

Charles Fice

SOLICITORS

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Our Ref. CAC/00018
Your Ref: ACB/SAL/5170604

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Mills Oakley Lawyers
Level 6, 530 Collins St
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Vic 3000

By email: aborland@millsOakley.com.au

Attention: Ms Ariel Borland

Dear Ms Borland,

CONFLICTS OF INTEREST OF YOUR CLIENTS, GEOFFREY NIELS HANDBERG AND BRENT LEIGH MORGAN, AS LIQUIDATORS OF TRADITIONAL VALUES MANAGEMENT LIMITED (IN LIQUIDATION)

OUR CLIENTS

1. As you know, we act for the fourth, tenth, eleventh, thirteenth, fourteenth, fifteenth, sixteenth, seventeenth, eighteenth, nineteenth and twentieth Unitholder Defendants (**"the Unitholder Defendants"**) in SCI 2012 00018 between TVM and Who Investments Pty Ltd & others. The Unitholder Defendants collectively own approximately 4.72 million unredeemed units of \$1 each in the Blue Diamond Deposits Trust. If their counterclaim in the above proceeding is successful they will be confirmed as creditors for the amount of \$4.385 million (approximately)¹.
2. Two of the Unitholder Defendants, namely 82nd Agenda Pty Ltd and GJR Investments Pty Ltd (**"Secured Creditors"**) are plaintiffs in SCI 2014 3254 commenced on 27 June 2014 against the liquidators and Lynne Philistin in SCI 2014 3254. By the writ of 63 pages the Secured Creditors seek damages from the liquidators for misrepresentations made by the liquidators over a period of some 50 months and negligence occurring during the liquidators' mismanagement of the Secured Creditors' security. Not all the Secured

¹ See Charles Fice letter to Mills Oakley dated 3 July 2014.

Creditors' damages are quantified in the Statement of Claim but on the evidence presently available total damages will exceed \$700,000.

3. We also act for a further 13 Unitholders who are plaintiffs in an action against TVM under SCI 2014 00989².
4. A schedule of the plaintiffs ("**the Plaintiff Unitholders**") in that proceeding is attached. The Plaintiff Unitholders together own 1.922 million unredeemed units in the Blue Diamond Deposits Trust. They will claim to be creditors of TVM in an amount exceeding \$1.78 million³.
5. At present the only other unsecured creditors of TVM total \$398,406⁴. The Unitholder Defendants and the Plaintiff Unitholders, by contrast, have a strong claim to be creditors in excess of \$6.1 million.

LIQUIDATORS' RESIGNATION DEMANDED BY CREDITORS

6. The Unitholder Defendants and the Plaintiff Unitholders call upon the liquidators to forthwith resign as liquidators of TVM due to serious conflicts of interest which are described below.

TVM's damages claim against the liquidators

7. From 2004 to 2007 Lynne Philistin (at the time an employee or agent of TVM) defrauded TVM and the Secured Creditors in relation to time share loans given by TVM to the Secured Creditors (and two other secured creditors for whom we also act) as security for loans totalling \$4,500,000.
8. The Secured Creditors' loans were long term loans entered into in 2006 and at the beginning of 2007. TVM and from 2010, the liquidators, represented that after full payment of the Secured Creditors, there would be a substantial surplus available to TVM (and its creditors) from the proceeds of the time share loans. The surplus was, at various times, represented by the liquidators to exceed \$1.7 million.
9. The liquidators – at their insistence - purported to manage the time share loans from 9 December 2009⁵ to the present and charged TVM and the liquidators' extraordinarily high fees for doing so. For example for the period between 17

² The Writ in this proceeding is a protective writ. It has not been and will not be served without the leave of the Court.

³ Their claim will be made on the same basis as the Unitholder Defendants' claim in SCI 2012 00018.

⁴ as per the liquidators' 6 monthly accounts.

⁵ being the date of their appointment as administrators

December 2009 and 2 August 2011 (less than 20 months) the liquidators claimed remuneration exclusively in relation to the care, preservation and realisation of the time share loans, of \$437,964.75⁶. Extrapolating that remuneration claim for a further 35 months results in a potential claim by the liquidators, just for managing the time share portfolio, in excess of \$1.2 million.

10. For approximately 50 months after their appointment, the liquidators repeatedly represented to the Secured Creditors to the effect that all was well with regard to the Time Share Debtors' portfolio. Finally, a week after a meeting between (inter alios) Mr Handberg and Geoffrey Rice (of the Secured Creditors) at which Mr Rice had queried the providence of the time share loans, the liquidators called a further meeting at short notice to announce admissions by Philistin as follows:

- In between 27 January 2014 and 29 May 2007 Philistin processed 71 bogus loan applications presently totalling \$1,803,976;
- The original applicants were real people who had previously signed loan applications but had decided not to proceed or had their applications denied;
- Once TVM approved the loans, the amounts were then disbursed by Philistin to one of two Commonwealth Bank Accounts maintained by Philistin, rather than (our client) Holiday Concepts, as would normally be the case;
- Philistin used \$500,000 over time to make repayments on the bogus loans to hide the true position and blew the balance on gambling;
- She had no funds remaining or assets;
- Since 2007 she "doctored" reports which would otherwise have alerted TVM's officers and directors to the existence of the bogus loans. Prior to this, details of the bogus loans were included with all other loans and the information provided to the auditors.

11. On 1 May 2014 the liquidators sent a report to Unitholders in which they identified the Philistin fraud and its consequences. In that report the liquidators asserted that the balance owing to the Secured Creditors as at 31 March 2014 was \$409,739.02 and that debt was only partly covered by 43 genuine time share loans under which \$293,585.40 was owed. For the Secured Creditors

⁶ See notice of objection to liquidators' application for remuneration filed on behalf of two of our clients, Resort Securities Pty Ltd and Holiday Concepts Management Ltd on 20 September 2011 in proceeding SCI 2011 01355 in which the liquidators were first plaintiffs and TVM was the second plaintiff.

that meant they had no hope of the balance of their loans ever being repaid. Indeed over time the amount paid to them from time share loans would be insufficient to pay interest and so the amount outstanding would forever increase. Further, the promised surplus for TVM from the Time Share Debtors had evaporated.

12. On 22 May 2014 we wrote an 8 paged letter to the liquidators on behalf of the Secured Creditors. A copy of that letter is attached. In that letter the Secured Creditors demanded damages from the liquidators personally in the sum of \$730,719.31 and stated the grounds for their demand. The (gross) negligence of the liquidators was fully canvassed and we concluded that on any view of the facts the liquidators had been asleep at the wheel – and asleep for a very long time.
13. The liquidators, by your letter of 25 June 2014, denied liability and made a series of incredible assertions to the effect that Messrs Rice and Reynolds had dissuaded them from doing their job. Those assertions were described by Mr Rice, with understatement, as “absolute rubbish and twaddle”⁷.
14. Following the liquidators’ denial of liability, the Secured Creditors, on 27 June 2014, issued the Writ against the liquidators and Philistin referred to in paragraph 2 above.
15. Our clients were not the only parties rushing to issue Supreme Court Writs in June, for a registry search shows that on 6 June 2014 TVM issued a writ against its auditors, Price Gibson Pty Ltd, Graeme Desmond Price and Peter John Gibson under SCI 2014 2835. A copy of that Writ is attached. Without descending into the detail of the Writ, we note that TVM seeks to blame the auditors for failing to detect the Philistin fraud, as a consequence of which TVM says it has lost the opportunity to make a claim under TVM’s insurance policy which included coverage for loss resulting directly from the dishonest acts of any employee discovered during the policy period; alternatively to make a claim against Dantay Pty Ltd to which its insurance policy (which included coverage for loss resulting directly from the dishonest or fraudulent acts of any of its employee) would have responded⁸.
16. We understand the defendants to the Price Gibson writ have not yet been served.

⁷ Mr Reynolds, recovering from illness, was less forgiving.

⁸ See paragraphs 21 to 23 of the Writ.

17. Our clients do not know whether TVM has a cause of action against the auditors which is not statute barred and which is viable. Irrespective, Price Gibson will surely join the liquidators in the proceeding as joint tortfeasors; for if the auditors, post June 2008, breached their duties to TVM, how much more negligent were the liquidators? After all, if the liquidators had conducted even the most elementary testing of the time share debtor's portfolio in the period from 9 December 2009 to 29 October 2011⁹ - a period in excess of 22 months – the fraud would have been detected and TVM, by its own assertion in the Price Gibson Writ, could have recovered the loss resulting, for the benefit of TVM's creditors including our clients¹⁰.
18. TVM, it seems to our client, has at least as good a cause of action against its liquidators as it has against its auditors. The existence of such a claim gives rise to a conflict between the liquidators' duty to cause TVM to sue them, and their own self-interest in avoiding a huge damages claim. A further conflict will inevitably arise when Price Gibson joins the liquidators as defendants or third parties in SCI 2014 2835 after service on them of the Writ – the conflict will again be between the liquidators' duties to TVM and the protection of their own interests.

Liquidators' Remuneration for managing Time Share Debtors' portfolio – further conflict

19. This conflict arises from the matters described in paragraph 9. The liquidators should only be able to recover remuneration for work competently done. They are not entitled to recover or retain remuneration for work performed negligently, particularly when that negligence caused serious loss to TVM and its creditors, being the annihilation of the expected (and promised) surplus.
20. The liquidators have a conflict between their interest in being paid (or retaining) remuneration of perhaps up to \$1.2 million and their duty to the company not to make unjustified payments.

Retention by the liquidators of one third of Time Share Debtors' proceeds - a further conflict

21. By terms of settlement dated 10 April 2013 the liquidators compromised Supreme Court Proceeding SCI 2012 0949 which the liquidators had brought against the Secured Creditors and their former receiver.

⁹ When the TVM policy expired.

¹⁰ It would seem ironic if the liquidators, by their own acts or omissions, caused the TVM insurance policy to expire on 29 October 2011. A case of shooting one's self in the foot?

22. One of the terms of the settlement agreement was that the liquidators will on the tenth of each month, commencing 10 June 2013, apply time share loan repayments received by them in the previous month as follows:
- (i) two thirds of the amount of all such repayments (net of "collection costs" as that termed is defined in the Deed of Agreement between the parties dated 24 August 2011) will be paid to the chargees in reduction of the Debt;
 - (ii) the remainder will be **retained by the liquidators.**
23. It is trite to state that liquidators are not permitted either directly or indirectly to profit from their office otherwise than to the extent expressly allowed by law. This means they are entitled to their authorised remuneration and anything in excess of this represents profit which the liquidators have no right to retain¹¹. In South Australia as well as in England the respective rules used to contain an express provision to the effect that a liquidator shall not under any circumstances accept from any person connected with the company of which he is a liquidator any remuneration or other consideration or benefit whatever, beyond the remuneration to which under the Act and the rules, he is entitled as liquidator.
24. In other jurisdictions, the courts have developed similar principles¹². In addition, liquidators are now defined as company officers under section 9 of the Corporations Act 2001 and are thus subject to the obligations of care and diligence, good faith and avoidance of improper use of position and information in sections 180-184.
25. The extreme strictness with which these rules are applied can be gauged from *re Gurtzenstein Ltd* [1937] Ch.115 where a solicitor was one of two liquidators in a voluntary winding up and was deprived of profit costs in respect of a compromise arising out of litigation in which he had acted on behalf of the liquidators. Whether the rule is based upon express statutory provision or ordinary equitable principles, the practical result is the same, for there is between the liquidator and the creditors of the company for which he is a liquidator, a fiduciary relationship which prevents the liquidator from making a profit out of his trust.

¹¹ See para [8.560] of *McPersons Law of Company Liquidation*

¹² *Corporate Affairs Commission (Vic) v Harvey* [1980] VR 669 and see para [8.560] *supra*

26. In the present case, lest it be argued that the liquidators' duty was discharged by full disclosure to and the fully informed consent of the creditors when they approved of the liquidators entering into a settlement agreement as a whole, we point out that when the liquidators listed "the salient terms" for the benefit of creditors¹³ they failed to mention that the liquidators were going to keep one third of the time share proceeds for themselves. At any event, it seems to us that any power to exonerate can only be exercised by the Court.
27. The amount retained by the liquidators under the Settlement Agreement presently exceeds \$100,000. Accordingly, it would appear that the liquidators have a conflict between their interest in personally retaining for themselves a substantial part of the past and future proceeds of the remaining "non bogus" time share loans, and their duty to TVM and its creditors, including our clients, to ensure that they do not.

The liquidators' duty to resign

28. When a conflict of duty and interest arises, the proper course for the liquidators is to apply to the court¹⁴, or to resign¹⁵.
29. We have identified above at least three conflicts facing the liquidators. All are serious and give rise to a reasonable apprehension on the part of our clients that the liquidators will be impeded or inhibited from acting impartially in the interests of all creditors.
30. Accordingly, our clients demand that the liquidators now resign in which event the creditors (including our clients), acting under section 499(5), may fill the vacancy.
31. This demand is reinforced by section 532(2)(a) which disqualifies liquidators from acting "*if the person ... is indebted to the company ... in an amount exceeding \$5,000*". By our clients' reckoning, the liquidators are, or soon will be, indebted to TVM in a sum exceeding \$2 million.
32. If a liquidators are in any doubt regarding their position, it is not for them to resolve that doubt in their favour. Instead they should seek directions from the court under s.511. If that is their chosen course, our clients require that the s. 511 application be made immediately.

¹³ Report by the liquidators of 2 May 2013.

¹⁴ Corporate Affairs Commission (Vic) v Harvey [1980] VR 669.

¹⁵ It is plainly contemplated by s.495(3) (members voluntary winding up) and s.499(5) (creditors voluntary winding up) that a liquidator may resign, because they provide for meetings of members and creditors respectively to fill the vacancy thereby caused.

33. If the liquidators disregard our clients' demands, our clients (or many of them) will make application under s.503 for the liquidators' removal, just as Mr Handberg himself did in *Re Greight Pty Ltd (in liquidation)* [2006] FCA 17 when he sought and obtained orders that Mr Cant be removed as the liquidator of two companies and be replaced by new liquidators. Justice Finkelstein was critical of Mr. Cant's "initial reluctance to face up to the problem"¹⁶. Our clients trust that the liquidators will not behave as Mr Cant did and will quickly acknowledge that "something must be done".
34. Mr Cant brought a cross application for the appointment of special liquidators to deal with known conflicts. The application was refused as was a similar application in *National Safety Council of Australia (Vic)* [1990] VR 29¹⁷. For the reasons given in those two judgments, and particularly because the liquidators' gross and obvious conflicts taint the whole of their administration, our clients believe it would not be appropriate for those conflicts to be looked after by a special purpose liquidator.
35. In the event that the liquidators choose to apply to the court for directions, please confirm that this letter (and its attachments) will be exhibited to any affidavit filed by the liquidator. Alternatively, please give us notice of the application as we expect we will receive instructions to attend.

Yours faithfully
CHARLES FICE



C.A. CHARLES

¹⁶ At para 2

¹⁷ A case in which the writer was the solicitor for the bank removing the liquidator.