Introduction

[1] Unitholders will recall that the Trustees have previously given notice of the Trustees' intention to seek a direction from the Supreme Court of Queensland that the Trustees would be justified in commencing proceedings against the former trustee of the MPF, LM Investment Management Limited (Receivers And Managers Appointed) (In Liquidation) (ACN 077 208 461) ("LMIM").

[2] The law requires personal service of such an application on all persons interested in it or on such of them as the Court thinks expedient. The Trustees formed the view that they should conserve trust assets by seeking to persuade the Court that it was not expedient for the Trustees to incur the expense of personally serving all 4,500 Unitholders with the many hundreds of pages of material in this matter, but rather the Court should be satisfied with less formal notice having been given of the application.

[3] That is why the Trustees gave notice to Unitholders by way of the Notice dated 24 September 2013 sent to Unitholders on 25 September 2013 and to the two emails the Trustees sent to Unitholders on 11 and 12 June 2014.

[4] The application came before the Supreme Court of Queensland on 17 June 2014 but was adjourned after Justice Boddice indicated that –

(a) He could be convinced that it would be inappropriate to require personal service of all of the Unitholders;

(b) However the Trustees would need to satisfy him that another method of giving notice had adequately brought to the attention of the Unitholders the substance of the application and the pros and cons of the proposed litigation; and

(c) He was not satisfied that the Trustees had yet sufficiently done that.

[5] The purpose of this communication is to address Justice Boddice's concerns as to the need for Unitholders to be given additional explanatory material and also to notify Unitholders of the date of the reconvened hearing and how Unitholders can arrange to have their views put before the Court.

[6] The structure of this notice is as follows:

(a) First, to explain the nature and purpose of the Trustees' application;

(b) Second, to explain the nature and purpose of the proposed litigation against LMIM;

(c) Third, to set out an explanation of why the Trustees hold the view that it is appropriate to prosecute the proposed litigation against LMIM;

(d) Finally to provide Unitholders with the formal information they need if they wish to be heard on the Trustees' application.

[7] All of the documents which have been filed in Court in relation to the application up to the date of this notice (some of which are referred to in this notice) are indexed and accessible on the KordaMentha website. The link to KordaMentha's website is at http://www.kordamentha.com/creditor-information/australia/109. The Trustees will update the website as soon as practicable after any new material is filed.

The nature and purpose of the Trustees' application

[8] The nature and purpose of the Trustees' application is explained in written submissions filed on behalf of the Trustees and which are to be found on the website – see document number 13. Unitholders wishing more detail are referred to that document, particularly at paragraphs [12] to [22].

[9] Essentially, the application is made pursuant to a procedure provided by s. 96 of the Trusts Act which authorises the Supreme Court to give judicial advice to trustees. There are two principal functions of the procedure. First, to give personal protection to trustees if they act in accordance with the advice. Second, to protect the interests of the trust (because the Court will consider the interests of the trust when deciding what advice to give).

[10] By the particular application in this case, the Trustees seek a direction from the Supreme Court as to whether they would be justified in prosecuting a proceeding against LMIM for the relief set out in the draft statement of claim. The nature of the proposed proceeding is explained below.

[11] In deciding this type of application, the court does not investigate the evidence and decide whether or not the Trustees will win against LMIM. Rather, the court determines whether or not the proceeding should be taken in the best interests of the trust estate. The question is a broad one and can involve the question whether it is practical and fair for trust assets to be used for the proposed purpose.

The nature and purpose of the proposed litigation against LMIM.

[12] The nature and purpose of the proposed litigation is set out in detail in the statement of claim which the Trustees propose to file against LMIM. A draft of that document is to be found on the website as exhibit SMV-52 to the affidavit of Simon Vertullo dated 25 September 2014 – see document number 19. The following paragraphs seek to set out a summary of the case. Unitholders wishing more detail are referred to the draft statement of claim.

[13] The Trustees replaced LMIM as trustee of the MPF on 12 April 2013.

[14] LMIM was a professional trustee and at the time it was the trustee of the MPF it was also the responsible entity for the LM Australian Income Fund (ARSN 133 497 917) (the "AIF"), a scheme registered under the Corporations Act. Under the Corporations Act, LMIM held the scheme property of the AIF on trust for the scheme members.

[15] It is convenient to refer to LMIM when it was acting as trustee for ("atf") the MPF as "LMIM atf MPF" and, when it was acting as trustee for the AIF, as "LMIM atf AIF".

[16] The business of both LMIM atf MPF and LMIM atf AIF was to use funds obtained from members by entering into property investment and structured loan transactions for the purchase and/or development of Australian real property for the eventual benefit of members.

[17] The essence of the complaint that the Trustees wish to allege against LMIM is that at a time when LMIM atf MPF had already entered into a loan agreement dated 29 June 2010 (pursuant to which it took on 29 June 2010 fixed and floating charge no. 2010141 and was entitled to and granted on 22 December 2011, through a custodian company, second registered mortgage no. 714236897 over Lot 74, Endeavour Drive, Northlakes, Qld "Property") with a third party ("Borrower") the outstanding loan balance of which was about $1m, LMIM decided to engage in a self dealing transaction ("Self Dealing Transaction") in which LMIM atf AIF would also lend about $1.7m to the Borrower but on terms which would entirely subordinate the lending which had already been made and would subsequently be made by LMIM atf MPF, to the lending by LMIM atf AIF.

[18] The Self Dealing Transaction was subsequently implemented such that between 25 June 2012 and 2 August 2012, the lending of in excess of $3,236,658.63 that had already been made by LMIM atf MPF to the Borrower was entirely subordinated to the subsequent lending of about $1,710,006 by LMIM atf AIF.

[19] The second registered mortgage granted to LMIM atf MPF (through the custodian company) ranked behind first registered mortgage no. 714235916 granted by the Borrower to Stockland North Lakes Pty Ltd ("Vendor") on 15 December 2011, which provided

vendor finance to the Borrower to enable it to complete the purchase of the Property from the Vendor.

[20] As far as the Trustees can tell without having seen all of LMIM atf AIF's documentation, the funds lent by LMIM atf AIF to the Borrower under the Self Dealing Transaction appear to have been used by the Borrower in June 2012 to repay, in whole or in part, what it owed to the Vendor. On 18 July 2012, the Vendor's first registered mortgage was released and a new mortgage in favour of LMIM atf AIF (through a custodian company) was registered over the Property and given dealing no. 714574199.

[21] The subordination referred to in [18] above was achieved through registered priority agreement no. 7146029919 and a priority and subordination deed dated 25 June 2012.

[22] The complaint is that the Self Dealing Transaction was neither for the benefit of the members of the MPF nor could it reasonably have been thought to be for the benefit of the members of the MPF that LMIM atf AIF would participate in the particular loan transaction in terms which entirely subordinated the lending which had already been made by LMIM atf MPF to the subsequent lending by LMIM atf AIF. The Trustees believe that there was a breach of the core duty of LMIM as trustee of the MPF to perform the trust honestly and in good faith for the benefit of the members of the MPF.

[23] The Trustees believe that by engaging in the Self Dealing Transaction LMIM also placed itself in a position where –

(a) the duties which it owed to the members of the MPF conflicted with its interest in its capacity as the responsible entity for AIF; and further or alternatively

(b) the duties which it owed to the members of the MPF conflicted with the duties which it owed to the members of the AIF.

[24] Ultimately the Borrower defaulted. LMIM sold the securities it held over the Borrower's property, but there was a very significant shortfall in the return which was obtained on the loan by LMIM atf MPF.

[25] In September 2013 a sum of $429,135.04 was received in respect of the $3.2m lending which had been made by LMIM atf MPF but on the other hand a sum of $1,925,729.92 was received in respect of the $1.7m loan which had been made by LMIM atf AIF.

[26] Because by the time the monies were received the Trustees had complained of breaches of trust by LMIM when it was acting as trustee of the MPF, the monies received in respect of the loan which had been made by LMIM atf AIF were paid into trust pending the resolution of the dispute concerning the alleged breaches of trust. The monies are currently held by a custodian trustee.

[27] In the proposed proceeding against LMIM the Trustees seek orders which would ultimately require LMIM to take steps to ensure that the custodian trustee paid to the Trustees the entirety of the $1,925,729.92 fund ("the Fund") together with any interest which accrued thereon.

Why the Trustees hold the view that it is appropriate to prosecute the litigation against LMIM

[28] The decision whether to spend trust monies in prosecuting litigation is a commercial one in which the Trustees weigh up the costs of litigation; the benefits which might be obtained in the event of success and the risks of success or failure.

[29] It should be emphasised that there are no certainties in assessing these matters or in making the estimations on which the assessments are based. The best that can be done is to form a view based on the facts and information known at the time.

[30] Bearing that caveat in mind, it is the opinion of the Trustees that it is in the commercial interests of the members of the MPF for the Trustees to seek to pursue the claim against LMIM. The principal matters considered by the Trustees in assessing the commerciality of the litigation and forming their opinion, are summarised below.

[31] As to the costs of the litigation:

(a) The Trustees estimate that it will cost at least $479,006 if the Court directs that the Trustees are justified in filing the statement of claim and there is a trial of the proceeding. This estimate consists of:

(i) $88,000 for the Trustees' fees;

(ii) $391,006 for legal fees.

(b) As at 30 June 2014, the Trustees' fees associated with this matter are approximately $28,363 and the billed legal fees are $188,231.86. From 30 June 2014, up to a determination about the direction, the Trustees' expect their fees will be about $15,000 and the legal fees will be about $85,000.

(c) If the Trustees' claim is successful, it is likely that the Trustees will obtain a costs order against LMIM. However, based upon the financial information available to the Trustees about LMIM and the fact that LMIM is in liquidation, the Trustees assume that recovery of payment pursuant to any such order would be at risk, although there may be some prospect that LMIM might have an indemnity for its costs against the assets of the AIF.

(d) If the Trustees' claim is unsuccessful, it is likely that the Trustees will be ordered to pay LMIM's costs of the proceeding. The Trustees estimate that LMIM's costs might be $386,547 - $509,547. This assumes that the custodian trustee takes no active part in the litigation and agrees to abide the order of the Court and the defence of the case does not involve many disputes in the lead up to trial. If the Trustees become aware that the custodian trustee wishes to participate actively in the litigation, they will inform the members of the MPF.

[32] As to the benefits of the litigation:

(a) The Fund is being held on trust by the liquidators of LMIM (through the custodian trustee) pending the resolution of this litigation. The Trustees are therefore confident that the Fund will be available to satisfy any judgment for proprietary relief that the Trustees obtain against LMIM.

(b) If the litigation is successful, the estimated net benefit after the payments of fees and costs will be approximately $1,130,129.06 (the amount of the Fund minus $795,600.86, being the estimated total of the Trustees' fees and legal expenses up to and including a trial) (excluding judgment interest). This would represent a 20-25% increase to the current asset pool of the MPF, from approximately $4.6 million to $5.73 million.

(c) In the worst-case scenario, there would be no recovery at all, and Trustees would have to pay the total cost of the proceeding (including liability to the other parties for their costs) out of existing trust funds. That net outlay might be as high as $1,305,147.86, decreasing the asset pool by 25-30% from approximately $4.6 million to approximately $3.3 million.

(d) The win/lose analysis of the matter, including a mid-case scenario (where the Court directs that the proceeding would not be justified and it is not commenced) is estimated to be as follows:

Event Description	Best	Mid-Case	Worst
	Win	**Only s96 application**	**Loss**
Claim	$1,925,729.92		
Trustees' legal costs to hearing of s96	($273,231.86)	($273,231.86)	($273,231.86)
Trustees' legal costs to trial	($391,006.00)		($391,006.00)
Trustees' fees	($131,363.00)	($43,363.00)	($131,363.00)
LMIM's legal costs			($509,547.00)
TOTAL	$1,130,129.06	($316,594.86)	($1,305,147.86)

[33] As to the risks of success or failure of the litigation:

(a) The Trustees have obtained privileged and confidential legal advice about the claim against LMIM.

(b) The Trustees are not making the legal advice available on the KordaMentha website or otherwise because they are concerned that to do so might result in a waiver of privilege in that legal advice and that, therefore, LMIM might obtain a copy of the advice. However, the advice will be offered to the Court on a confidential basis.

(c) The Trustees are presently satisfied that they have reasonable prospects of being successful in the claim against LMIM.

(d) The question of prospects will, however, be kept under review. For example, it is possible that issues raised by LMIM in the defence of the claim and documentary and other explanatory material shedding light on why LMIM acted in the way it did might alter the Trustees view on prospects of success (whether for the better or the worse).

(e) In this regard, LMIM's solicitors have indicated that LMIM will allege the following by way of defence to any claim made by the Trustees:

(i) the loan by LMIM atf MPF was always intended to be a loan that was second ranking in priority;

(ii) the loan made by LMIM atf MPF to the Borrower was in the nature of mezzanine funding;

(iii) as at June 2012, the Borrower owed approximately $1.7 million in vendor finance, which was secured by a first ranking mortgage;

(iv) the purpose of the AIF Loan Transaction was to payout this vendor finance;

(v) LMIM atf MPF was unable to advance further funds to complete the acquisition of the Property (i.e. to retire the vendor finance) as LMIM atf MPF had insufficient funds available to it;

(vi) LMIM atf MPF was contractually obliged to advance further funds to the Borrower (which it was unable to do) and a failure to advance such funds, to permit the payout of the vendor finance, would have exposed LMIM atf MPF to litigation by the Borrower for breach of contract. The Vendor would also have been able to move to sell the Property as first mortgagee given the default in failing to payout the vendor finance when it became due for payment;

(vii) at the time LMIM atf AIF advanced the $1.7m to the Borrower, the Property had been valued at $2.7m.

(f) The Trustees will consider any such allegations if they are pleaded and particularised and will also consider any evidence which LMIM produces in support of them. Presently, the mere assertion of these propositions by LMIM's solicitors does not cause the Trustees to change their view about commencing proceedings against LMIM.

[34] Other options:

(a) Given that the Fund is being preserved and the view they currently have of the prospects of success, the Trustees do not consider it is appropriate to give up on the proposed claim. At a minimum, it is appropriate to obtain judicial advice.

(b) The Trustees conduct of the claim in the future will depend on the advice that is obtained from the Court.

(c) If the Court gives the direction that the Trustees seek, the Trustees propose to act in accordance with the direction and prosecute the proposed proceeding. That said, the Trustees recognise that litigation is unpredictable. They will keep under review the possibility of resolving the proceeding before trial by alternative means, including the possibility of a negotiated settlement.

(d) However if the Court disagrees and advises the Trustees that they are not justified in prosecuting the proceeding, then, subject to the possibility of appeal, the Trustees would propose to act in accordance with that direction and would then not prosecute the proposed proceeding.

Formal information for Unitholders

[35] The hearing of this matter is now set down to be heard by a Justice of the Supreme Court on 16 October 2014 at 10:00am. On the same date, LMIM atf AIF is also applying to the Supreme Court. The Trustees have not been served with the originating application filed by LMIM atf AIF but will update Unitholders about this matter if and when they are served with the originating application and any supporting material.

[36] If a Unitholder wishes to support or oppose the Trustees' application or to argue that any different order or direction should be made, they can do so by attending before the Court on the date and time mentioned above either personally or by engaging a legal advisor for that purpose. Any Unitholder wishing to retain lawyers should do so promptly to ensure there is sufficient time to brief their legal representatives.

[37] Alternatively, Unitholders can send emails about this matter to the Trustees addressed to lminvestors@kordamentha.com, and the Trustees will seek to put all of those emails before the Court.