

SUPREME COURT OF QUEENSLAND

REGISTRY: Brisbane
NUMBER: 3383 /2013

Applicants:

RAYMOND EDWARD BRUCE AND
VICKI PATRICIA BRUCE
AND

First Respondent:

LM INVESTMENT MANAGEMENT LIMITED
(ADMINISTRATORS APPOINTED), ACN 077 208
461, IN ITS CAPACITY AS RESPONSIBLE ENTITY
OF THE LM FIRST MORTGAGE INCOME FUND
AND

Second Respondent:

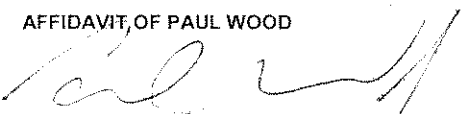
THE MEMBERS OF THE LM FIRST MORTGAGE
INCOME FUND ARSN 089 343 288

AFFIDAVIT

I, **PAUL WOOD** of Level 10, 241 Adelaide Street, Brisbane, Queensland 4000, Lending
Manager, say on oath:

1. I am the lending manager of Trilogy Funds Management Limited (**Trilogy**) and am authorised to swear this affidavit on its behalf.
2. Throughout this affidavit, I make references to various documents and page numbers. Those documents are contained in a paginated bundle of documents exhibited to this affidavit and marked "PW-1" (the **Exhibit**) and the page numbers to which I refer are the page numbers within the Exhibit.
3. I make this affidavit based on my own knowledge or from my review of the relevant documents referred to herein, and from my knowledge obtained whilst working at Trilogy as the lending manager. I have been responsible for making enquiries on the loan book of the LM First Mortgage Income Fund (**LMFMIF**) as Trilogy is the responsible entity of the Wholesale Fund (as set out at paragraph 6 below).

AFFIDAVIT OF PAUL WOOD


Filed on Behalf of the Applicants

Piper Alderman
Level 23, Governor Macquarie Tower, 1 Farrer Place, SYDNEY
2000
Ref: AB:SB:380287
Phone No: +61 2 9253 9999
Fax No: +61 2 9253 9900

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Trilogy

4. Trilogy acts as responsible entity and manager for a number of mortgage funds, property syndicates and asset based investment trusts in Queensland, New South Wales and Victoria.
5. Trilogy is the responsible entity for 14 registered managed investment funds with mortgage and property assets spread from Cairns to Melbourne: Trilogy, in association with CYRE Funds Management Limited, took over management of a number of Austgrowth property funds in 2011 from Australian Property Growth Fund (**APGF**); and, in 2012 Trilogy became the responsible entity of a further two property funds, which were previously subject to management by APGF.
6. On 16 November 2012, Trilogy was appointed responsible entity of the LM Wholesale First Mortgage Income Fund, ARSN 099 857 511 (the **Wholesale Fund**), which is a registered managed investment scheme. At pages 1 to 6 of the Exhibit is a copy of a search of the records of the Australian Securities and Investment Commission (**ASIC**) that I caused to be conducted on 22 March 2013 for the Wholesale Fund.
7. At pages 7 to 45 of the Exhibit is a copy of the annual financial report of the Wholesale Fund for the year ended 30 June 2011. That financial report shows that:
 - (a) the Wholesale Fund holds units in the registered managed investment scheme known as the LM First Mortgage Income Fund, ARSN 089 343 288 (**LMFMIF**);
 - (b) the collective value of the Wholesale Fund's investment in the LMFMIF is approximately \$73.9 million;
 - (c) the Wholesale Fund is recorded in the register of the LMFMIF as the second largest investor in the LMFMIF. At Exhibit PW-2 is a copy of the

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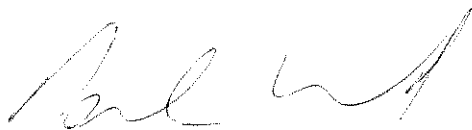
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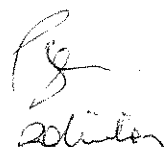
Register for the LMFMIF, which shows at page 122 of the Exhibit PW-2 the entry for the Wholesale Fund; and

- (d) the Wholesale Fund's investment in the LMFMIF is the only investment of the Wholesale Fund.
8. Accordingly, the unit value of the Wholesale Fund (for which Trilogy is the responsible entity) is dependent upon the performance of the LMFMIF.
9. Given these matters, Trilogy has agreed to indemnify the Applicants for the costs of these proceedings as it considers it to be in the best interests of the Wholesale Fund unit holders to have an alternative responsible entity appointed to investigate possible claims against LMIM in its capacity as responsible entity of the LMFMIF.
10. A copy of Trilogy's Australian Financial Services Licence, being licence number 261425 and dated 18 March 2009 is at pages 46 to 69 of the Exhibit. Trilogy also has an agreement with Oakvale Treasury in relation to its currency hedging. A copy of the engagement letter dated 26 March 2013 is at pages 70 to 73 of the Exhibit. A copy of Oakvale Treasury's AFSL is at pages 73A to 73B of the Exhibit.
11. At pages 74 to 108 of the Exhibit is a copy of the Financial Report for Trilogy for the year ended 30 June 2012.
12. At pages 109 to 132 of the Exhibit is a copy of the Notice of Meeting and Explanatory Memorandum issued by Trilogy to members of the Wholesale Fund dated 28 September 2012. At page 8 of the Explanatory Memorandum (page 166 of the Exhibit), Trilogy's intention to seek to be appointed as responsible entity for the LMFMIF is set out. Section 7 of the Explanatory Memorandum (page 121 to 122 of the Exhibit) sets out Trilogy's strategy for the LMFMIF in the event that it is appointed as responsible entity. The matters stated therein are, to my knowledge, true.

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13. By email dated 15 January 2013, Trilogy wrote to the auditors of LMIM about the concerns held by Trilogy in relation to LMFMIF and the conduct of LMIM as responsible entity of LMFMIF. A true copy of Trilogy's email is at pages 133 to 135 of the Exhibit.
14. On 18 January 2013, Trilogy also wrote to members of the Compliance Committee of a number of the managed investments schemes for which LMIM is responsible entity, setting out the concerns held by Trilogy in relation to LMFMIF and the conduct of LMIM as responsible entity of LMFMIF. A true copy of Trilogy's letter is at pages 136 to 141 of the Exhibit.
15. At pages 142 to 143 of the Exhibit is a true copy of an email that Trilogy received from Francene Mulder, Executive Director - Distribution/Product, of LMIM on 13 February 2013 in response to Trilogy's letter to the Compliance Committee members dated 18 January 2013. This response did not allay either Trilogy's or my own concerns (which are expressed in the email dated 15 January 2013 and the letter dated 18 January 2013) about LMIM's conduct as responsible entity of LMFMIF.

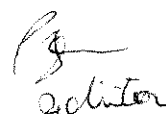
LMIM's Licence

16. As noted at paragraph 23 of the Bruce Affidavit, on 9 April 2013, ASIC suspended LMIM's Australian Financial Services Licence ("**AFSL**"). At pages 144 to 155 of the Exhibit is a copy of a search of the records of ASIC that I caused to be conducted on 11 April 2013 for LMIM's suspended AFSL. A copy of the suspension notice is at page 243 of the Bruce Affidavit. The AFSL of LMIM (as suspended) is limited to what is reasonably necessary for, or incidental to, the transfer to a new responsible entity, investigating or preserving the assets and affairs of, or winding up of, LMIM. Trilogy's AFSL has not been suspended.
17. If this Court was to appoint Trilogy in place of LMIM as responsible entity of the LMFMIF, Trilogy as the new responsible entity would seek to:
 - (a) consider selling (as appropriate) assets of the LMFMIF; and

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- (b) obtain appropriate finance (either via external borrowings or the sale of assets) to enable the development of other assets of the LMFMIF to be completed (including upgrading the zoning of these developments) so that they can be sold for a greater price than they would otherwise sell for if sold in an incomplete state.

18. At pages 156 to 173 of the Exhibit is ASIC Class Order 11/1140 relating to financial requirements for responsible entities, which I caused to be obtained from the records of the ASIC.

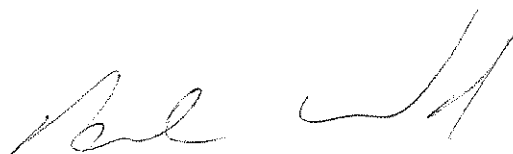
Cavill Avenue

19. At pages 174 to 179 of the Exhibit is a title search that I caused to be made on 26 April 2013 of the records of the Queensland Land Titles Office for 38 Cavill Avenue, Surfers Paradise (**Cavill Avenue**). The registered owner of that property is Baronsand Pty Ltd (**Baronsand**).
20. At pages 180 to 184 of the Exhibit is a copy of a search that I caused to be conducted on 26 April 2013 of the records of the ASIC of Baronsand. The ASIC search records that the directors of Baronsand are Mr Scott McMurtrie and Mr Peter Drake. LMIM does not appear to be a shareholder in Baronsand.
21. Pages 185 to 200 of the Exhibit have intentionally been left blank on my instruction.

Concerns about the Conflict

22. At pages 201 to 209 of the Exhibit is a copy of a search that I caused to be conducted on 18 April 2013 of the records of the ASIC in relation to LM Administration Pty Ltd (ACN 055 691 426) (**LMA**). This records that:
- (a) the Administrators of LMIM are also the Administrators of LMA; and
 - (b) the sole shareholder of LMA is Mr Peter Drake, a director of LMIM.

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23. I am aware from the Speaking Notes provided by the Administrators at the first meeting of creditors of LMIM on 2 April 2013 that LMA was formerly engaged by LMIM to provide management services to LMIM (I refer to page 235 of the Exhibit to the Bruce Affidavit, which exhibits those Speaking Notes).
24. As set out in paragraph 20 of the Bruce Affidavit, the Administrators of LMIM are considering the future of LMIM (as they are required to do), which necessarily means that they will consider whether it is appropriate for LMIM to enter into a compromise or arrangement with its creditors through a Deed of Company Arrangement (**DOCA**).
25. I am concerned that a number of claims may be available to unit holders in the LMFMIF (including the Wholesale Fund) against LMA and LMIM and its directors arising from alleged breaches of duty in respect of the LMFMIF. I have set out details of the claims that my investigations have shown that unit holders and/or the LMFMIF itself may have against LMIM at paragraphs 35 to 52 below.
26. At pages 209A to 209AA of the Exhibit is a copy of a search of the records of ASIC that I caused to be conducted on 24 April 2013 for LMIM's AFSL dated 7 September 2013. Paragraph 22 of LMIM's AFSL dated 7 September 2013 requires it to "maintain an insurance policy covering professional indemnity". Accordingly, the unit holders' potential claims against LMIM may be covered by LMIM's professional indemnity insurance (which LMIM is required to maintain for the purposes of its AFSL) and any directors' and officers' insurance that LMIM holds.
27. I refer to the "Attendance/Admission of Proxies" section of the Administrators' Speaking Notes from the first meeting of creditors of LMIM held on 2 April 2013, which appears at page 232 of the Bruce Affidavit. Paragraph 7 of that section records that at the first meeting of creditors of LMIM, the Administrators stated that unless investors could properly particularise claims for breach of trust or misleading and deceptive conduct against LMIM, and therefore also provide a just estimate of the loss/debt resulting from those claims, those investors' proofs of debt would be admitted for only \$1.

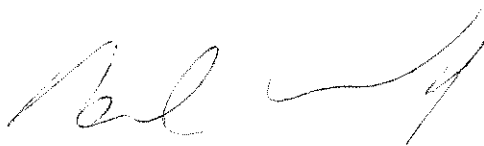
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28. At paragraphs 35 to 52 below I have set out details of the claims (that my investigations have shown) that unit holders in the LMFMIF (such as the Wholesale Fund), or the LMFMIF itself, may have against LMIM.
29. Unit holders in the LMFMIF, including the Wholesale Fund and the Applicants, will not be able to properly particularise and quantify their claims against LMIM for the purpose of submitting proofs of debt in the Administration until such time as unit holders are given access to the books and records of LMIM and LMA (insofar as they relate to LMFMIF) or an investigation of these claims is undertaken on their behalf by the responsible entity.
30. In my view the interests of the Wholesale Fund, and the interests of the other unit holders of the LMFMIF, will potentially be prejudiced if a Deed of Company Arrangement (**DOCA**) is proposed for LMIM and entered into as:-
- (a) unit holders will not be able to properly investigate and particularise claims that they may have against LMIM for the purpose of preparing a proof of debt, or prepare a just estimate of the loss or damage they may have suffered; and
 - (b) as a result, in light of the Administrators' stated intention set out in paragraph 27 above, unit holders may be deprived of the right to vote on the DOCA for any amount that properly reflects a just estimate of the loss or damage they may have suffered, notwithstanding that the DOCA may compromise their rights by releasing claims against LMIM.
31. At pages 210 to 211 of the Exhibit is a sealed copy of the order of Chief Justice de Jersey of the Supreme Court of Queensland made on 12 April 2013 ordering that the convening period for the meeting of creditors of LMIM be extended up to and including 25 July 2013.
32. Any person (which could include the Wholesale Fund or other unit holders of the LMFMIF, or a new responsible entity of the LMFMIF) who may wish to lodge a proof of debt in relation to any claim they have against LMIM in its capacity as

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responsible entity of LMFMIF will need to have investigated their possible claims and provide a "just estimate" of the losses suffered by them before that time.

33. Given the complexity and magnitude of the investigations that need to be undertaken (as set out at paragraphs 35 to 52 below), in my view the investigation and preparation of any claim by the Wholesale Fund (and potentially other investors) needs to be commenced as a matter of urgency.
34. If Trilogy were appointed as responsible entity of the LMFMIF, I would cause urgent investigations to be undertaken as to possible claims against LMIM, obtain advice about those claims and whether proofs of debt should be lodged in relation to the same, or otherwise make notifications on LMIM's insurance policies.

Investigations to be undertaken by new responsible entity

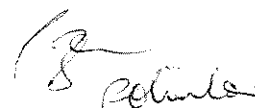
Changes to Constitution

35. At pages 37 to 103 of the Exhibit to the Bruce Affidavit is a copy of the current constitution of the LMFMIF, being the replacement constitution of LMFMIF dated 11 April 2008 as amended by supplementary deeds dated 16 May 2012 and 26 October 2012 respectively.
36. At pages 212 to 329 of the Exhibit are copies of the following constitutions (and or modifications) of the LMFMIF, which I caused to be obtained from searches of the records of ASIC:
 - (a) Constitution dated 24 August 1999 (at 212 to 245 of the Exhibit);
 - (b) Deed of Modification of Constitution dated 19 July 2002 (at 246 to 248 of the Exhibit);
 - (c) Replacement Constitution dated 6 June 2005 (at 249 to 285 of the Exhibit);
 - (d) Deed of Modification of Constitution dated 21 April 2006 (at 286 to 289 of the Exhibit); and

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(e) Replacement Constitution dated 31 May 2007 (at 290 to 329 of the Exhibit).

37. In accordance with the LMFMIF's constitution and s601GC(1)(b) of the Corporations Act 2001 (**Act**), LMIM could only amend the constitution of the LMFMIF by a special resolution of the unit holders of the LMFMIF, or by making amendments itself if it reasonably considered that the changes would not adversely affect unit holders' rights.
38. The constitution dated 24 August 1999 shows that the LMFMIF was first constituted, by deed poll, on 24 August 1999. Since that date, the documents listed at paragraph 36 above record that LMIM has made various amendments to the constitution of LMFMIF, each without the approval of unit holders or judicial advice.
39. The Wholesale Fund, and potentially other unit holders, would wish to investigate whether the following amendments to the LMFMIF constitution (recorded in the documents listed at paragraph 36 above) could have been made with a reasonable belief that the change would not adversely affect unit holders' rights:
- (a) On 19 July 2002, LMIM increased the permitted loan-to-value-ratio (**LVR**) from 66.66% to 75%;
 - (b) On 6 June 2005:
 - (1) LMIM amended the meaning of 'distributable income'. Previously it was defined to mean: the income of the LMFMIF less expenses and provisions. LMIM's amendment meant distributable income was now "such amount as the RE determines";
 - (2) LMIM permitted itself to approve a LVR greater than 75% after a loan settled, where it considered that to be in the best interests of unit holders;
 - (c) On 21 April 2006, LMIM again amended the LVR provisions such that a loan at settlement could be made with an LVR of 75% and could go up

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after settlement to 85% at the discretion of LMIM, and a loan in default could exceed 85% if LMIM perceived it to be in the interests of the unit holders;

- (d) On 31 May 2007, LMIM amended the Constitution to increase the management fees it was entitled to earn to 5.5%. Previously, the maximum allowable fee was 5%.

(collectively, **the Amendments**).

40. I caused a copy of ASIC's Regulatory Guide 45 (**Guide 45**) dated September 2008 to be obtained from the website maintained by ASIC. A copy of Guide 45 is at pages 330 to 386 of the Exhibit.
41. Paragraph RG45.56 of Guide 45, under the heading "Lending Principles – Loan to Valuation ratios", states that property development loans should not exceed an LVR of 70% of "as-if-complete" valuations, and for all other loans the maximum LVR should not exceed 80%. As set out above, by reason of the Amendments, LMFMIF was able to lend at an LVR in excess of the LVR limits in Guide 45.
42. Paragraph RG45.57 of Guide 45 details the policy considerations behind the LVR limits and the risk of exceeding the recommended LVR: an LVR higher than is recommended in Guide 45 may make a scheme more vulnerable to risk in that a change in the market conditions (e.g. a downturn in the property market) may mean it is unable to fully recover the money it has lent to borrowers. It also increases the risk that the security obtained from borrowers will be insufficient to cover the loan.
43. In the events that occurred, the average LVR of the LMFMIF's mortgage portfolio increased as follows:
- (a) from 63.89% as at 29 February 2008 (at page 387 of the Exhibit is a copy of the relevant page from LMFMIF's Product Disclosure Statement dated 10 April 2008, which I caused to be obtained (over the course of time) from the website of LMIM);

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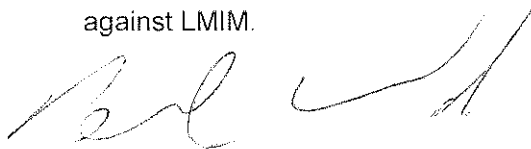


- (b) by 30 September 2009 it was 82.03% (at page 388 of the Exhibit is a copy of the relevant page from LMFMI's Product Disclosure Statement dated 10 April 2008, which I caused to be obtained (over the course of time) from the website of LMIM);
- (c) by 31 January 2010 it was 83.59% (at page 389 of the Exhibit is a copy of the relevant page from the ASIC Benchmark Disclosure and Update for Investors dated 9 April 2010, which I caused to be obtained (over the course of time) from the website of LMIM);
- (d) by 30 June 2010 it was 86.56% (at page 390 of the Exhibit is a copy of the relevant page from the ASIC Benchmark Disclosure dated 2 September 2010, which I caused to be obtained (over the course of time) from the website of LMIM);
- (e) by 31 May 2011 it was 91.98% (at page 391 of the Exhibit is a copy of the relevant page from the ASIC Benchmark Disclosure and Update for Investors dated 24 August 2011, which I caused to be obtained (over the course of time) from the website of LMIM);
- (f) by 31 October 2012 it was 100% (at page 392 of the Exhibit is a copy of the relevant page from ASIC Benchmark Disclosure dated 31 December 2012, which I caused to be obtained (over the course of time) from the website of LMIM);

44. At page 393 of the Exhibit is the relevant page of LMFMI's Financial Report for the year ended 30 June 2008, which I caused to be obtained (over the course of time) from searches of the records of ASIC. It shows that in the 12 months leading up to 30 June 2008, the net assets of the Fund decreased from \$783,324,637 to \$479,886,460, or approximately 39 per cent.

45. If Trilogy were to be appointed as responsible entity of the LMFMI, I would cause investigations to be made into these changes to the constitution, and obtain legal advice as to whether those changes give rise to a cause of action against LMIM.

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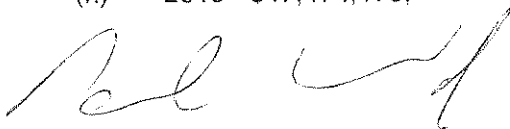
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Related party transactions

46. I caused copies of LMFMI's financial reports for each of the years from 2003 to 2012 to be obtained (over the course of time) from searches of the records of ASIC. At pages 394 to 403 of the Exhibit is a copy of the relevant page from each of these financial reports, showing that the LMFMI entered into a number of related party transactions.
47. Pages 394 to 403 of the Exhibit record that LMIM entered into related party transactions and conferred financial benefits on related parties by making payments and loans to related parties, including LMA for prepayment of management fees. I have not been able to locate any record of members approval of those transactions. The Wholesale Fund, and potentially other unit holders, would wish to investigate whether these related party transactions were made on terms that would have been reasonable if LMIM had been dealing with those entities at arm's length.
48. Pages 394 to 403 of the Exhibit (being relevant pages extracted from each financial report of the LMFMI for the years 2003 to 2012) record that between 2003 and 2012 these payments to related entities amounted to \$168,598,723, being:
- (a) 2003 - \$1,139,543;
 - (b) 2004 - \$1,935,881;
 - (c) 2005 - \$3,354,615;
 - (d) 2006 - \$5,559,587;
 - (e) 2007 - \$5,313,556;
 - (f) 2008 - \$19,597,053;
 - (g) 2009 - \$55,514,948;
 - (h) 2010 - \$47,474,178;

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(i) 2011 - \$16,212,213; and

(j) 2012 - \$12,497,149.

49. If Trilogy were appointed as responsible entity of the LMFMIF, I would cause investigations to be made into the related party transactions and obtain legal advice as to whether those related party transactions were proper.

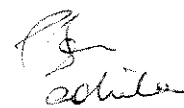
Loans conduct

50. I caused a copy of LMFMIF's ASIC Benchmark Disclosure dated 31 December 2012 to be obtained (over the course of time) from searches of the records of ASIC. At page 392 of the Exhibit is a copy of the relevant page from the Benchmark Disclosure and Update dated 31 December 2012. This records that LMIM made several loans accounting for more than 5% of the total value of the LMFMIF's loan book.
51. Pages 393 and 404 respectively of the Exhibit (being relevant pages extracted from each financial report of the LMFMIF for the years 2008 and 2009 which I caused to be obtained (over the course of time) from searches of the records of ASIC or from the LM website) record that:
- (a) in the 12 months leading up to 30 June 2008, the net assets of the Fund decreased from \$783,324,637 to \$479,886,460, or approximately 39 per cent; and
 - (b) In the 12 months leading up to 30 June 2009 Net Default Loans increased from \$98,443,132 to \$328,806,714.
52. The Wholesale Fund wishes to investigate the matters sworn to in paragraphs 50 and 51. However, the Wholesale Fund can only be properly investigated these matters by gaining access to the books and records of LMIM and the LMFMIF. If Trilogy were to be appointed as responsible entity of the LMFMIF, I would cause investigations to be made into the conduct of LMIM in making loans and entering into transactions, and obtain legal advice as to whether that conduct may have been in breach of the Corporations Act or any other legislation, negligent or in

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breach of trust. I would also cause a proof of debt to be put into the
Administration of LMIM if that was appropriate.

SWORN by **PAUL WOOD** on 6 May
2013 in Brisbane Queensland in the
Presence of:

Deponent

Witness

Name: Paul Wood
~~Solicitor/Justice of the Peace~~

Signed:

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