SUPREME COURT OF QUEENSLAND

REGISTRY: Brisbane
NUMBER: 3508 of 2015

IN THE MATTER OF LM INVESTMENT MANAGEMENT LIMITED (IN LIQUIDATION)(RECEIVERS APPOINTED) ACN 077 208 461

First Applicants:	**JOHN RICHARD PARK AND GINETTE DAWN MULLER AS LIQUIDATORS OF LM INVESTMENT MANAGEMENT LIMITED (IN LIQUIDATION)(RECEIVERS APPOINTED) ACN 077 208 461 THE RESPONSIBLE ENTITY OF THE LM FIRST MORTGAGE INCOME FUND ARSN 089 343 288**
	AND
Second Applicant:	**LM INVESTMENT MANAGEMENT LIMITED (IN LIQUIDATION)(RECEIVERS APPOINTED) ACN 077 208 461 THE RESPONSIBLE ENTITY OF THE LM FIRST MORTGAGE INCOME FUND ARSN 089 343 288**
	AND
Respondent:	**DAVID WHYTE AS THE PERSON APPOINTED TO SUPERVISE THE WINDING UP OF THE LM FIRST MORTGAGE INCOME FUND ARSN 089 343 288 PURSUANT TO SECTION 601NF OF THE CORPORATIONS ACT 2001**

APPLICANTS' OUTLINE OF SUBMISSIONS

8 JULY 2015

Applicants' material

- Application filed 8 April 2015, being Court Document 1
- Affidavit of Stephen Charles Russell filed 8 April 2015, being Court Document 2
- Affidavit of John Richard Park filed 22 April 2015, being Court Document 3
- Affidavit of Sean Charles Russell filed 7 May 2015, being Court Document 6
- Further affidavit of John Richard Park filed 11 June 2015, being Court Document 10
- Further affidavit of Sean Charles Russell filed 29 June 2015, being Court Document 15
- BY LEAVE Amended Originating application to be filed

Overview

1. The applicants apply for directions as to the conduct of the liquidation of the second applicant, in circumstances where there is a dispute between the applicants and the respondent about their roles in the orderly winding up of the managed investment scheme known as the LM First Mortgage Income Fund ("**FMIF**").

2. The issue for determination is whether, on a true construction of the constitution the FMIF[1] ("**Constitution**"), Part 5C.9 of the *Corporations Act* 2001 ("**Act**") and the Order of Dalton J dated 26 August 2013 ("**Order**"), the respondent should, and has the power to, conduct the winding up of the FMIF as though he were conducting the winding up of a company.

3. The controversy arises because the receiver takes a very expansive view of his powers and responsibilities, such that he asserts that he is entitled (and empowered) to carry out all of the statutory functions of the liquidators and the trustee obligations of the second applicant ("**LMIM**").

4. The Applicants' position is that there is a clear demarcation between the role of the receiver to gather in the assets of the Fund and the role of the Applicants to distribute those assets in accordance with the Constitution. Not only is there no power in the Receiver to do that latter task, but the practical problems identified by the Receiver in his affidavit (including drawing out creditors' claims and determining them) are easily within the statutory power and responsibility of the Applicants to resolve.

Background facts

5. Prior to March 2013, LMIM was the responsible entity for seven managed investment schemes registered under the Act and one trust (also an investment scheme, albeit not requiring to be registered under the Act)[2]. The FMIF is one

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1 In fact a replacement constitution dated 10 April 2008, exhibited at bundle pages 1-40 to the affidavit of Mr Park

2 The managed investment schemes are the LM First Mortgage Income Fund, LM Australian Income Fund, LM Australian Structured Products Fund, LM Cash Performance Fund, LM Currency Protected Australian Income Fund, LM Institutional Currency Protected Income Fund and LM Wholesale First Mortgage Income Fund. The trust is the LM Managed Performance Fund

of the registered managed investment schemes. The other registered schemes and the trust are not otherwise relevant for the purposes of this application.

6. On 19 March 2013, the first applicants were appointed as voluntary administrators of LMIM. Since March 2013, Trilogy Funds Management Limited has replaced LMIM as responsible entity of the LM Wholesale First Mortgage Income Fund and KordaMentha Pty Ltd has replaced LMIM as trustee of the LM Managed Performance Fund. LMIM otherwise remains the responsible entity of the remaining schemes.

7. Of the schemes, the FMIF has the most significant assets. The assets of the other managed investment schemes of which LMIM is the responsible entity are largely comprised of units in the FMIF.

8. Without going into the detail of the matters leading to the Order, the Order in summary provided as follows:

   (a) LMIM was directed to wind up the FMIF subject to certain further orders;

   (b) Mr Whyte was appointed to take responsibility for ensuring that the FMIF was wound up in accordance with its constitution, defined as the "**Appointment**";

   (c) Mr Whyte was then also appointed as the receiver of the property of the FMIF, with the powers of a receiver set out in s.420 of the Act and specified further powers set out in clauses 7(a) and (b) of the Order.

9. As is apparent from the face of the Order and the terms of Part 5C.9 of the Act, there is a potential for uncertainty and demarcation disputes between LMIM and the receiver as to who is to carry out particular functions in relation to the winding up of the FMIF. This will be dealt with in particular detail below, but the following further background facts are relevant to understand the Order as made.

10. The Order was made by Dalton J on day 5 of the hearing of an application by two small unitholders of the FMIF for orders, inter alia, that LMIM be removed as responsible entity and replaced by Trilogy Funds Management Ltd as a temporary responsible entity[3]. Her Honour's principal reasons for judgment set out the background of the dispute and the matters litigated. For present purposes, it suffices to say that at the conclusion of the hearing, Dalton J dismissed the application to replace LMIM as incompetent[4] but was otherwise satisfied that someone other than the first applicants ought to oversee the winding up of the FMIF. Her Honour made some adverse findings against Ms Muller, in particular.[5] An appeal by the first respondents succeeded in overturning many of the adverse findings, but the substantive Order appointing Mr Whyte was not overturned.[6]

11. The other relevant background matter is the argument that took place on 21 August 2013. The transcript of that argument is at bundle pages 7-24 to the affidavit of Mr Stephen Russell. The form of Order that was under discussion in that transcript, including the clauses that were relevantly deleted, appears at bundle pages 1-4 to the affidavit of Mr Stephen Russell ("**Tucker & Cowen Draft Order**").

12. The significance of the transcript and the Tucker & Cowen Draft Order is as follows:

    (a) Her Honour recognises a "*real tension, I think, between – and it comes from the Act, I think, that the responsible entities [*sic*] directed to wind up, but then somebody else whose [*sic*] really given control of it*"[7], leading to a potential overlap between work down by the responsible entity and the person appointed to oversee the winding up;

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3 See *Bruce v LM Investment Management Ltd* (2013) 94 ACSR 684 at [8]
4 See *Bruce* at [20]
5 See *Bruce* at [89] to [96]
6 See *LM Investment Management Ltd v Bruce* (2014) 102 ACSR 482 at [108] to [132]
7 See transcript 5-6 at bundle page 12 to the affidavit of Mr Russell

(b) The form of Order appointing Mr Whyte was as an "*equity trust [*sic*] style Order where the responsible entity remains*"[8], being a reference to the form of Order made by Applegarth J in *Re: Equititrust* (2011) 254 FLR 444 which will be dealt with in further detail below;

(c) at the hearing on 21 August 2013, both ASIC and Mr Shotten (the small investor then represented by Tucker & Cowen) argued for the inclusion of two additional clauses in the Tucker & Cowen Draft Order, being paragraphs 8(c) and 10, which provided as follows:

> *"8(c) [*Mr Whyte is authorised to*] Perform each of the duties set out in clause 18.4 of the FMIF Constitution";*
>
> *"10 Pursuant to s 601NF(2) of the Act, in the winding up of FMIF, the obligations of the receiver pursuant to paragraphs 1 to 8 above exclude and replace any obligation of the first respondent arising by reason of paragraph 1 hereof and s 601NE(1) of the Act, or either of them, save for an obligation to cooperate with the receiver in the performance of his duties and obligations";*

(d) after argument, Dalton J refused to make Orders in terms of paragraphs 8(c) and (10) after commenting that "*why have I made the Order in paragraph 1 if I am just going to negate it ten paragraphs later*"[9], and then further identifying that if a demarcation dispute arose in the future then it will be better for the court to deal with "*a real dispute rather than trying to prophylactically deal with something when the nature and extent of it isn't known. So I am refusing to make 8(c), and I am refusing to make 10*".

13. There was no appeal by ASIC or Mr Shotten against the Order as made, nor has the receiver ever sought any further clarification or directions from the Court.

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8 See transcript 5-10, at bundle page 16 to the affidavit of Mr Russell

9 See transcript 5-10, at bundle page 16 to the affidavit of Mr Russell

14. Since the hearing on 21 August 2013, there has been correspondence between the solicitors for the first and second applicants (being Russells) and the solicitors for Mr Whyte (Tucker & Cowen). The letters between September 2014 and April 2015 are exhibited to the affidavit of Mr Park at bundle pages 45 to 151. In essence, a demarcation dispute has arisen between the parties, the most significant of which is that the receiver asserts that all responsibility for the winding up be removed from the responsible entity[10] and rejects the Applicants' claim that the funds of the FMIF, once gathered in, be remitted to the responsible entity for distribution: see Tucker & Cowen letter dated 20 November 2014.[11]

15. The position of the Applicants is that they have statutory obligations (and entitlements) and trust obligations under the Constitution. The statutory obligations are set out in the response of Russells dated 21 January 2015.[12]

The statutory provisions

16. Part 5C.9 of the Act contains seven sections, from 601NA to 601NG, dealing with winding up of a registered managed investment scheme. Detailed consideration of the provisions, and their relationship to the other statutory provisions in Chapter 5C concerning managed investment schemes will be addressed at the hearing. For the purposes of this outline, the following matters are highlighted:

    (a) By s.601NA, a constitution of a registered scheme may provide that the scheme may be wound up, but the section does not provide how it is to be wound up;

    (b) by s.601NB, the members of a scheme may call for the responsible entity to wind up the scheme;

    (c) by s.601NC, the responsible entity itself may propose to wind up the scheme;

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10 See bundle page 99
11 See affidavit of Mr Park at bundle page 98-99
12 See affidavit of Mr Park at bundle page 116

(d) by s.601ND, the Court may direct a responsible entity to wind up the scheme;

(e) by s.601NE, under the headings "*The Winding Up of the Scheme*" and "*How Scheme Must be Wound Up*", the responsible entity of a registered scheme must ensure that the scheme is wound up in accordance with its constitution and any Orders under subsection 601NF(2) in one of four circumstances, being those set out in s.601NA, s.601NB, s.601NC and s.601ND;

(f) by s.601NF, the Court may make an Order appointing "*a person to take responsibility for ensuring a registered scheme is wound up in accordance with its constitution and any Orders under subsection 2 if the Court thinks it necessary to do so* …" and may give directions about how the scheme is to be wound up;

(g) by s.602NG, unclaimed monies remaining at the end of the winding up process are dealt with.

17. Of note from these provisions, there is no statutory scheme in Part 5C.9 (or otherwise) setting out a regime for the winding up of registered schemes. Dalton J recognised this in *Bruce* at [46]. White J in *Re: Stacks Managed Investments Limited* (2005) 219 ALR 532, dealt with this issue in some detail.

18. The second matter of note is that nowhere in the seven provisions is there any reference to any person other than the responsible entity carrying out the winding up process. This is dealt with in the further consideration of *Re Stacks* below.

19. It is appropriate to turn briefly to the historical development of statutory provisions concerning the winding up of managed investment schemes and their predecessors, prescribed interest schemes. In overview, the historical development has not progressed to regulate the winding up of such schemes as though they were companies. As stated by White J in *Re Stacks* at [46],

parliament did not adopt, in 1998, prior recommendations for such regulation.

20. The provisions in Part 5C.9 of the Act were first enacted by the passing of the *Managed Investment Bill* 1997, originally to be enacted as the *Managed Investments Act* 1997, but which ultimately became enacted as the new Chapter 5C of the Corporations Law.[13] The regime was said to represent the Government's response to the recommendations made by the Australian Law Reform Commission and the Companies and Securities Advisory Committee in the Report entitled "*Collective Investments: Other People's Money*" and the final Report of the Financial System Inquiry. Of note, the Explanatory Memorandum records that "*the fundamental recommendation of the Review was that there be a single scheme operator in relation to each scheme*".[14] These provisions gave rise to the single responsible entity for each managed investment scheme instead of the previous regime under the prescribed interest scheme which involved both a management company and a trustee.

21. Prior to the introduction of the *Managed Investment Bill* 1997, the provisions of the Corporations Law, as enacted in conjunction with the *Corporations Act* 1989, included provisions dealing with prescribed interests at Part 7.12, Division 5. Relevantly, s.1074 of the *Corporations Law* dealt with the winding up of a prescribed interest scheme in s.1074(5) as follows:

> *"[Court's powers] On an application by the trustee or representative, the court may, if it is satisfied that it is in the interest of the holder of the prescribed interests, confirm the resolution and may make such orders as it thinks just and reasonable for the effective winding up of the undertaking, scheme, enterprise, contract or arrangement."*

The Constitution of the FMIF.

22. The Constitution of the FMIF is a replacement constitution dated 10 April 2008[15].

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13 See Explanatory Memorandum for the *Managed Investments Bill* 1997
14 See paragraph 1.3 of the Explanatory Memorandum
15 See affidavit of Park filed 22 April 2015 at bundle pages 1-40

23. The Constitution refers, in the recitals, to the establishment of a pooled mortgage unit trust called the LM Mortgage Income Fund on 28 September 1999 and which, by the Constitution, became the LM First Mortgage Income Fund. The Constitution defines the "Scheme" as being a managed investment scheme to be registered under s.601EB of the Act. By clause 2, the continuation of the trust was re-affirmed. By clause 13.1 of the Constitution, the responsible entity was given all of the powers necessary to carry on the business of the Scheme.

24. Clause 16 of the Constitution deals with winding up the scheme. Thereafter, in clauses 16.2 through 16.10, a number of the statutory provisions of Part 5C.9 are mirrored in the Constitution.

25. Importantly, clause 16.7 sets out seven steps to be taken by the responsible entity upon winding up of the Scheme. They include realising the assets of the Scheme property, paying all liabilities, paying expenses and then distributing the net proceeds of realisation among the members.

26. Accordingly, LMIM as trustee of the Scheme property, has clearly defined obligations in the Constitution in respect of any winding up of the Scheme.

The Order of Dalton J

27. As set out in the background above, Dalton J recognised at the time of the making of the Order that there was a tension between the provisions of the Act that provided for the responsible entity to carry out the winding up and the provision in s 601NF about the appointment of a person to oversee the winding up. Her Honour reconciled the tension by reference to the type of Order made in *re Equititrust* (2011) 254 FLR 444, which includes copies of the Orders made at pages 463-466.[16]

28. The *Equititrust* Order appears to be the first time an Order was made for the appointment of a receiver under s.601NF(2) in aid of an appointment of a person under s. 601NF(1).[17] It was made in very different circumstances to

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16 See *Bruce* at [120] to [121]

17 See *Re Equititrust* at [38] to 54]

that of LMIM as the company was in breach of its AFSL and the Act and the independent directors had all very recently resigned[18]. There was no independent insolvency practitioner involved. Applegarth J's concerns in that case are quite different to LMIM's position.

Resolving the tension

29. The applicants do not challenge the appointment or powers of the receiver. What is unresolved[19] however is how the powers of the receiver impact upon the obligations of LMIM under the Constitution (and in particular clause 16.7) and the Act.

30. At the outset, it is submitted that there is a clear demarcation between the appointment of a receiver to gather in the assets of a scheme in circumstances where the Court is not satisfied that the responsible entity is in a position to do so. But such a power is not to be extended to displace the statutory regime in Part 5C.9 with a separate appointment, with defined or ill-defined powers, of someone to conduct the winding up of a scheme.

31. In *Stacks*, White J considered an application by a responsible entity, faced with difficulties in winding up a managed investment scheme, to appoint two liquidators to wind up the scheme as if they were winding up a company. White J dismissed the application on the basis that Parliament deliberately decided not to apply the regime for winding up of companies to the winding up of managed investment schemes, and there was therefore no power in s.601NF(2) to impose a regime that would affect the substantive rights of third parties; that is, to wind up the trust as if it were a company.

32. In *Re Rubicon Asset Management Ltd (Administrators appointed)* (2009) 77 NSWLR 96, McDougall J considered the extent to which s.601NF(2) could be used as a source of power to give directions as to how the costs and expenses of winding up a scheme could be paid. After a consideration of *Re Stacks*, McDougall J held that there was such a power[20], but approved the

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18 See *Re Equititrust* at [57] to [60].

19 Dalton J uses the term "*may yet to be fully explored*": see *Bruce* at [46]

20 At [33] to [66]

limiting statement of White J in *Re Stacks* that s.601NF(2) does not authorise the grant of wide powers "*to bring the winding up of the scheme into line with the winding up of companies*".[21]

33. In *Mier & Johnson v F N Management Pty Ltd* [2005] QCA 408, the Court of Appeal considered the powers to be granted to the liquidators appointed by the Court to wind up an unregistered managed investment scheme under s. 601EE. Keane JA held that the powers granted to the liquidators could not extend to include a power to sell property that was not "scheme property". Whilst that case involved s.601EE and is therefore quite different to Part 5C.9[22], it highlights the limits on powers to interfere in third party rights.

34. That is precisely what Mr Whyte seeks to do. In his affidavit, at paragraph 29, he talks of making an interim distributions to FMIF members. He also talks, in paragraph 43, of determining claims by "*creditors of the FMIF*".

35. These statements highlight the issues addressed by White J in *Stacks* at [42] to [46]. The "*creditors of the FMIF*" are in fact creditors of LMIM, and if the debts were properly incurred by LMIM in the discharge of its duties as trustee for the FMIF, then it is entitled to an indemnity out of the assets of the FMIF in respect of those liabilities, and the creditors may be entitled to be subrogated to that right. But that is not to say that Mr Whyte as receiver of the assets has powers to determine the validity of claims against LMIM, or whether there is a corresponding right of indemnity out of the FMIF assets. Those are only matters for LMIM to determine, as recognised by White J. In the case of LMIM being in liquidation, the liquidators have available to them the entire statutory regime in the Act for calling for and determining claims, including the proof of debt regime. Mr Whyte has no such power, and s.601NF(2) cannot be the source of such power. Indeed, the fact that Mr Whyte does not have such powers is highlighted in his affidavit as he must simply wait for creditors to pursue claims that may or may not be made within limitation periods that might extend to 2019.

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21 At [61] to [62]

22 See R*e Stacks* at [52]

36. The matters that lead to Dalton J appointing Mr Whyte as receiver on the basis of potential conflicts (as recognised by Fraser JA at paragraph [132] of the appeal decision) extends only to the collecting in of the assets of the FMIF. Once those assets have been collected in, there remains no conflict. It is a matter of paying the net proceeds of realisation to LMIM which can, by its liquidators, assess and determine the claims, discharge such debts from the trust assets that are proper and then distribute the balance among the members, as envisaged by clause 16.7(c) of the replacement constitution. Furthermore, the appointment of Mr Whyte as receiver of the assets of the FMIF is no longer necessary once those assets have in fact been collected in and converted to cash. At that stage, they can be made available for LMIM to distribute in accordance with clause 16.7. That is the proper course; namely for him to deliver up the proceeds of sale to the entity legally entitled to them. Such an approach would be consistent with the statutory framework in part 5C.9 of the Act.

37. It is appropriate to turn to the specific functions of the liquidators in Schedule 1 to the proposed Amended Originating Application.

Call for and determine claims against LMIM as RE for the FMIF

38. The receiver has no power under the Order or the Act to assess or determine third party rights, including those of creditors. The liquidators are uniquely and better placed to do so.

39. The receiver makes mention of unspecified claims in is affidavit[23], but his affidavit does not provide any summary of the value of cash in hand and to be received, or prepared a likely estimate of claims against LMIM as RE of the FMIF.

Recovery of assets which are only available to the liquidators

40. The receiver is only appointed over the assets of the FMIF. Yet there are other assets available to LMIM, acting by its liquidators or by the liquidators

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[23] See affidavit of Mr Whyte at paragraph 29

themselves, such as a monetary claim against the directors for breach of s 182 of the Act, and not any receiver.

Management and dealing with members, units and the capital of FMIF

41. There is nothing in the order of Dalton J that deals with the obligations on LMIM in the clauses identified in paragraph 3 of schedule 1 to the amended application. Nor is there any evidence that the applicants are unable to discharge their obligations in that respect.

Determine and report upon the financial status of the FMIF

42. Whilst the receiver is in possession of the books and records and assets of the FMIF themselves, the receiver has no obligation to report to the members of the FMIF. That is the obligation of the responsible entity and unless and until it is removed or discharged from its obligations, it remains obliged to do so.

43. Similar considerations apply in respect of the specific functions of LMIM in Schedule 2 to the proposed Amended Originating Application.

Preparing financial reports, having them audited and reporting to members

44. The receiver could in theory carry out these functions. But the obligation is on the trustee to do them and there is no impediment to it doing so, provided that the receiver co-operates by providing the necessary financial information.

45. The receiver has now stated that he intends to seek an exemption from doing any financial reporting under the Act until the conclusion of the "*winding up*"[24]. He says that to do the reporting would be "*unduly expensive*". But he states that he would do an audited report at the conclusion of the winding up. It is unclear why that would be cheaper. There are clearly funds available for such expenses, as is apparent from Mr Whyte having drawn remuneration of $3.9M for the 20 months to 30 April 2015, and which appears to be

[24] See affidavit of Mr Whyte at paragraph 55

accelerating in the past 7 months to the average rate of $314,875 per month[25]. These figures do not include expenses.

46. In all of the above circumstances, the directions sought by the Applicants are not only consistent with the Act and the Constitution, but will provide an earlier and more certain return for members.

J W Peden
Counsel for the Applicants

8 July 2015

[25] See affidavit of Mr Whyte at paragraph 19