Neutral Citation [2012] IEHC 595

THE HIGH COURT

[2012 1 CAB]

IN THE MATTER OF SECTION 3(3) OF THE PROCEEDS OF CRIME ACT 1996 AND 2005

BETWEEN

CRIMINAL ASSETS BUREAU

AND

EAMONN KELLY and EKYS ESTATES LIMITED T/A REMAX PROPERTIES

Judgment of Mr. Justice Kevin Feeney delivered on the 28th day of September, 2012

1. On the 11th of January 2012 this Court made an order pursuant to Section 2 of the Proceeds of Crime Act 1996 (as amended) prohibiting for a 21-day period the disposal or dealing with certain property which was set out in the schedule to that order.

2. The property in the schedule was:

> (i) Cash in the sum of €454,844.17 held at Ulster Bank Walkinstown, Dublin 12 in a current account bearing number 28886021 bearing the name EKYS Estates Limited, trading as Remax Properties.
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> (ii) Cash in the sum of 4,874 held at Permanent TSB Blanchardstown, Dublin 15 bearing account number 16702910 bearing the name Eamonn Kelly.
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> (iii) Cash in the sum of €20,492 held at Educational Building Society, Crumlin, Dublin bearing account number 42943051 bearing the name EKYS Estates Limited, trading as Remax Properties.

3. A motion seeking a Section 3 order was brought on the 30th of January 2012 which resulted in a Section 3 order being made on the 24th of May 2012 in respect of the same items as in the Section 2 order; being all the cash deposits set out in the schedule.

4. The background to the making of those orders is that Eamonn Kelly, the first Respondent who is a director of the second Respondent company operated a fraudulent investment scheme, colloquially known as a Ponzi scheme. The first Respondent admitted the fraudulent nature of the scheme and has now pleaded guilty to criminal charges in relation to his operation of the investment scheme and has received a six-year sentence. At the commencement of these proceedings, the Detective Sergeant Fergal Harrington of the Criminal Assets Bureau briefly described the illegal and fraudulent investment scheme at paragraph 6 of his affidavit of the 11th of January 2012 in the following words:

> *"The first Respondent operated as an estate agent since in or about 2003 trading under the name of Remax Properties, Crumlin. Towards the end of 2006 he began to experience financial difficulties; he began to seek investments from friends and associates for what he said were projects to purchase land without planning permission and then sell the land with planning permission. The investments were to be of short duration with substantial returns. Following the investigation by the Garda Bureau of Fraud Investigation, the first named Respondent admitted that there are, were no such investments and that the monies received were used to defray living expenses and to repay the capital sum and/or interest on the investments made by other investors. He admitted that some of the monies were lodged into account number 28886021 at Ulster Bank, which is the business account of the second Respondent company. He also admitted that when this account was frozen by court order, he lodged monies to two further accounts, as set out at the previous paragraph in his affidavit. A total of 480,210.17 is currently held in these accounts, which sums are currently the subject of an order by the Court pursuant to Section 24 of the Criminal Justice Act, 1994. Both the Ulster Bank and Permanent TSB account are current accounts and do not earn interest, however the EBS account is an interest-bearing account. "*

5. As is apparent from that averment, a Section 24 freezing order had been made pursuant to Section 24 of the Criminal Justice Act 1994 prior to the commencement of these proceedings. The three bank accounts referred to by Detect Sergeant Harrington in his affidavit are the same bank accounts covered by the orders of this Court and also are the accounts which were subject to the Section 24 Order. That is to say that the same three accounts which were covered by the Section 23 Order were later the subject of Section 2 and Section 3 Orders made by this Court. The information available to this Court indicates that the sums in those accounts are the only remaining funds of the Ponzi scheme which were not dissipated and represent the funds which the investors can endeavour to access to be refunded in whole or in part.

6. The persons who invested in the Ponzi scheme and who were the victims of the first Respondent's criminal activities were put on notice at various stages of these proceedings. This has resulted in a number of applications pursuant to Section 3(3) of the 1996 Act. Some of applications concern funds which are directly identifiable and have been traced to the three accounts the subject of the Section 3 Order, whilst others concern funds which were previously in these accounts but which have since been dissipated. There are also applications concerning funds which have been traced to different bank accounts and which are not associated with the bank accounts the subject matter of the Section 3 Order.

7. Various persons who invested in the Ponzi scheme have made applications under Section 3(3) of the Act seeking that money be paid out of the funds subject to the Section 3 Order to them. In effect to either repay them their investment or to provide for a pro-rata payment proportionate to their original investment out of the entire funds the subject of the Section 3 Order.

8. The issue which is central to this application and which arises from the facts is that there are two different types of claimant. Because of that fact, I ordered a hearing were each of the different categories would be heard.

9. The two different category of claimant arises from the fact that when the freezing order under Section 24 was made on the 22nd of July 2010, one of accounts covered and the one containing almost the entire remaining funds was the Ulster Bank account in Walkinstown with a balance of €455,248.50.

10. It is the composition, origin and source of the funds in the Ulster Bank account which gives rise to the fact that the Court is being urged to adopt a particular approach to certain of the Section 3(3) applications to the potential detriment of the other investors and the other Section 3(3) claimants.

11. The facts which give rise to that position are that in or about December 2009, Mr.Shaun Lafferty, acting on behalf of Eamonn Kelly, contacted a number of potential investors in Donegal and advised them of an investment opportunity. Mr. Lafferty obtained sums of money from a number of parties to invest in the scheme which was part of Mr. Kelly's Ponzi schemes. A number of cheques and bank drafts were furnished to Mr. Lafferty from the various parties, which were then lodged, together with Mr. Lafferty's own investment, to the Ulster Bank account number 28886021 on the 4th of February 2010. One cheque, that is a further cheque of 50,000 from the investors, was lodged to this account on the following day, the 5th of February 2010. Shortly thereafter Ulster Bank became concerned over the activities of Eamonn Kelly and the operation of account 28886021. On about the 16th of February 2010 the bank contacted the Gardai to express concerns in respect of the activities of the first Respondent and the operation of the account. Those concerns included the use of a forged letter purporting to be from Ulster Bank. Arising from that contact, the Gardai made a direction to Ulster Bank that account number 28886021 not be dealt with in any way. This resulted in that account being frozen as of mid February 2010 and the account remained intact up until the 26th of July 2010, and following investigations by the DPP an application was made by the DPP for an order. On the 26th of July 2010 the Court made an order pursuant to Section 24 of the Criminal Justice Act, 1994 prohibiting the Respondent or any of the parties on notice of the order from disposing of or dealing with or diminishing the value of the property contained in three bank accounts. They are the same three bank accounts as are the subject matter of the Section 2 and 3 Orders. The first bank account, the Ulster Bank Walkinstown account is the account which was frozen some five months previously.

12. Because the Ulster Bank account was frozen and then subject to the Section 24 Order, the funds which the Donegal investors had paid to Mr. Lafferty, including his own funds which all had been lodged to the Ulster Bank account had not yet been dissipated or used in any way and the funds remained in the account and it is claimed that they are traceable and should be repaid to him in full and that it is also claimed by the eight Donegal investors who put in a total of€450,000. That is to say that the €450,000 is and remains their property. Those investors also contend, through the argument put forward on behalf of Mr. Danny McBride, that the concept of tracing as understood in an equitable context does not apply based upon the contention that there was no trust created and as such there can be no proprietary claims rising from same beyond those persons specifically identified as the true and proper owners of the property. Part of that argument rests on the fact that whilst the money might have gone into the possession and control of Mr. Kelly, he never owned it and they, the investors, continued to be the true owners. This arises from the fact that there was no transfer or conversion of the $450,000 being part of the funds remaining in the Ulster Bank.

13. The Donegal investors further argue that if the Court were to decide the issue on the basis that there was a trust and thus a potential proprietary claim arising that the Court should apply the principle commonly referred to as the rule in Clayton's case, *Devaynes v. Noble* (1816) 1 Mer 572. It is also reported in 1814-1823 35 All England Reports. Application of that rule would result in the equitable remedy that the eight Donegal investor funds, being fully identifiable and that such funds would therefore be returned to those eight investors.

14. The opposite case is made by earlier investors in the Ponzi scheme, as put forward on behalf of Yvonne Sergeant and Geraldine Kelly, which is that the monies the subject of the Section 3 order should be distributed between all the injured parties, that is all the investors who suffered loss on a pro-rata basis and that justice under Section 3(3) requires the available funds the Section 3 order be divided pro-rata to the funds lost by each of the investors in the Ponzi scheme and that the Section 3(3) orders should reflect that approach. Those investors claim that the Donegal investors in common with all other investors paid into the Ponzi scheme and gave up control of their funds and that such funds were blended into the funds within the Ponzi scheme and mixed together and in effect invested into a common fund. And that following the approach identified by the Court of Appeal in *Barlow Clowes International Limited (in liquidation) v. Vaughan* [1992] 4 All ER 22, the funds remaining and available should be dealt with and shared pari passu rateably in proportion to the amounts due to or lost by all investors. They claim that such approach would be just and any other would create an injustice under Section 3(3) of the Proceeds of Crime Act. Those investors also urge the Court to follow and to be guided by the approach taken by Murphy J. in the case of *Re W & R Morrogh* [2007] 4IR 1 where the Judge shied away from an application, preferring one set of, or one particular investor in circumstances where the issue of division of the available funds turned on nothing other than the good fortune or timing and that in those circumstances such available funds should be dealt with *pari passu*. The investors making a claim for *pari passu*, rely on Murphy J's finding in the *Morrogh* case that the rule in *Clayton's* case could be displaced in the particular circumstances of that case, where its application would result in an injustice between claimants to the remaining funds in an insolvent stockbrokers. Murphy J. held that the application of the *Clayton* case rule would cause an injustice between investors, as it would favour clients whose money entered the firm's their bank accounts immediately prior to the Receiver's appointment. He held that the principal equality is equity should apply and that the monies in the stockbroker's bank account had the characteristics of a mixed pool and should be distributed rateably. The non-Donegal investors seek to have this Court follow the conclusion of Murphy J in the *Morrogh* case at page 43 where he held:

> *"In the view of this Court, a compelling argument has been made by all of those appointed to argue against the application of the rule in Clayton's case. They stress that its application would result in injustice between clients because it would favour those clients whose monies entered accounts in the days immediately prior to the appointment of the Receiver. Counsel for Mr. and Mrs. Hall, on the other hand, argued strongly that persons in the position of his clients had a greater equity than those whose monies entered the pool at an earlier time.*
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> *I agree with the Receiver that for those whose money entered the account in the days immediately prior to the appointment of the Receiver to argue that they had a stronger or more greater equity than those whose monies entered the account at an earlier time would be a difficult task. All of the unpaid clients whose monies have entered the account suffer the same misfortune; the misfortune that there is insufficient money to pay them all in full. There appears to be no reason in logic why those whose monies entered the account at a later time should be said to have a greater equity than those whose monies entered the account at an earlier time. All of them have equitable or trust claims against the account.*

15. The non-Donegal investors in the Ponzi scheme, that is the earlier investors contend that the circumstances of this case are not dissimilar to those dealt with by Murphy J. in the *Morrogh* case and that this Court is also faced with a stark decision and to rigidly apply the rule in *Clayton's* case would create a manifest hardship and injustice. It is claimed that a distribution following the *Clayton* rule would be an injustice and that the proceeds of crime should be dealt with in a manner to avoid such injustice and a *pari passu*

approach would ensure justice and would, it is claimed, be:

"In accordance with the presumed intention of all the investors.

16. Before addressing the opposing contentions it is appropriate to set out certain facts and legal consequences that can be identified from the affidavit evidence before the Court:

(i) The investment scheme operated by Mr. Kelly, the first Respondent, was at all times a fraud.

(ii) It was a Ponzi scheme; there never were any investments and money received for purported investment was taken and then in part used later to repay earlier investors, giving an apparent return or dividend of the investment and in part to provide money to Mr. Kelly.

(iii) He thereby obtained money fraud. for his own use by means of a

(iv) As with all Ponzi schemes, the continuation of the scheme was dependent upon on a continuing supply of fresh or new funds which could be used to provide apparent investment returns.

(v) Mr. Kelly has pleaded guilty and there is no issue but that there were no investments and all funds were for use in the Ponzi scheme and for his illegal profit or benefit.

(vi) Money paid by the investors was paid under a mistake induced by fraud and it follows that such money can be recovered as money had and received (see *Edward Owen v. Barclays Bank Investment Limited* [1978] QB 159 at pages 169-171. It is also reported in 1978 1 All England reports at 976.

(vii) The funds invested never became the legal property of Mr. Kelly, even though he took possession and control of the money invested. And, in most instances, used the funds after he took control and possession by paying out purported profit on earlier investments and using funds for his own benefit.

(viii) All the funds the subject of the Section 2 and Section 3 orders were in the possession and control of Mr. Kelly, but he never owned those funds.

(ix) Section 2 and Section 3 Orders were made as the funds or money the subject of the orders were in the possession or control of Mr. Kelly.

(x) Those funds constituted directly or indirectly the proceeds of crime as they were in the possession of and under the control of Mr. Kelly as part of his fraudulent scheme. And he intended to deal with the funds in an illegal and fraudulent manner.

(xi) The manner in which the Donegal investments were dealt with is comprehensively dealt with in the affidavit of the Bureau financial crime analyst's number 3, sworn on the 23rd of May 2012, which is sworn supplemental to her two earlier affidavits and is an update of those affidavits based on further investigations and analysis. At paragraph 3 and following she averred as follows in relation to the funds in the Ulster Bank.

"The above mentioned account is Item 1 on the schedule of the originating notice of motion and the funds the subject of the Section 2 order amount to €454,844.17. As a result of further investigations, I am satisfied that the balance on this account is made up as follows:

26th of January 2010 EBS draft amount 4,200 FIFO (that is first in first out) balance 391,90.

29th of January 2010 cheque lodgement 181.50, first in first out balance 181.50.

29th of January 2010 Social Welfare 668. First in first out balance 668.

4/2/2010 Shaun Lafferty 50,000, first in first out balance, 50,000.

4/2/2010 Pat Lafferty 50,000, FIFO balance 50,000.

4/2/2010 Charles Gallagher amount 50,000, FIFO balance 50,000.

4/2/2010 Michael Kelly 50,000, FIFO balance 50,000.

4/2/2010 Daniel McBride 50,000 FIFO balance 50,000.

4/2/2010 Bernard and Judy McCarron 50,000, amount FIFO balance 50,000.

4/2/2010 Noel Gallan balance amount 50,000.

5/2/2010 Noreen Marley 50,000, FIFO balance 50,000.

5/2/2010 PP O'Sullivan & Company, solicitor's client account 3,602. 77. FIFO balance is 3,677.

4. The difference between this table and the one included at paragraph 3 of my affidavit sworn herein on the 10th of May 2010 arises as a result of a bounced cheque for the sum of 2,000 being treated as part of the balance.

5. I am advised by Sergeant Harrington and believe that he has asked PP O'Sullivan and company for details of the nature and source of the lodgements of 3,602. 77 and is awaiting response. Further investigations are also being carried out into the source of the lodgements on the 26th and 29th of January 2010. I have included a calculation using the first in first out principles (FIFO) of how much of an individual lodgement contributes to the balance the subject of the Section 2 Order."

(xii) As the balance present in the Ulster Bank was 454,844 when the account was frozen and since the first payment in of funds emanating from the Donegal investors occurred on the 4/2/2012 and since the total of all lodgements, credits including those from the Donegal investors was less than 454,844.17 it follows that the account was in credit when the Donegal funds were paid in and that none of those funds were drawn down or used, but remained in the account.

(xiii) Mr. Kelly never used or dealt with any of the funds paid in by the Donegal investors.

That is 50,000 x 7 and 100,000 x 1 totalling €450,000.

(xiv) The application before the Court falls to be dealt with under the provisions of Section 3(3) of the Proceeds of Crime Act 1996 (as amended). The relevant provision is Section 3(3) where an interlocutory order is in force, the Court on an application to it in that behalf at any time by the Respondent or any other person claiming ownership of any of the property concerned may if it is shown to the satisfaction of the Court that the property or a specified part of it is property which paragraph 1 of subsection 1 applies or that the order causes any other injustice, discharge or as may be appropriate vary an order. Subsection 1(1) of Section 3 reads that:

"The particular property does not constitute directly or indirectly proceeds of crime and was not acquired in whole or in part with or in connection with property that directly or indirectly constitutes the proceeds of crime. "

17. Decision

The first and potentially decisive argument made by the Donegal investors is that the €450,000 in the Ulster Bank account is their property and that they are entitled to its return and that it would be clearly unjust to deprive them as owners of any part of that property. The facts are that whilst the funds of 450,000 went into the bank account and under the control of the fraudster, the ownership of that property never passed. The funds were paid by the Donegal investors under a mistake induced by a fraud. Those investors as owners of the funds can recover the money as money had and received. Those investors were induced to pay the money into the control and possession of Mr. Kelly by the fraud. They could recover the money paid in by order against the bank as money had and received. The money, that is the €450,000 of the investors, was intended to be used for investment by Mr. Kelly. What precise investment would be made is unclear, if any, other than it was for use to further the continuing Ponzi scheme. What is clear is that the funds never went into a common fund, were never used or dealt with by Mr. Kelly, and cannot, in any true sense, be said to be blended with the funds of the other investors. The Donegal funds at all times remained separate and identifiable and had not been dissipated or fraudulently dealt with by the date that the account was frozen.

Due to the lack of any real blending this is not a situation where the funds have been mixed or blended and what is in the account under consideration is what remains to recompense the common misfortune of all the investors. The Donegal funds remain separate and identifiable; given the owner had the clear capacity to identify the Donegal funds, that even if I did decide this case on the basis of ownership -- even if I did not decide this case on the basis of ownership and that is something which I, in fact, do, the approach contended for in *Barlow Clowes* case would be appropriate. This is due to the fact that the Donegal funds were not blended into one current or running account, the funds were placed in a running account with a small credit, but the funds never lost their identity and were not in any true sense mixed with other funds. The Donegal funds remained entire, unused and identifiable.

The facts of this case are different from the facts in the *Barlow Clowes* case. This is not an investment into a recognised collective fund, nor did the Donegal funds become mixed. Mr. Kelly did not own the funds, the Donegal investors continued, as long as the funds were unused and identifiable to have the right to recover those funds as owners.

18. The scheme of the Proceeds of Crime 1996 Act (as amended) is to permit the making of orders for the preservation of property which directly or indirectly represents the proceeds of crime and to dispose of the property thereafter according to the factual circumstances. Where those circumstances identify that the factual position is that the property is not owned by the person involved in crime, the Act recognises that the Court must in applying the provisions of the Act in a constitutional way give due and full recognition to the property rights and ownership of and by third parties. The scheme of the Act proceeds on the premise that where it can be shown that the proceeds are truly owned by third parties, that the owners of such property are entitled to the property and to have their property rights recognised. It would be unjust if the true owners of the property were to be deprived of the property or if the making of a Section 2 or Section 3 order was to diminish their right to recover their property. The Donegal investors are entitled to have their property back and they are entitled to a Section 3(3) Order which has the effect of providing for the restitution of their own funds. If the Section 3 order did not exist they could recover their property which is identifiable on the basis that they paid out funds under a mistake induced by fraud, on the basis of a claim based on money had and received, or on the basis of restitution based on Mr. Kelly's deceit. The Donegal investors are, in effect, entitled to trace their money, as in the words of Lord Millett *in Foskett v. McKeown* [2000] ER 97 at page 121:

"Tracing is neither a claim or a proceeds of a claimant's property. "the remedy, it is simply a process to identify."

19. The applications in this case do not relate to a winding up or receivership but to a Section 3(3) application under the Proceeds of Crime Act 1996. Fundamental to a constitutional application of that Act, is that the Court must have due regard to property rights.

20. The facts in this case have much in common with the facts i*n Re Money Markets International Stockbrokers Limited* case (1994] IR 267 where Laffoy J. held at page 277 as follows:

"On this application I do not propose to determine, and I am not taken as expressing any view as to whether as between all of the parties who may have a claim to the balance in the current account in issue, the rule in Clayton's case is applicable to determine entitlement, because I am not satisfied that all relevant interests were represented in this application, and in any event I consider that it is not necessary to do so. What I propose to consider is whether as between the Applicant, on the one hand, and all other claimants to the funds represented by the balance on the current account, on the other hand, in accordance with equitable principles the applicant should be bound by a pari passu distribution if the rule in Clayton's case is not applicable. It is not to be referred however that I am of the view that a pari passu distribution is the appropriate method of distribution as between all other claimants to the monies represented by the credit balance on the account. On the evidence before the Court, the principles to be deduced from the decision in re: Hallett's Estate (1880) 13 Ch D 696 may come into play. Having regard to the uniqueness of the Applicant's position I do not think that applying equitable principles the Applicant should be bound by a pari passu distribution. The Applicant transferred the monies in issue to the current account for a specific purpose to discharge sums due in respect of the share purchase transaction confirmed on the 15th of February 1990 to enable that purchase

> *to be completed The Applicant transferred the monies into the company's current account prior to the settlement date and all the company did was receive them. However, after the transfer and receipt of monies and before the settlement day, the suspension of the company as a member of the stock exchange supervened so that the company was not in a position to use the monies transferred and received for the purpose for which they were intended, because the company was not in a position to complete a purchase transaction. It seems to me that given this combination of circumstances, the Applicant must have a better equity than the other client creditors who have a claim against the monies represented by a balance on the current account. The equities are not equal and equitable principles do not require that the Applicant should be subject to a pari passu distribution under which he would be treated in the same way as other clients who have equitable claims against the funds."*

The facts in this case have many similarities and can be equally said to be unique, as those in the case under review by Ms. Justice Laffoy. The Donegal claimants transferred funds for a specific purpose and all the first Respondent did was receive them. After the transfer and before they could be used, events intervened in the form of a freezing order so that the funds could not be used. Those similar facts lead me, if I was required to, to favour the approach adopted by Laffoy J. to conclude that the Donegal investors have a greater equity and that the equities are not equal as between them and earlier investors and that a *pari passu* distribution would not be appropriate if I was to decide this case on equitable principles, as opposed to the basis upon which I have done, which is based on the Donegal investors' ownership of the funds amounting to the €450,000 in the Ulster Bank.

21. Even if I was to have decided these applications on equitable principles I would not have applied the pari passu distribution, I would have followed the reasoning of Laffoy J. in *Money Markets* and recognised the superior equitable claims of the Donegal investors. I was urged to follow the approach of Murphy J. in Re: *W&R Morrogh*, but in that case the factual situation of the monies under consideration was very different. The judgment stated:

> *"In the nature of a mixed pool. Page 43.' The payments were also into the same account or accounts and as Murphy J held at page 44, whether Mr. and Mrs. Hall and/or those in a similar position are entitled to trace individually their monies into the client account of the firm is a different matter. Tracing is neither a right or a remedy and in any effect there is no application before the Court for a declaration in that regard."*

In this case the Donegal investors would be entitled to individually trace their monies into the Ulster Bank account. The facts in the *W & R Morrogh* case are based on a mixed pool and does not address the situation such as exist in this case which is much more similar to the facts in the *Money Markets* case.

22. I am satisfied that the Donegal investors are entitled to the Section 3(3) Orders that they have sought which will provide for the full repayment of their monies standing in the Ulster Bank and the resulting recognition of their ownership of such monies.