less critical in relation to liquidation than elsewhere."[63] Prior to the amendments, the Law Commission expressly rejected the suggestion that the term "value" should be replaced with "adequate" or "full" consideration.[64] With clarity in mind, it is unlikely that Parliament would have omitted the term ”equivalent" from the section if that is what it was intended to mean. This only creates a *lack* of clarity. Parliament expressly stated that value is to be more than nominal but without further guidance, it is reasonable to assume that value needs only to be substantial (encompassing both adequate and equivalent value), consistent with *Allied Concrete.* A premise of statutory interpretation is that words are omitted designedly.[65] Whether "nominal", "adequate", or "equivalent", Parliament would have put a gloss on the term "value" in order to impose a sufficiency requirement, if that is what it intended. Leaving the term out is a clear indication that Parliament did not want courts undertaking an analysis of equivalence for every voidable transaction before them. Consequently, there is no room to read in a requirement that Parliament simply did not intend.

Finding that an investment of $500,000 is not value, in order to avoid the application of the defence, requires going to extraordinary lengths. Miller J admitted that the measure is "real and substantial value" following *Allied Concrete*. He then went on to say that this means the creditor must have given value "substantially equivalent" to the value he received on

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[61] At [92].

[62] *Allied Concrete v Meltzer*, above n 35, at [76].

[63] Law Commission, above n 4, at 151.

[64] Law Commission *A New Property Law Act* (NZLC R29 1994) at [51].

[65] JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 210.

payment in order for the defence to apply.[66] Real and substantial *does not mean* substantially equivalent. Miller J makes these contradictory statements with no further explanation as to how he has tied the differing concepts together. The judge cannot accept both the meaning in *Allied Concrete* and find a requirement of equivalence.

A Practical problems with "equivalence"

1 Cost and time

If *Allied Concrete* is overturned and it is accepted that equivalent value is required under s 296(3)(c), an inquiry into equivalence of value would be necessary for every voidable transaction to which the defence applies. There is no room for undertaking a mathematical comparison of the quantum of value provided with the size of the payment received for every transaction.[67] This would place a heavy burden on the legal system. During the debate on the 2006 Amendments to the Act, Parliament stated that the bills were designed to provide for an insolvency regime that is simple, predictable, and efficient to administer, without imposing unnecessary compliance and regulatory costs on its users.[68] An inquiry into equivalence of value for every voidable transaction would impose a time-consuming, cost-heavy procedure, opposite to what was envisaged. Citing *Midland Bank*[69] with approval, the Court in *Allied Concrete* stated that inquiries beyond whether some real value has actually been passed over, into whether valuable consideration was "inadequate" would embark the law upon analyses that were not "contemplated by Parliament".[70]

[66] *McIntosh v Fish*, above n 33, at [99].
[67] *Fisk v McIntosh*, above n 1, at [84].
[68] (26 October 2006) 624 NZPD 6172.
[69] *Midland Bank Trust Co Ltd v Green* [1981] AC 513 (HL) at [532].
[70] *Allied Concrete v Meltzer*, above n 35, at [159].

2 *Internal discrepancies*

Value is presumed to have one meaning throughout the Act.[71] A finding that it means 'equivalent value' thus creates discrepancies within the Act. Section 296(3) is a general provision expressly intended to apply as a defence to any recovery action by a liquidator under any section of the Act.[72] Following the Courts' interpretation, all actions under ss 292, 293, 297, 298 and 299 of the voidable transaction regime where s 296(3) is raised as a defence will require valuation evidence to establish whether the quantum of value given was "equivalent" to the challenged payment so that the defence should apply. For example, s 297 allows recovery by a liquidator where a person has purchased something from an insolvent company at an undervalue (below the good's market value) within the specified period.[73] The defence should apply to protect bona fide purchasers for value in this situation.[74] However, the Court's interpretation seems to mean that a s 296(3)(c) defence will never be available for an action under s 297, a transaction at an undervalue. It is axiomatic that where s 297 is engaged, the creditor has not given equivalent value (as they purchased the good for less than its market value).[75] Take the scenario where a business with cash flow difficulties sells goods at a discount to an otherwise bona fide purchaser for value. Business A sells to Person B for 50% of what it paid for an item 18 months previously. A goes into liquidation one year later and the liquidator determines that the item was sold at an undervalue. Applying the equivalent value test, if the liquidator claims the difference between the price B paid and the good's market value at the time of sale, B will have no defence under s 296(3)(c) because B did not provide equivalent value.

Contrary to Parliament's intention, a requirement of equivalence excludes the defence from applying in many situations. If real and substantial value is accepted as the meaning following *Allied Concrete*, the defence could still be raised to an action under s 297, in line

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[71] It is presumed that drafters use words consistently throughout a statute. Burrows and Carter, above n 64, at 163.

[72] Brown and Telfer, above n 16, at 106.

[73] Companies Act, s 297.

[74] *Allied Concrete v Meltzer,* above n 35, at [25], [76].

with parliamentary purpose. This must be the correct interpretation of the defence provision, enabling it to work consistently throughout the legislatory framework and to apply to all instances of liquidation.

3 Insufficient guidelines

If equivalent value is the correct interpretation of s 296(3)(c), Parliament would have provided guidelines as to what 'equivalence' requires, how it is to be assessed, or how strict the requirement is – whether it means dollar-for-dollar equivalency or if takes into account factors such as the time value of money. Parliament has provided no such direction in terms of the defence. If an equivalence requirement is strict, issues would arise where money was provided in exchange for a good that can change in value. Courts would have to determine whether the payment provided was exactly equivalent to the value of the good received, and at which point in time equivalence would need to be assessed. For example, Person A pays Company B market value for a real estate property that is to be transferred to A in one year's time. One year later, the property has gone up in value, and shortly after, B enters liquidation. Liquidators should not be entitled to claw back A's property simply because the value A provided one year earlier was not equivalent to what it is now worth. A strict interpretation of equivalence would not allow a defence to this recovery action. Similarly, $500,000 invested is unlikely to ever come back as only $500,000 over time but that does not mean that investors should never be entitled to their profits.

The Act deals with economic value, so it is reasonable to assume that the time value of money would be taken into account when assessing whether the value given was equivalent to the payment received. McIntosh borrowed $500,000 from Westpac in order to fund his investment with RAM[76] and paid $200,000 interest on that borrowing over the course of his investment.[77] Assuming a strict interpretation of equivalence, the Courts took no

[76] *Fisk v McIntosh*, above n 1, at [12].

[77] J B M Smith QC and J L W Wass "McIntosh v Fisk" (Synopsis of Submissions for Appellant, Court of Appeal, 2015) at [2.7].

account of the time value of money, or McIntosh's lost opportunity. Their argument relies on a misconception – a focus on the $500,000 sum that McIntosh invested rather than the *value* he exchanged for his final payout. Economically, investors transfer both their principal and the rental value of that principal, the time value of money, to the debtor. Legally, investors discharge a contractual obligation in exchange for both principal and interest. Mackenzie J argued that the costs McIntosh incurred are irrelevant because it is only value to RAM that is required.[78] That finding is not in line with ordinary principles of contractual interpretation. What the courts went on to find is not equivalence under any form of economic accounting. $500,000 in 2007 is not equivalent to $500,000 in 2011. In any other liquidation, courts would assess the totality of circumstances, including market value[79] and inflationary costs.[80] The time value of money is an economic reality that courts cannot ignore in determining equivalence of value.[81]

In light of their aims of increasing commercial certainty and clarity in the law, it is unlikely that Parliament would have intended that s 296(3) require equivalent value without making room for the time value of money. Parliament would not leave it up to judges to ignore factors which are otherwise relevant to contractual interpretation. Real and substantial value reflects the fundamental economic maxim that a dollar today is worth more than a dollar tomorrow.[82] In an Act dealing primarily with economic value, Parliament would not have intended a requirement that does not take this into account, therefore real and substantial value must be the correct interpretation.

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[78] *Fisk v McIntosh*, above n 1, at [76].

[79] Karen E Nelson "Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks" (2011) 95 Minn L Rev 1456 at 1481.

[80] *Re Waipawa Finance Company Ltd (in liq)* [2011] NZCCLR 14 (HC) at [44].

[81] Nelson, above n 77, at 1485.

[82] At 1485.

IX Real and substantial value

A primary purpose of the Companies Act amendments was to align New Zealand's voidable transaction regime with Australia's.[83] Australia's regime requires "consideration that is *real and substantial value*, rather than being simply a reference to the concept of consideration in contract law."[84] To acknowledge the Act's purpose, New Zealand should take a similar view. The Court in *Allied Concrete* said that value does not require "consideration of sufficiency as long as some value is given in the form of executed consideration."[85] Real and substantial value is an appropriate method of assessment, allowing courts simply to assess whether the value was significant, considering all factors, without undertaking precise equations of quantum. Without authority to split a single payment, an assessment would simply be of whether the original value provided was significant value for the sum received.

This method is not without its own shortcomings. If value is defined as "real and substantial" it may be difficult to determine a lower limit: a point at which the payment received is too excessive and the value provided is insufficient to engage the defence. However, this issue is minimised by the lack of knowledge and suspicion requirements of the defence.[86] These guiding principles of the provision make the method of assessment workable. When the value provided is seemingly insufficient for the payment received, one would assume that the reasonable person would suspect foul play. The burden then falls on the defendant to prove that a reasonable person in the situation would not suspect that the company could become insolvent.[87] Where the payment is far in excess of the value given

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[83] Sean Gollin and Richard Gordon "Business Insolvency - key commercial issues and developments" (NZ:S Continuing Legal Education, March 2015) at 40.

[84] Andrew R Keay *McPherson's Law of Company Liquidation* (3rd ed, Sweet & Maxwell, London, 2013) at [111650].

[85] *Midland Bank Trust Co Ltd v Green,* above n 68, at [531] cited in *Allied Concrete v Meltzer*, above n 35, at [159].

[86] Companies Act, ss 296(3)(a), 296(3)(b).

[87] David Brown and Thomas GW Telfer "The New 'Australasian' Voidable Preference Law: Plus ca Change?" 13 NZBLQ 160 at [312].

for it, the defendant may have difficulty in establishing the negative – although one may not have *known,* it would probably be reasonable to suspect the involvement of fraud.[88] This fairly demanding test would prevent the defence from applying in many situations. [89] Where value given was reasonable such that there was no reason to have knowledge or suspicion of insolvency, and there was in fact no such state of mind, defendants should be entitled to their payments by way of the operation of the defence.[90]

Before November 2007,[91] the defence applied only to defendants able to show that they received payments in good faith, had altered their positions in the reasonably held belief that the transfer would not be set aside, and that it was, in the Court's opinion, inequitable to order recovery.[92] The Court in *Allied Concrete* considered this defence to have a wide application.[93] The Amendment incorporated, along with the value aspect of the defence, the Australian suspicion of insolvency test as a guiding provision. [94] The good faith requirement was replaced with the condition that the investor must have had no knowledge, or grounds to suspect, that the company would become insolvent. This new "creditor culpability" model was introduced to reduce uncertainty and make the defence easier to apply.[95] It focuses primarily on the creditor's state of mind[96] in order to safeguard against fraud. The "lack of suspicion" test was introduced in substitution for one asking whether it is, in the Court's view, inequitable to order recovery.[97] This suggests that where there is no suspicion, it is justifiable for the creditor to keep their payment, provided the other elements of the defence have been made out.[98]

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[88] Law Commission, above n 62 at [51].
[89] *Pegulan Floor Coverings Pty Ltd v Carter* [1997 24 ASCR 651, at 658.
[90] David Brown *Voidable Transactions – A Report for the Ministry of Commerce* (October 1999).
[91] The Companies Act amendments came into effect on this date.
[92] Brown and Telfer, above n 16, at 106.
[93] *Allied Concrete v Meltzer*, above n 35, at [99].
[94] Brown and Telfer, above n 16, at 106.
[95] Brown and Telfer, above n 84, at [4].
[96] Brown and Telfer, above n 16, at 108.
[97] At 106.
[98] Law Commission, above n 62 at [51].

In Australia, only payments made within six months prior to liquidation can be clawed back by liquidators, a limitation aimed at increasing commercial certainty and creditor protection.[99] The short period reflects a judgment that finality of transfers is of utmost importance.[100] A wider interpretation of s 296(3) is therefore more in line with Parliament's purpose of aligning New Zealand insolvency law with Australia's. In New Zealand, payments received up to six years before liquidation can be clawed back.[101] It follows that the defence should have a wide application to offer protection to innocent individual creditors. An interpretation of "real and substantial" value would achieve this aim.

Meaningfully, value must mean "real and substantial" value. This would not be too wide an interpretation as control over the statutory defence is primarily exercised through the lack of knowledge and suspicion requirements.[102] Where these are not in doubt, the Court should be reluctant to impose a more demanding interpretation of value than it does for any other insolvency case.

X Provision of value by McIntosh

Once accepting that the payment should be assessed as a single transaction, and the measure of value is "real and substantial", it is clear that McIntosh provided sufficient value such that the defence should apply to the entire payment. Contrary to the Court's finding that the payment far exceeds the value given by McIntosh,[103] it is almost impossible to see how $500,000 does not amount to real and substantial use of money value for the entire return on that investment. It is a significant sum of money that is more than nominal consideration. McIntosh borrowed it from Westpac bank and had paid $200,000 interest on the sum by the time the payment was made.[104] Furthermore, he suffered detriment by

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[99]Corporations Act 2001 (Cth) s 588FE(2). This is in line with many other jurisdictions, see for example: Insolvency Act 1986 (UK) s 240; Bankruptcy Code 11 USC §547.

[100] John C. McCoid "Bankruptcy, Preferences, and Efficiency: An Expression of Doubt" (1981) 67 Va L Rev 249

[101] Companies Act, s 292(5); Property Law Act, s 348.

[102] Law Commission, above n 62, at [51].

[103] *Fisk v McIntosh*, above n 1, at [92].

[104] *McIntosh v Fisk*, above n 73, at [2.7].

being dispossessed of the money. RAM had the benefit of legal title to, and use of the money for four years. It was Ross's *choice* to misappropriate the funds; he had the opportunity to invest them. It should not matter what RAM actually did with the money. What it is important is that it had the opportunity to use it for four and a half years, which amounts to significant, use of money value. On this basis, the transaction should not be voidable.

XI Competing Principles

Two important but conflicting policy aims are engaged in most insolvency situations. Determining what constitutes value highlights the trade-offs to be made between the principles of *pari passu* distribution and commercial certainty.[105]

A Pari passu distribution

Pari passu is a general principle of liquidation requiring equal treatment of creditors in like positions and facilitating the efficient realisation of a company's assets for distribution to creditors.[106] Some transactions made prior to insolvency confer an advantage on certain creditors by allowing them to recover more than they would in a liquidation. A purpose of the voidable transaction regime is to protect the company's creditors as a whole against a diminution of assets available to them resulting from such transactions.[107]

Pari passu accords importance to the interests of unsecured creditors as a whole, at the expense of fairness to individual creditors who have accepted payments in good faith, where there was no reasonable basis to suspect the debtor company's insolvency.[108] Application of the *pari passu* principle would create a species of certainty. There would be a clear rule, routinely applied on liquidation. However, there would be both legal and

[105] "Towards a Coherent Voidable Preference Regime for New Zealand", above n 11, at 31.
[106] *Allied Concrete v Meltzer*, above n 35, at [1].
[107] *Rubin v Eurofinance SA* [2012] UKSC 46, cited in *Farrell v Fences & Kerbs Ltd* [2013] NZCA 91 at [66].
[108] *Allied Concrete v Meltzer*, above n 35, at [55].

commercial *uncertainty* because routine transactions would be vulnerable to challenges, years after their occurrence.

B Commercial Confidence

The principle of commercial confidence engages considerations of fairness to individual creditors. Parliament has long acknowledged that creditors entering transactions with companies that subsequently reach the point of insolvency are entitled to protection in some circumstances. The risk posed to commercial confidence is high if everyday commercial transactions are vulnerable to being re-opened long after their occurrence. This consideration holds particular relevance in New Zealand, with its significant proportion of small business enterprises and six-year period in advance of liquidation during which transactions may be voidable.[109] The long specified period creates an unstable system by putting all former-creditors at risk of their money being taken retrospectively after receiving their payment, should the company become insolvent.

If commercial confidence is upheld as the primary aim of the legislation, primacy will be accorded to individual creditors who receive what appear to be routine payments in circumstances where they have no reason to suspect insolvency. This reflects the broader social interest of not disrupting the routine flow of credit in commercial transactions, at the expense of the class of creditors as a whole and the concept of collective realisation.[110]

Before a liquidation, commercial confidence is the aim of the legislation and should be protected. Once a company is in liquidation, *pari passu* enters as a general principle. It does not *overtake* commercial confidence at this stage; it merely enters as a competing principle. Any system that creates a regime rendering some transactions void has to choose between these competing interests.[111] The existence of such a regime means that some

[109] At [1].
[110] *Allied Concrete v Meltzer*, above n 35, at [55].
[111] Law Commission, above n 4, at [696].

measure of commercial certainty is sacrificed in favour of fairness to all creditors,[112] whereas allowing creditors a defence in the name of commercial confidence inhibits the *pari passu* principle by reducing the pool of assets available to share among remaining unsecured creditors.

C Applying the competing principles to Ponzis

Ponzi schemes are a zero-sum game. In a Ponzi situation, there are net winners and net losers.[113] Net winners are investors who withdraw funds from the scheme early and receive both their principal and some or all of their profit before the scheme's collapse.[114] McIntosh and others in his position are the net winners of RAM. They are at an advantage vis-à-vis other creditors. The net losers are those who invested in RAM and did not withdraw before liquidation. As at August 2016, they are entitled to three cents in the dollar.[115] The liquidator is seeking to force the net winners to disgorge their profits to distribute equally among all victims of the scheme.[116] If the liquidator were entitled to claw back payments made to creditors in McIntosh's position, they would have to share with the other investors, all receiving a proportionately equal amount. Under the *pari passu* principle, no one creditor would get more than another because they withdrew their funds earlier.

The *pari passu* principle requires drawing an arbitrary line. Take the situation where Person A took $500,000 out of RAM on 11 November 2010 and Person B took $700,000 out on 12 November 2010. If the company enters liquidation on 12 November 2012, A will be entitled to retain their funds, while B will have to return everything. Understandably, a level of arbitrariness is necessary in such scenarios but protection of individual creditors in this situation is the exact reason for a wider application of the defence. As there is an unfair

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[112] At [696].
[113] Winters, above n 5, at 119.
[114] At 124.
[115] Jonathon Underhill "Former RAM investors Duncan, Nora Priest win case against RAM liquidators to get shares back" *The National Business Review* (New Zealand, 5 August 2016).
[116] Winters, above n 5, at 199.

situation between McIntosh and creditors that never withdrew their funds, the two-year period creates a similar unfair situation between McIntosh and creditors that withdrew their funds just before him (outside of the specified period). The narrow interpretation does not create less unfairness, it merely narrows the pool of net winners.

Miller J states that allowing McIntosh to keep his payout undermines the principle of collective realisation, creating a "free for all."[117] In reality, it does not. The principle of equal distribution still applies among the unsecured creditors remaining in RAM at the time of liquidation. McIntosh has requested and received a payout prior to the liquidation and has exited the scheme. He no longer fits into the category of an unsecured creditor of RAM. Where a person has provided value and innocently exited a fraudulent scheme, the principle of collective realisation is not so much undermined as it is limited. A necessary exception is made in circumstances where a person that was not party to any fraud simply left.

Allied Concrete admitted a wider interpretation of s 296(3) than was held to be the case in previous courts. The consequence of the outcome was a preference for individual creditors and commercial certainty over collective realisation for the group of unsecured creditors facing losses on the company's insolvency. This was in line with parliamentary purpose at the time of the defence's enactment, which was to expand the defence under the prior regime,[118] and increase certainty for creditors that transactions they enter into will not be made void.[119] The Court found the protection of commercial confidence to be of utmost importance to a functioning society, upholding that: [120]

> "The purpose of the [defence] provisions is to protect creditors who have received payment from a debtor company in good faith, without suspecting insolvency, and who have given something in return for their payment. Equity allows them to retain that payment."

[117] *McIntosh v Fish*, above n 33, at [23].
[118] *Allied Concrete v Meltzer*, above n 35 at [135].
[119] Gollin and Gordon, above n 80, at 40.
[120] *Farrell and Rogan (liquidators of Contract Engineering Ltd) v Fences v Kerbs Limited* [2012] NZHC 2865 at [64]-[66].

Parliament's intention was to protect commercial certainty, regardless of the nature of the insolvent scheme. McIntosh, and others in his position, withdrew their money up to two years before liquidation and thought that they had cut all ties with RAM. The public should feel safe investing in the market and capitalising on their investments without worrying about the possibility of their winnings being clawed back within the following specified period.[121] There must be some acknowledgment of early withdrawal. When parting with money, there is always risk involved – whether the risk of a bad investment, market collapse, or the possibility of being part of a Ponzi scheme. These situations should be treated in the same way. The law should not aim to remedy the effects of fortuitous circumstances that by standard property rules would occasionally permit a few relatively fortunate victims to lose proportionately less than others.[122] The move in *Fisk v McIntosh* has been away from a view that takes victims as it finds them, toward one that seeks to socialise and equalise, so far as possible, the consequences of a casualty to which multiple victims have been uniformly subject.[123] This view should be reversed. Albeit in different senses and with one party being worse off than the other, both parties are victims of the scheme; both are victims of a fraud to which they were unknowingly subject.

When A's house is destroyed by a meteorite and B's neighbouring house is left untouched, no one would put B under a legal obligation to contribute to A's loss.[124] Similarly, when A advances money to an investment scheme and B intends to do the same but forgets to mail his cheque, no one would want to equalise losses between A and B upon the company's liquidation. However, when B invests in the scheme and receives a payment before the scheme's accounts are frozen, courts following *Fisk v McIntosh* would require B to share A's loss. The law should not seek to equalise the position of all victims in this way, or punish some in order to provide a better remedy to those that find themselves in unfortunate situations that are not the fault of others. In the light of the increasing attention paid to

[121] Two years under the Companies Act 1993, s 292; six years under the Property Law Act 2007, s 348.
[122] Andrew Kull "Ponzi, property, and luck" (2014) 100(1) Iowa L Rev 291.
[123] Kull, above n 116.
[124] At 315.

consumer confidence in modern times, s 296(3) should not be narrowed to make it easier for liquidators to claw back payments where doing so would create increasing uncertainty.[125] The defence should accord, as much as possible, with normal business practice.[126] With commercial confidence being a guiding principle of the Act, a finding that payments made from a company prior to liquidation should be kept by innocent creditors where significant value was given, is justifiable.

XII Nature of the scheme

Section 296(3) is a general provision that goes beyond the debtor/creditor relationship to apply to all types of insolvency.[127] The defence, derived from s 94B of the Judicature Act 1908 is not confined to voidable transactions, transactions under the Companies Act, or any other Act.[128] It applies to any recovery action by a liquidator.[129]

In *McIntosh v Fisk,* the focus on the nature of the particular insolvency led the Courts to find inconsistently with parliamentary intent. Miller J's analysis creates a special application of the s 296(3) defence for Ponzi schemes. He distinguished the situation based on the type of arrangement prior to insolvency to find differing outcomes for trade creditors and creditors in Ponzi schemes. He determined that *Allied Concrete* was about trade creditors only, a class meriting protection for reasons of commercial confidence whereas McIntosh was not a trade creditor, so was not entitled to the same protections.[130] Miller J found that because the contract value was not used as intended, investment in a Ponzi scheme delivers no value, therefore no distinction should be drawn between McIntosh and the general pool of unsecured creditors. He found that the original $500,000 investment did not constitute value, allowing the liquidator's cross appeal.[131]

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[125] Burrows and Carter, above n 64.
[126] Brown and Telfer, above n 16, at 110.
[127] Companies Act, s 296(3).
[128] Judicature Act 1908, s 94B.
[129] Brown and Telfer, above n 16, at 107.
[130] *McIntosh v Fish*, above n 33, at [98].
[131] At [97].

If Miller J's analysis were upheld, the defence of giving value under s 296(3)(c) would never apply to a voidable transaction under a Ponzi scheme. The original investment would never constitute value and creditors would not be entitled to keep their payments in the event the company entered liquidation within two years. Having a special rule for Ponzis undermines the purpose of the statute, which Parliament expressly stated is to apply to *all* instances of insolvency.[132] Rules dependent on the type of scheme are not what Parliament intended. The fact that RAM was operating as a Ponzi scheme should be irrelevant. $500,000 is value – whether invested with a legitimate company or one that is unknowingly fraudulent, it is value given by one party and used by another.

Miller J stated that trade creditors serve a "valuable economic function". Though investment into a Ponzi scheme may not serve a valuable function in the same way, at the time of investment, investors are unaware that the scheme is a Ponzi. To all outward appearances the scheme is serving a valuable economic function. RAM managed share portfolios offered by many companies which matched the market situation at the time. Any company offering similar managed funds could at this very moment be a Ponzi. The very nature of fraud is that it is well disguised. There is no justifiable reason why ordinary people who have invested their money with schemes that they believe are legitimate should not merit protection for reasons of commercial confidence. The purpose of the defence is to safeguard innocent creditors.[133] *Allied Concrete* cannot be a rule for trade creditors only. The Court was articulating rules to apply to all instances of liquidation based on the Act's policy and principles. If Miller J's analysis were upheld, it would not only rule out a defence for Ponzi schemes, but many forms of liquidation that do not fall under the category of trade credit.

Mackenzie J opined that this situation is unique because the money paid out never actually belonged to RAM and the funds recovered will belong to other investors, not RAM.[134] The

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[132] Companies Act, s 296(3).

[133] Brown *Voidable Transactions – A Report for the Ministry of Commerce,* above n 88.

[134] *Fisk v McIntosh*, above n 1, at [20].

liquidation rules under the Act, however, apply to all claims, whether in contract, trust, tort or any other cause of action. The Court misled itself into thinking that if the claim is in trust, different rules apply from regular wind-up rules. That situation would arise only if the facts were such as to allow tracing, which is not the case. The money that RAM used to pay McIntosh was not others' money in a *legal* sense therefore should not be treated differently. The way that RAM misappropriated the money and where the payments came from is of no relevance under the liquidation procedure of the Companies Act. The Court of Appeal itself noted that there was no room for a "sliding scale of circumstances" nor can the fact that the scheme was of a Ponzi nature influence the legal analysis.[135] Despite this, the Court went on to create special rules for Ponzi schemes allowing it to assess one payment as two distinct elements, which it would not do for any other liquidation under the Act. The fact that the scheme is a Ponzi makes no difference in the assessment of what constitutes "value" and of whether the defence should apply.

An analogous situation is one where an investment company goes into liquidation because of some instances of fraud that its creditors were unaware of. A year before liquidation, creditors withdraw their money, including profits (which may have been obtained fraudulently) and cut ties with the scheme. When the company enters liquidation the liquidators claim all of the creditors' payments under the voidable transaction regime. Under a legitimate investment scheme, creditors would not be made to return the money where they had provided value, even if it were possible that their particular payout came from a fraudulent transaction. Such minor distinctions should not be made.

Weeding out undeserving parties is what the knowledge requirement is for – an inquiry into knowledge allows courts to ascertain the classes that merit protection based on whether they knew of the insolvency. Whether a Ponzi or fraud of any kind, if the parties are unaffected by knowledge and if they provide significant value, the statute entitles them to retain their money. That is the minimum that is required in order to uphold commercial certainty.

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[135] *McIntosh v Fish*, above n 33, at [33].

XIII Conclusion

Ponzi schemes bring a unique situation to New Zealand's company law regime, one that has not been dealt with specifically under any enactment so should not be treated differently under the law. The Companies Act requires that commercial certainty be placed at the forefront of all considerations that fall within the statute, which applies to all cases of insolvency, regardless of how the company came to be insolvent.

Following *Fisk v McIntosh,* an insolvency law review group has been set up by Parliament to review "whether the current law could be improved so innocent investors can recover more lost money from Ponzi schemes."[136] The group will look at whether the voidable transaction rules can be reformed, including whether the law can be changed to aid the recovery of funds from Ponzi schemes.[137] The Courts should await this review rather than taking it into their own hands to change the law.

For the moment, the Courts must decide cases such as *Fisk v McIntosh* on the basis of the current law. The correct interpretation of value under s 296(3) is real and substantial value, following the decision in *Allied Concrete.* An inquiry into whether value is equivalent is difficult to reconcile with the legislative policy of promoting commercial certainty, because it entails evaluation in many cases.[138] Without a requirement of equivalence, there is no basis for dividing a single transaction into two separate elements. Once this principle is appreciated, there is no justification for saying that $500,000, given in good faith, with no suspicion of insolvency, is not value. Meaningfully, $500,000 must be real and substantial value for the entire sum of the payout received, not to mention for at least a supplement to represent its time value. If a full clawback were allowed, it would only be because the Courts want a certain outcome for which there is no legal justification. This outcome

[136] Paul Goldsmith "Expert group set up to review insolvency law" (press release, 18 November 2015).
[137] "Expert group set up to review insolvency law", above n 126.
[138] *Allied Concrete v Meltzer*, above n 35, at [160].

confuses the entire meaning of the voidable transaction regime. *McIntosh v Fisk* is a hard case, but that does not mean that it should make bad law.

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