Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare

NORTON ROSE FULBRIGHT

Legal update

Even the winners lose in a Ponzi scheme: payments made to investors in a Ponzi scheme clawed back as fraudulent conveyances

---

April 2018
Litigation

In what is typically referred to as a "clawback proceeding," a trustee in bankruptcy seeks to recover, or "claw back," funds paid to innocent investors in a Ponzi scheme lucky enough to make a profit (net winners) for the benefit of the remaining, and equally innocent, unlucky investors (net losers).

A recent example of a clawback proceeding in British Columbia is *Boale, Wood & Company Ltd. v Whitmore* (*Whitmore*), where the BC Supreme Court found the defendant, a net winner in a Ponzi scheme, was not entitled to keep the proceeds of his "investment."

The decision illustrates important differences between the legislative schemes in British Columbia and Alberta employed by courts in clawback proceedings. Specifically, *Whitmore* highlights how the operation of fraudulent conveyance and preference legislation differ in British Columbia and Alberta and what this may mean for victims of Ponzi schemes.

Whitmore

In *Whitmore*, Rashida Samji, a former notary, offered a purported investment in a wine and liquor business through a group of companies (the Samji Group). To keep her scheme going, and in typical Ponzi fashion, Ms. Samji paid investors from their own money or from money invested by others. Ms. Samji's fraud was eventually discovered and, as the court expressed, the "house of cards imploded." The majority of the investors in the scheme lost money; others, including the defendant, Kay Whitmore, made a profit. The Samji Group made a voluntary assignment into bankruptcy and a trustee was appointed over its estate to claw back the funds received by Mr. Whitmore.

The court concluded that Mr. Whitmore, who made approximately $384,000 from his investment in the scheme, was not entitled to these proceeds. The bulk of the court's analysis considered whether the payments from Ms. Samji to Mr. Whitmore were void under the *Fraudulent Conveyance Act* (*FCA*), a two-section-long British Columbia statute governing the disposition of property made to "delay, hinder or defraud creditors and others of their just and lawful remedies." Relying on the Alberta Court of Queen's Bench decision in *Titan Investments Ltd. Partnership, Re* (*Titan Investments*), the court inferred that Ms. Samji intended to defraud the net losers from the mere fact that she was running a Ponzi scheme.

The remaining analysis considered whether Mr. Whitmore could benefit from the defence in s. 2 of the *FCA*. This provision provides a defence where property is in good faith "lawfully transferred" to a person who had no knowledge of the fraud and the transfer was for good consideration. Although the court accepted that Mr. Whitmore had no knowledge of the fraud, it did not accept that the disposition was made for good consideration. After a lengthy analysis, the court concluded the transactions were in no way "loans," as argued by Mr. Whitmore. Rather, the parties' use of words such as "investment," "return," and "fee" were clear indications the payments were not made for "good

consideration" and were therefore void under the *FCA*. The payments were also not "lawfully transferred" because they were transferred to Mr. Whitmore as part of Ms. Samji's unlawful scheme.

Though unnecessary to grant the relief sought by the trustee, the court also considered how Ms. Samji's payments to Mr. Whitmore would fare under BC's *Fraudulent Preference Act* (BC *FPA*), which declares as void payments made by an insolvent debtor that have a preferential effect over other creditors. Relying on *Titan Investments*, the court accepted that Ponzi schemes are insolvent from their inception. However, because the BC *FPA* exempts creditors acting in good faith, and the court accepted that Mr. Whitmore did not intend to receive the fraudulent preference, the BC *FPA* did not apply and the payments were not void on that basis.

Titan Investments

The facts in *Whitmore* are strikingly similar to *Titan Investments*, a decision out of the Alberta Court of Queen's Bench decided more than a decade ago. Titan Investment Limited Partnership was represented as an investment vehicle in which investor funds were purported to be pooled for trading in futures and equities markets. Individuals who invested in Titan expected net returns in the range of 50% to 100%.

In reality, Titan was operating as a Ponzi scheme and, as the court noted, the partnership was a fraud and insolvent from its inception. Like in *Whitmore*, the application before the Alberta Court of Queen's Bench was whether funds paid to certain investors in the scheme could be clawed back for the benefit of the net losers. The court in *Titan Investments* ultimately found the payments to the net winners were void under Alberta's *Fraudulent Preferences Act* (Alberta *FPA*).

Unlike the BC *FPA*, there is no requirement under the Alberta *FPA* for the creditor to *intend* to receive the fraudulent preference. On that basis and given the broad definition of "creditor" in the Alberta *FPA*, the payments by Titan to the net winners were void as fraudulent preferences. These payments, however, were not void as fraudulent conveyances under Alberta's fraudulent conveyance legislation (the *Statute of Elizabeth*). Though broader in application than the Alberta *FPA* in that it does not require the transfer to be made by an insolvent debtor to a creditor, the *Statute of Elizabeth* requires the debtor (in this case, the fraudster) to receive a benefit from the disposition in question.

In *Titan Investments*, the court found the fraudster did not reserve a benefit to himself by paying out the net winners and therefore the transaction was not a fraudulent conveyance. Receiving a benefit is not a requirement under BC's fraudulent conveyance legislative scheme. Notably, however, the court in *Whitmore* expressed that, even if there was such a requirement in BC, Ms. Samji clearly benefited from paying the net winners because doing so allowed her to continue with the Ponzi scheme.

Take-away

Both *Whitmore* and *Titan Investments* outline a variety of mechanisms through which funds distributed in a Ponzi scheme may be clawed back for the benefit of net losers. As the decisions make clear, however, these mechanisms are not always straightforward and can result in diverging legal effects depending on the jurisdiction in which the fraud was committed or how the fraud was perpetrated. Net losers in a Ponzi scheme may have less difficulty recovering invested funds under BC's fraudulent conveyances legislation but would not likely benefit from the province's fraudulent preferences scheme. In Alberta, net losers can likely expect the opposite: they may have more success proceeding through Alberta's fraudulent preferences legislation than through the *Statute of Elizabeth* governing fraudulent conveyances.

In both jurisdictions, however, the analysis required to characterize payments in a Ponzi scheme as either fraudulent conveyances or preferences is complex and often convoluted. Victims of Ponzi schemes – as either the net winners or net losers – should therefore be cognizant of these challenges and seek guidance from legal counsel experienced in responding to Ponzi schemes as soon as the fraud is discovered.

Jordan Deering
Kieran Siddall
Emily McCartney

For further information, please contact one of the following lawyers:

> Jordan Deering	Calgary	+1 403.267.8257	jordan.deering@nortonrosefulbright.com
> Emily McCartney	Calgary	+1 403.267.8274	emily.mccartney@nortonrosefulbright.com
> Kieran Siddall	Vancouver	+1 604.641.4868	kieran.siddall@nortonrosefulbright.com

Norton Rose Fulbright Canada LLP, Norton Rose Fulbright LLP, Norton Rose Fulbright Australia, Norton Rose Fulbright South Africa Inc and Norton Rose Fulbright US LLP are separate legal entities and all of them are members of Norton Rose Fulbright Verein, a Swiss verein. Norton Rose Fulbright Verein helps coordinate the activities of the members but does not itself provide legal services to clients.

References to “Norton Rose Fulbright”, “the law firm”, and “legal practice” are to one or more of the Norton Rose Fulbright members or to one of their respective affiliates (together “Norton Rose Fulbright entity/entities”). No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any Norton Rose Fulbright entity (whether or not such individual is described as a “partner”) accepts or assumes responsibility, or has any liability, to any person in respect of this communication. Any reference to a partner or director is to a member, employee or consultant with equivalent standing and qualifications of the relevant Norton Rose Fulbright entity.

The purpose of this communication is to provide general information of a legal nature. It does not contain a full analysis of the law nor does it constitute an opinion of any Norton Rose Fulbright entity on the points of law discussed. You must take specific legal advice on any particular matter which concerns you. If you require any advice or further information, please speak to your usual contact at Norton Rose Fulbright.

© Norton Rose Fulbright Canada LLP 2018