**IN THE HIGH COURT OF NEW ZEALAND**
**CHRISTCHURCH REGISTRY**

**CIV-2015-404-1500**
**[2016] NZHC 194**

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| BETWEEN | ROBERT GRANT GRAHAM AND NEALE JACKSON<br>Plaintiffs |
| AND | ARENA CAPITAL LIMITED (IN LIQUIDATION)<br>Defendant |

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| Hearing: | 5 February 2016 |
| Appearances: | G Colson and L W Brazier for Plaintiffs<br>M J Borcoski and T J Brown for Defendants |
| Judgment: | 17 February 2016 |

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**JUDGMENT OF MANDER J**

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[1] The liquidators of Arena Capital Ltd (in liquidation) (Arena) have applied for directions under the Companies Act 1993 in relation to a category of deposits made to the company's bank account.[1] These deposits were made by investors on or after the date on which the Financial Markets Authority (FMA) was granted initial asset preservation orders (APOs) over Arena's assets.

[2] The liquidators seek directions that these funds form part of the assets of Arena and be treated in the liquidation in the same way as any other funds held in Arena's bank account prior to 15 May 2016. The liquidator's application is resisted by the post-APO depositors. Ancillary orders are also sought which are not the subject of contest.

1 Companies Act 1993, s 284(1)(a).

**Background**

[3] Arena purported to operate a foreign exchange trading business. Despite deposits being received from clients for the purpose of investment, the company did not conduct any foreign exchange trading nor any other form of investment activity. A single bank account was operated by Arena into which these deposits were received. "Profits" the clients were led to believe existed were in fact fictitious. Monies disbursed to clients to maintain the façade of an active operation were paid out from deposits from other clients. Arena was operating in essence a simple Ponzi scheme.

[4] The FMA obtained initial interim APOs over Arena's assets on 15 May 2015. The terms of the APO prohibited Arena from transferring, charging or otherwise dealing with money, including the bank account. There was, however, no prohibition on deposits continuing to be received into the account. It does not appear that any media release or publicity was given to the making of the APOs until 21 May 2015. In the interim, the bank account continued to receive investors' deposits.

[5] Seventeen Arena clients made deposits into the account on or after 15 May 2015 to a total sum of $249,000. Up until that date, the pattern of activity of the account involved a large number of deposits by investors, some payments out to investors and those associated with the management and ownership of the company, and payments of wages and transfers to third parties usually related to Arena.

[6] Of the seventeen post-APO depositors, eleven had previously made deposits to Arena prior to 15 May and two received withdrawals before the APOs were in place, although for lesser sums than they had deposited. One post-APO depositor had deposited a sum and withdrawn a greater sum prior to the APOs being in place (the greater sum presumably being a "profit" from purported foreign exchange trades) but had then deposited a further larger sum after the imposition of the APOs.

[7] In general terms, the liquidators presently have available to them the bank account with a balance of $728,690.12 as at the date of receivership, and other assets of the company with an estimated value of $300,000. Contingent recoveries from related parties and from clients to whom Arena paid fictitious profits are to be the

subject of legal remedies. There is a single trade creditor claim for $1,400 and three claims by people whose status as employees are disputed by the liquidators. As a result, the only persons having a substantive claim to the Arena assets are the clients of the company. The present application, therefore, essentially involves a contest between the interests of the post-APO depositors and those of Arena's earlier investors.

[8] It was the liquidator's preferred course to seek directions the subject of the present application as part of a "final" directions application once all assets of Arena had been realised. However, the post-APO depositors claim they are in a different position from other investors as a result of their deposits being made on or after the date of the APOs. A number of investors indicated they would issue proceedings to recover their post-APO deposits. As a result, the liquidators have taken the initiative of seeking directions as to whether the post-APO depositors have different rights in the liquidation from other Arena investors.

**The dispute**

[9] The post-APO investors claim a proprietary interest in their deposits. That interest is premised on them having the benefit of either a statutory trust, a remedial constructive trust, and/or a resulting trust (a Quistclose trust) over the funds they deposited with Arena after the making of the APOs.

[10] Importantly, the post-APO investors submit their deposits are capable of identification and can be directly traced to funds currently held in Arena's bank account. As a result, they argue those funds should be paid to them in priority to any other distribution.

[11] The liquidators dispute the post-APO depositors' entitlement to priority. They submit the post-APO depositors are in no different position from other Arena investors who contributed to the existing balance of the bank account. Insofar as the monies held in the bank account are subject to a trust obligation, it is one that is owed by Arena to all its investors without distinction.

## The Issues

[12] It is therefore necessary, firstly, to examine whether the funds deposited by the investors with Arena are held on trust. If so, whether that trust obligation is owed exclusively to the post-APO depositors and, if not, whether there are material factors and circumstances which entitles them to be treated in the liquidation differently from the pre-APO depositors.

## Were the deposits held on Trust?

*Statutory trust*

[13] It is not contested that monies paid by all Arena investors are, in the circumstances, subject to a statutory trust as a result of the effect of securities legislation.

[14] The Financial Markets Conduct Act 2013 (FMCA) came into force on 1 December 2014. However, the effect of transitional provisions means that aspects of the Securities Act 1978 continue to have application to certain offers of securities until 1 December 2016. Arena's activities straddle the commencement of the FMCA, however, the effect of these transitional provisions is immaterial. Whether under the previous or current legislation, the effect of the relevant provisions is the same.

[15] It is undisputed that the arrangements between Arena and its investors constituted a financial product being either a debt security, a managed investment product or a derivative.[2] Arena did not discharge its disclosure obligations and investors, therefore, had a right to have any monies paid reimbursed or any derivative withdrawn. In any event, the money paid was never invested and so was required to be held in trust by the company pending its investment or repayment.[3]

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2 Financial Markets Conduct Act 2013, s 7(1).

3 Financial Markets Conduct Act 2013, ss 39, 50, 54 and 87; Securities Act 1978, s 36A

*Remedial constructive trust*

[16] A remedial constructive trust is a potential remedy which New Zealand Courts have acknowledged may be available where equity requires a proprietary remedy in the absence of recognised situations giving rise to an institutional constructive trust or an express or resulting trust. In *Fortex Group Ltd (in rec and liq) v MacIntosh,* the Court of Appeal recognised that in appropriate circumstances a remedial constructive trust could be imposed.[4]

[17] In *Fortex,* the plaintiffs sought an order to the effect that the balance of funds paid by employers into a superannuation scheme managed by a trust company but banked into the general account of the employer, were held on constructive trust. The Court of Appeal, while recognising the potential remedy, declined to impose a remedial constructive trust because there were insufficient equitable grounds for the plaintiffs to be preferred over the secured creditors in the liquidation. Tipping J (delivering the judgment of himself, Gault and Keith JJ) held that parties seeking the Court to impress a trust on some asset in the defendant's hands must do so on a principled basis, vis-à-vis both the person owning the asset and any third party who has an interest in the asset. Furthermore, they:[5]

> … must be able to point to something which can be said to make it unconscionable – contrary to good conscience – for the [party against whom the order is sought] to rely on their rights at law.

[18] In that case, the parties against whom the order was sought were secured creditors and it was necessary for those seeking the imposition of a remedial constructive trust to demonstrate that it would be unconscionable for the secured creditors to rely on their rights.

[19] In rejecting a submission that there was an element of unjust enrichment that should affect the secured creditors' conscience in insisting on their rights, Tipping J observed that insisting on one's rights at law can hardly be regarded as constituting

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[4] *Fortex Group Ltd (in rec and liq) v MacIntosh* [1998] 3 NZLR 171 (CA); See also *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 (HC) at [40].

[5] *Fortex Group Ltd (in rec and liq) v MacIntosh,* above n 4, at 175.

unjust enrichment.[6] His Honour explained that although a remedial constructive trust will not always be an appropriate remedy, there may be occasions when it is required:[7]

> When the claim is for a money sum, the need for the plaintiff to seek a proprietary remedy will usually arise only when the defendant is insolvent. In such circumstances the rights of parties other than the defendant are likely to be affected. If the plaintiff wishes to gain priority over those who would otherwise be entitled to the defendant's assets, the Court must be careful not to vary settled insolvency rules on too loose a basis. That said, there may be occasions, in the present field or others, when a proprietary remedy, such as the so-called remedial constructive trust, would be a useful weapon in equity's armoury.

[20] In *Commonwealth Reserves I v Chodar,* Glazebrook J considered the availability of a remedial constructive trust as a discretionary remedy potentially triggered by either unjust enrichment or unconscionability.[8] Her Honour, however, cautioned that in cases where the interests of third parties would be prejudiced by a proprietary remedy being granted, particularly if those third parties were in a substantially similar position to the party seeking the relief or where that party had accepted the risk of the defendant's insolvency, then proprietary relief "is likely to be inappropriate".[9]

[21] The post-APO depositors submitted they deposited funds into Arena's account at a time when the company was prohibited from disbursing funds. Because Arena could not, as a result of the APOs, either invest these funds or disburse the funds to them, their position should be distinguished from the pre-APO depositors in respect of whom Arena simply chose not to discharge its contractual obligations.

[22] The post-APO depositors argued that allowing the funds to be pooled with the pre-APO depositors' funds for the purpose of distribution to all investors would result in a windfall to the pre-APO depositors. Identifiable funds of the post-APO depositors would be unfairly used to mitigate the loss of pre-APO depositors. This, it was submitted, would be unconscionable and should result in a constructive trust

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6 At 177.
7 At 179.
8 *Commonwealth Reserves I v Chowder,* above n 4 at [42].
9 At [48].

for their benefit creating a proprietary interest in those funds in priority to other investors.

[23] I am not persuaded that these identified differences in the positions of the respective investors give rise to unconscionability or unjust enrichment. All the depositors were in the same position vis-à-vis Arena and as between themselves. None were aware their funds were not being used for the purpose that they were originally invested with the company. All the depositors invested their monies on the same premise with the same expectation. The imposition of the APO was a factor external to the investors' relationship with Arena. While pre-APO depositors had the ability to withdraw funds and even to receive returns on their investment, the insolvency of the company and the resulting losses to depositors was because of the fraud committed on all the investors. Vis-à-vis

[24] In assessing whether the court should exercise its discretion to impose a remedy, I do not consider the two sets of investors to have been in such different positions to warrant distinguishing between them. The factors relied upon by the post-APO investors are not, in the circumstances, sufficient to justify taking the rare step of retrospectively granting a proprietary interest over the post-APO deposits by imposing a remedial constructive trust.

*Resulting trust (Quistclose trust)*

[25] The Court's have recognised that resulting trusts can arise when a purpose of the trust has failed. One category of resulting trusts which involves a failure of purpose is that known as a Quistclose trust. In *Barclays Bank Ltd v Quistclose Investments Ltd*, the House of Lords held a loan made to a business for the express purpose of paying a dividend gave rise to a trust.[10] When the purpose for which the loan was made failed as a result of the company's liquidation, a resulting trust was held to apply over the funds to prioritise the lender over other creditors. As emphasised by the post-APO depositors, a critical factor in finding the funds to be held on trust was the fact the purpose for which the money was paid was not achieved.

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[10] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 (HL).

[26] In *Twinsectra Ltd v Yardley*, Lord Millett held that, in such situations, the resulting trust comes into being at the time the funds are advanced with the lender's beneficial interest only becoming subject to any new interest created by the use of the loan in fulfilment of the trust's purpose.[11]

[27] The post-APO depositors submitted that once the purpose for which the funds have been provided was frustrated, a resulting trust will provide a proprietary remedy. In the present case, they submitted the purpose for which the funds were advanced was for foreign exchange trading. However, Arena was incapable of carrying out that purpose because of the APOs. Because Arena was unable to give effect to the purpose for which the funds were advanced, the post-APO investors beneficial interest in their deposits was never realised and the money was required to be restored to them.

[28] In opposing the finding of a Quistclose trust, the liquidators focused on the requirement that the commercial arrangement entered into between the parties must be one which only permits a party to have the limited use of the others' money for a specific purpose. It must have been agreed, either expressly or implicitly, that the money could not be applied for any other purpose and would be returned if for any reason the purpose was not able to be carried out.[12]

[29] It was submitted that, in order for a Quistclose trust to be established, it must be shown that the presumed intention of the parties was not to allow "the money to be at the free disposal of the recipient".[13] Their intention must be that the payer will disburse the funds in such a way that his or her beneficial interest is not exhausted.[14]

[30] In examining these issues, the liquidators emphasised that while the purpose of investing the monies with Arena was undoubtedly for the purpose of engaging in foreign exchange trading, there were no strictures on how the money might be applied more generally to that end, or in a way that did not exhaust the post-APO depositors' beneficial interest in the funds. The liquidator submitted that, in the

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11 *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 AC 164.

12 *Twinsectra Ltd v Yardley,* above n 11, at [73] per Lord Milllet.

13 At [73]; David Fox "Resulting Trusts" in John McGhee (ed), *Snell's Equity* (33rd ed, Sweet & Maxwell, London, 2015) at [25-034].

14 *Twinsectra Limited v Yardley*, above n 11, at [98], [100] and [102].

circumstances, all that was created between the investor and Arena was a debtor/creditor relationship giving rise to a personal obligation.[15]

[31] In that regard, the liquidators emphasised the contractual arrangements between the investors and the company which it was submitted can only be interpreted as indicating the parties intended that, upon payment to Arena, the investors' beneficial interest in their funds would come to an end and that Arena obtained some discretion or flexibility as to how to use those monies for the purpose of investment in the foreign exchange trading.

[32] The post-APO investors do not contend that the documentation (such as it is), which to varying degrees some investors received or executed, was intended to create a trust obligation. One document, which a majority of the post-APO depositors sighted or signed, contains a guarantee on the part of the company in favour of the client which would be unnecessary, and it was submitted, would be inconsistent with any intention to create a trust relationship. The same document refers to the client depositing a sum into an assigned bank account with no indication that it is to be held separately or in trust. Such sum is described as an "investment".

[33] Another document, which takes the form of a letter between the company and investors, refers to the depositing of an amount into a bank account. Such deposit is described as an "investment" which is to be the subject of a "guarantee". The investment is referred to as a "public offering" and is described as a "fund". There appears to be no requirement to keep deposits separate and only the one "fund" is referred to. This limited documentation is no doubt deliberately vague and the money invested must be accounted for to the investor. However, there is no specific statement that the funds are to be used directly for a specific transaction nor that it cannot or will not be drawn upon to pay for operational expenses and overheads associated with the purported foreign exchange trading.

[34] If a Quistclose trust is to be found to apply to the monies advanced to Arena, then such a trust applies to funds provided both before and after the imposition of the APOs; the monies having been advanced for the same purpose. The fact that Arena

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15 *Potter v Potter* [2003] 3 NZLR 145 (CA) at [13].

was incapable of carrying out that purpose after the imposition of the APO does not affect the basis upon which the deposits were received by the company, the obligations owed by the company, nor the timing of any resulting trust coming into being. Whether failure of purpose arises from the APO or Arena's deliberate fraud does not bear on whether the arrangement entered into between the investor and the company gave rise to a Quistclose trust.

[35] It follows therefore that, if I was to find that such a trust came into being when the money was invested, it would have application to all the investors and would not be a basis upon which to distinguish between them. In that event, it is submitted by the post-APO investors that, as their funds are the only readily identifiable deposits able to be traced and therefore the only proprietary interest capable of being given effect to, their funds should be repaid in priority over the pre-APO depositors.

[36] As noted at [13], it is not disputed that the monies in the bank account, whether sourced from pre or post-APO deposits, are the subject of a statutory trust. The post-APO depositors submit the critical distinguishing factor is that their funds can be traced. It is apparent, therefore, that the issue of a Quistclose trust, which if present will have application to all deposits, does not materially advance the post-APO investors' position. The dispute between the post-APO depositors and the liquidator distils to one of tracing and its place in the approach which should be taken by the liquidator to the distribution of the company's assets.

[37] As a result, it is not strictly necessary for me to come to any concluded position regarding whether, in the present circumstances, a Quistclose trust arises. If it had been necessary for me to make that determination, I would have concluded that a resulting trust cannot be presumed as having been the intention of the parties. The arrangements between the depositors and Arena were not sufficiently specific or confined to displace the ordinary debtor/creditor relationship which the provision of funds to another usually gives rise.

[38] It is not fatal to a finding the parties intended to create a trust, that the money is mingled with other funds or pooled with other deposits into a single account,

however, it is a factor that tends to count against concluding the arrangement was intended to create a trustee/beneficiary relationship rather than one of a simple contract creditor/debtor.

[39] While the purpose of the deposits was clearly to provide funds to invest in foreign exchange transactions and Arena was under an obligation to account to investors for the monies deposited for that purpose, there is nothing to indicate that the sums paid were other than to be pooled in the fund to be drawn upon by the company to achieve zero return to the investors from the company's foreign exchange trading. I am unable to discern any intention that investors would retain a beneficial interest in the money paid into the bank account, rather than the creation of a debt owed. Nor would I conclude, from the circumstances in which the investment was made, that it was the parties' intention that, in the absence of the deposit being directly used to make a foreign exchange trade, the sum was to be returned to the individual investor.

**Tracing and the approach to distribution**

[40] As will be apparent, a finding that monies paid to Arena by investors were subject to a trust does not, in itself, assist the post-APO depositors. They must distinguish their position from the pre-APO depositors and justify why the deposits they made on or after 15 May should be repaid in full, in priority to any distributions by the liquidators to other investors.

[41] The post-APO depositors submitted that the critical distinguishing factor is that their deposits can be traced, whereas the pre-APO depositors' funds cannot. In oral argument, that submission was refined by acknowledging that should pre-APO depositors be able to trace their deposits, they too are entitled to have such monies repaid in priority to other investors' claims. The tracing issue is therefore the pivotal issue in dispute between the liquidators and the post-APO depositors.

[42] The post-APO depositors submitted that the same approach recognised by Ronald Young J in *Re Waipawa Finance Company Ltd (in liq)* should be applied to

the present case.[16] Having found under the Securities Act that funds recovered by the liquidators from the defunct investment company were held on trust for the benefit of the investors, the Court addressed the issue of distribution. It first posed the question of whether any money could be traced to individual investors. Having identified that the money held by the liquidators belonged to the investors, Ronald Young J observed "where there can be tracing there should be tracing".[17] The post-APO depositors submitted this question is an essential preliminary step required to be addressed after determining that funds held by Arena were subject to a trust.

[43] In *Re Waipawa*, there was no challenge to the liquidators' conclusion that it was impossible to trace the investors' funds and that no order could be made tracing any funds held by the liquidators to individual investors.[18] The Court then moved to consider the method of distribution that should be applied and, in particular, whether the monies should be allocated in accordance with the rule in *Clayton's Case*[19] or the *pari passu* method.[20]

[44] The rule in *Clayton's Case* encompasses the proposition that, in a situation such as the present, the first investment is to be treated as the first investment to have been lost – the "first in, first out" approach. Because earlier investment monies are deemed to have been those first used or lost and no longer available for distribution, the later investors are to be paid in full and the residue of funds (if any) divided between the earlier investors.[21] The *pari passu* approach does not discriminate on the basis of the timing of the investments and seeks to make a distribution apportioned equally or on a pro rate basis between all investors.

[45] The post-APO depositors submitted the liquidators were obliged to first examine whether the deposits into Arena's bank account could be traced. In the case of the post-APO deposits no difficulty arises because of the effect of the APOs which prevented any funds in the bank account being utilised by the company on or after

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16 *Re Waipawa Finance Company Ltd (in liq)* [2011] NZCCLR 14 (HC).
17 At [14], citing *McKenzie v Alexander Associates Ltd (No 2)* (1991) 5 NZCLC 67,046 (HC); *Re International Investment Unit Trust* [2005] 1 NZLR 270 (HC).
18 At [15].
19 *Clayton's Case* [1816] 35 ER 781.
20 *Re Waipawa Finance Company Ltd (in liq),* above n 16, at [20].
21 *Clayton's Case,* above n 19.

15 May. They remain effectively in their original form as deposited into the bank account and are capable of being directly traced. The funds have not been mingled or applied in any way after being deposited into the bank account which was in credit.

[46] In *Re Waipawa*, it was not necessary for the Court to examine why the possible tracing of funds should be considered as a separate preliminary inquiry before the liquidators consider their approach to the discharge of their wider obligations in relation to the distribution of monies held on trust for all investors. However, the post-APO depositors submitted that Ronald Young J applied established jurisprudence by examining, as a first step, whether monies received by the company in which investors had retained a beneficial interest could be traced.[22]

[47] In *McKenzie v Alexander Associates Limited (No 2)*, McGechan J considered the approach taken to the application of funds held by a group of companies which, amongst other activities, raised money from the public for lending through contributory mortgages and which had been placed into statutory management.[23] Investors' funds had been banked into the company's general bank account pending investment. The Court examined whether there had been an intention to create specific trusts in an individual contributory scheme by which money invested may be able to be traced or alternatively whether the company had operated a "pooling scheme" involving the pooling of the mortgages which required a distribution on a pro rata basis.

[48] McGechan J concluded there was an onus on the party seeking pooling to show that a particular investor's asserted specific trust had not been created either because the internal operation of the business did not permit tracing of individual investments, or the funds in question could be traced as not having flowed into any identified mortgage. Where tracing requires an enormous effort for unreliable results, justice will require pooling. After reviewing relevant authorities McGechan J concluded:[24]

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22 *McKenzie v Alexander Associates Ltd (No. 2)* above n 17; *Re International Investment Unit Trust,* above n 17 .

23 *McKenzie v AlexanderAssociates Ltd (No 2),* above n 17.

24 At 67,065.

> … where there can be tracing, there shall be tracing. Where there cannot, the "nearest approach practicable to substantial justice" shall be taken … I see nothing in the decisions which would preclude tracing as to part, where such tracing was possible, and pooling, as a reflection of the nearest approach practicable to substantial justice, as to the untraceable balance, where such a course was appropriate on particular facts.

[49] In *Re International Investment Unit Trust*, the Court addressed the most appropriate method of distributing funds held by an investment company placed into statutory management.[25] The balance available for distribution, which had resulted from a number of contributions made by investors, was now insufficient to meet all claims, however, orders were made in favour of three investors whose funds could be traced.

[50] The liquidators submitted that *Re International Investment Unit Trust* is of limited assistance because the statutory managers accepted that investors who could identify funds they had contributed to a bank account had a proprietary claim to them. There was therefore no considered analysis of the underlying principles as to whether the statutory managers' concession was correct.

[51] The Court accepted the statutory managers' conclusion that only three investors could show their funds had not been disbursed to other investors or otherwise withdrawn and were thus identifiable as a discrete part of the funds held. However, in accepting that approach, Williams J noted the views of Lord Browne-Wilkinson in *Foskett v McKeown*.[26] In allowing an appeal by purchasers of land granting them access to the proceeds of a life policy where their funds had been held in trust but from which, in breach of that trust, premiums have been paid on the policy, Lord Browne-Wilkinson observed:[27]

> If, as a result of tracing, it can be said that certain of the policy moneys are what now represent part of the assets subject to the trusts of the purchasers trust deed, then as a matter of English property law the purchasers have an absolute interest in such moneys. There is no discretion vested in the Court. There is no room for any consideration whether, in the circumstance of this particular case, it is in a moral sense "equitable" for the purchasers to be so entitled. The rules establishing equitable proprietary interests and their enforceability against certain parties have been developed over the centuries and are an integral part of the property law of England. It is a fundamental

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25 *Re International Investment Unit Trust,* above n 17.

26 *Foskett v McKeown* [2001] 1 AC 102 (HL).

27 At 109.

> error to think that, because certain property rights are equitable rather than legal, such rights are in some way discretionary. This case does not depend on whether it is fair, just and reasonable to give the purchasers an interest as a result of which the Court in its discretion provides a remedy. It is a case of hard-nosed property rights.

[52] The liquidators rejoinder was to cite Lord Millett from his speech in the same case:[28]

> 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.
>
> The primary role in regard to a mixed fund, therefore, is that gains and losses are borne by the contributors rateably.

[53] The liquidators submitted the post-APO depositors' claim of priority over earlier investors would result in an injustice. They would be repaid in full, to the disadvantage of earlier investors, simply because of the date of their deposit. In criticising the approach taken by Ronald Young J in *Re Waipawa,* the liquidators submitted the Court's view that "where there can be tracing there should be tracing" is inconsistent with its subsequent rejection of the application of the rule in *Clayton's Case,* that a "first in, first out" approach would be substantially unjust and unfairly advantage later investors. This latter observation by Ronald Young J, however, needs to be considered in the context of a case where the monies invested were allocated randomly between two companies and disappeared into an overall fund from which it was impossible to effectively identify "what money is what".[29] In effect the monies were so mixed that no identification of individual investors deposits or monies was able to be undertaken.

[54] The liquidators stressed that "tracing" is but a set of rules of evidence which allow a claimant to identify misapplied property or its proceeds. It ought not to be viewed as a claim or remedy in itself but merely a process by which a claimant may provide an evidential foundation to demonstrate what has happened to his or her

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[28] At 132.

[29] *Re Waipawa Finance Company Ltd (in liq),* above n 16 , at [17], and [26-27].

property and which is necessary to prove some claim against a defendant which the claimant is able to enforce.[30]

[55] The liquidators drew my attention to the observation of Lord Millett that money paid into a bank account belongs legally and beneficially to the bank rather than to the account holder and that, while "[w]e speak of tracing money into and out of the account", there is no money in the account, merely a debt of an amount equal to the final balance standing to the credit of the account holder.[31] However, these remarks were made to emphasise that tracing involves the process of identification of the *value* of the original asset rather than to suggest that the balance of the account, or part thereof, cannot be the subject of tracing to give effect to a proprietary interest.

[56] A claimants' original deposit may become "mixed" in a bank account. That money may be withdrawn and used to acquire a substitute asset in respect of which the value of the original asset may be claimed. Difficult questions may arise regarding the identification of funds used to acquire the subject asset. In many cases there may be a series of transactions over the course of the accounts existence and various assets bought and sold. In the present case however, the "money" claimed, or at least its value, has not been withdrawn. The sum deposited remains readily identifiable and no issues of evidential uncertainty arise from any subsequent transactions.

[57] The liquidators, however, argued the depositing of the monies in Arena's bank account did result in the mixing of the post-APO depositors' funds with those of the pre-APO investors' funds, or at least the balance thereof. Moreover, because each group of investors were innocent contributors to this mixed fund, there should be no reason to favour the interests of one over the other. To do otherwise, would be to apply the rule in *Clayton*'s *Case* which should be rejected on any modern approach to the issue of distribution in such situations and, in particular, in the absence of evidence to infer it was the investors' intentions that the later investors be paid in full or in preference to earlier investors.

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30 David Fox "Breach of Trust" in John McGhee (ed) *Snells Equity* (33rd ed, Sweet & Maxwell, London, 2015) at [30-051], citing *Foskett v McKeown*, above n 26, at 127-128.

31 *Foskett v McKeown,* above n 26, at 128.

[58] The liquidators submitted that in the present case the effect of allowing the rule in *Clayton's Case* to apply (first in, first out) would be arbitrary as both the pre and post-APO depositors had been the victims of the same fraud. Arena never invested any of the monies deposited with it and never apparently had any intention of investing funds for the purpose of foreign exchange trading. Both sets of investors accepted the risk of Arena's insolvency and the APOs were the result of the insolvency risk being realised.

[59] Therefore, the liquidators argued the post-APO depositors ought not be able to rely upon the imposition of the APOs as a basis to differentiate themselves from the pre-APO depositors. The present position has resulted from the company's insolvency and the non-performance of its contractual obligations. It follows, the liquidators argued, that the post-APO depositors should be treated no differently from other investors for the purposes of the company's insolvency.

[60] The liquidators submitted that to allow the post-APO depositors to trace their monies in Arena's bank account would be contrary to recent authority which has recognised that the rule in *Clayton's Case* will be displaced if it results in one innocent contributor being favoured at the expense of another in the absence of any actual or presumed intention of the contributors of such a result. The liquidators submitted the appropriate approach would be to treat all deposits into the account as having equal status and the funds in the account distributed on a *pari passu* basis.

**Decision**

[61] I accept the traditional approach to the allocation of trust assets held in a mixed fund, as recognised in *Clayton's Case*, has largely fallen into disfavour. As the Court of Appeal in *Re Registered Securities Ltd* observed, the automatic application of the rule would not ordinarily withstand scrutiny, founded as it is on a presumed intention which is "in truth a fiction and cannot be allowed to work an injustice".[32] This view has been endorsed more recently in *Vero Liability Insurance Ltd v Heartland Bank Ltd*, where it was held the rule in *Clayton's Case* may be

[32] *Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA) at 553.

displaced by an agreement to the contrary or evidence pointing to a contrary conclusion, even by a "slight counterweight".[33]

[62] *Re Registered Securities Ltd* was a case which involved a contributory mortgage scheme.[34] Despite having been informed to the contrary, investors monies were pooled and paid into a principal trust account. Investors were purportedly allocated shares in specific mortgages, however, the pool of funds was used to pay interest to other investors and for other purposes. The account became overdrawn as a result of the inward flow of interest from mortgages being far short of what the contributory mortgagee company had undertaken to pay its investors. The liquidators applied for directions as to whether mortgages purporting to have been allocated by the company, in whole or part, to specific investors, were to be dealt with on the footing that such investors were the beneficial proprietors of the mortgages or of an interest therein. Alternatively, whether the proceeds of the mortgages should be distributed pro rata among all presently unpaid investors or some class or classes of them.

[63] While the Court of Appeal rejected the automatic application of the rule in *Clayton's Case* as between innocent beneficiaries, it clearly did not discount the possible tracing of investors' monies to mortgages purportedly allocated to them. When it was not possible to trace investors' monies into mortgages, a division of assets based on the contribution of each investor was viewed as the only "rational mode of distribution".[35]

[64] The Court observed that there will be cases where an attempt to trace will involve enormous effort and which on the material known would be unlikely to produce a reliable result. In such instances the Court will be left to give such directions as will do substantial justice between the parties. However, it remained open to individual investors to try and trace their monies to a particular mortgage or mortgagors. The corollary of that acknowledged opportunity is that, where tracing can be undertaken on a reliable basis, it is a course that can legitimately be followed

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33 *Vero Liability Insurance Ltd v Heartland Bank Ltd* [2015] NZCA 288 at [100], citing *Russell-Cooke Trust Co v Prentis* [2002] EWHC 2227, [2003] 2 All ER 478 (Ch) at [55].

34 *Re Registered Securities Limited,* above n 32.

35 At 558.

and reflects the approach subsequently taken by McGechan J in *McKenzie*, as discussed at [47]-[48].[36]

[65] I am satisfied that, while the application of *Clayton's Case* is ordinarily to be deprecated in situations involving innocent contributors to a mixed fund, that ought not be to the exclusion, in appropriate circumstances, to giving effect to the proprietary interest of depositors whose monies can be identified as untouched or effectively "unmixed" in the company's bank account and therefore readily traced. The reason for such monies being able to be characterised in such terms ought, however, to be substantially because of some factor beyond the simple chronological order in which deposits were received before the company was placed into receivership. In the present case, the imposition of the APOs had a direct effect on the operation of the bank account.

[66] Arguably in the present case the deposits made on or after 15 May were not truly "mixed." That is because they were not and, indeed, were unable to be drawn upon or utilised in any way in combination with the existing balance of the account due to the invocation of the APOs. The post-APO deposits could not be used to acquire any substitute asset or indeed be able to be used in any way by the company.

[67] The liquidators' arguments of the absence of a proper basis upon which to distinguish the pre and post-APO depositors, are met by the formal intervention of the public regulator which resulted in the Ponzi scheme coming to an end. While the liquidators may argue that such a consideration ought not bear on the approach to the company's insolvency, I consider it relevant to the inferences to be drawn as to the investors' intentions in terms of the extent to which the rule in *Clayton's Case* should be displaced.

[68] The investment activity, which the company purported to operate, was a fraud. The monies deposited by all the investors were not used for the purpose for which they were provided and, to that extent, all the investors share that common complaint. From that common failure it is not possible to discern or presume the investors' intention to be that the latest investors be paid in full or in preference to

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[36] *McKenzie v Alexander Associates Ltd (No 2),* above n 17.

earlier investors. In my view however, that implied or presumed intention cannot realistically extend to include investors who paid their deposits into a frozen bank account after the intervention of the FMA.

[69] Monies deposited on or after 15 May, while invested in the belief they would be used for the same purpose as pre-15 May deposits, simply could not, as a matter of fact and law, be applied as contemplated by the investor. While the company had never invested deposits for the purpose of foreign exchange trading, in my view the imposition of the APOs created a material change of circumstance which altered the position of the post-APO investors and therefore the status of their deposits when compared with the earlier investors. A consequence of that changed circumstance was that the post-APO investors' deposits were made to an account frozen by the regulator resulting in such monies being readily identifiable and therefore, without any difficulty, able to be traced.

[70] An intended effect of the regulator obtaining the APOs was to prevent the bank account from being further utilised for the purpose of the fraudulent operation. The fact the account was still able to receive the deposits after the regulator had secured the APOs may point to a deficiency in the drafting of the orders. However, the objective and effect of those orders cannot be doubted, namely to prevent any further fraud from being committed and any further loss to innocent investors. Any deficiency in the efficacy of the APOs in achieving that purpose was readily overcome by the fact that, with the APOs in place, funds deposited on or after 15 May could not be utilised by Arena. They would remain identifiable and inviolate. In my view, this was an implicit intended consequence of the APOs which ensured the proprietary interests of any innocent investor who may subsequently deposit monies into the account would be recognised and able to be given effect to.

[71] I conclude, therefore, that the post-APO depositors' funds were the subject of a statutory trust. Because of the circumstances (albeit unknown to the investors) in which they were made, the deposits are thereby, without difficulty, able to be traced and should be paid to the post-APO investors in priority to any other distribution. It follows that I decline the liquidators' application for orders directing that the funds deposited by clients of Arena into its bank account on or after 15 May 2015 totalling

$249,400 form part of the assets of Arena. More particularly, I decline the application for an order directing that such funds are to be treated in the liquidation in the same way as any other funds held in the bank account prior to 15 May.

[72] Whether there is any basis to differentiate the position of pre-APO depositors as between themselves for the purpose of the liquidation is a matter for the liquidators to assess. As will be apparent from this judgment, the intervention of the regulator and the consequential effect of the APOs effectively quarantined any subsequent deposits. This was a material and influential factor in assessing the inferences to be drawn as to the investors' intentions regarding the extent to which the rule in *Clayton's Case* should be approached in the circumstances.

**Other orders**

[73] By agreement I make the following orders:

(a) the reasonable legal costs of one lawyer acting for one or more of the clients of Arena who deposited funds on or after 15 May 2015 (post-APO depositors) are to be paid out of the $249,400 funds deposited by the post-APO depositors;

(b) there is to be no other order as to costs between the parties;

(c) the names of the pre and post-APO depositors and the amounts that each deposited is to be confidential and is not to be provided from the Court file to any non-parties without further order of the Court on notice to the liquidators and the post-APO depositors; and

(d) leave to apply for further directions is reserved.

**Mander, J**

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