

Receivers' Submissions

VID 95 of 2010

Federal Court of Australia
District Registry: Victoria
Division: General

IN THE MATTER OF THE *CORPORATIONS ACT 2001*

IN THE MATTER OF MARK RONALD LETTEN & ORS

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION
Plaintiff

MARK RONALD LETTEN & ORS
Respondents

A Introduction

- 1 The Receivers refer to their Preliminary Submissions dated 13 September 2011 which sets out the background to this application and the materials relied upon. The Preliminary Submissions also summarise the legal principles and facts that are relevant to this application. Terms used in these further submissions have the meaning given in the Preliminary Submissions.
- 2 In these submissions the Receivers will address the following issues:
 - (a) **Issue 1:** Are Twinview and/or TGCH liable as trustees for losses to their respective trust estates such that any right of exoneration which might otherwise have subsisted in respect of either trade creditors or investor claimants is extinguished by the operation of the so-called "clear accounts rule"?
 - (b) **Issue 2:** Are Twinview and/or TGCH otherwise entitled to exoneration in respect of:
 - (i) trade creditors;
 - (ii) investor claims,having regard to the circumstances in which those debts and liabilities were incurred?
 - (c) **Issue 3:** Are Twinview and/or TGCH entitled to exoneration in respect of the Investor claims at all?
- 3 In these submissions the Receivers also address the submissions of Bridgehead dated 12

October 2011 (“**Bridgehead Submissions**”).

4 As no viable contradictor has emerged who might be in a position to make submissions from the perspective of the broader investor pool, the Receivers have adopted this perspective for the purposes of these submissions.

B Issue 1 - Clear Accounts Rule

5 A trustee’s right of indemnification is subject to the condition precedent that the trustee makes good any loss that it has caused to the estate (“**clear accounts rule**”). In broad summary, the clear accounts rule provides that a trustee’s right of indemnification is subject to the condition precedent that the trustee makes good any loss that it has caused to the trust estate.

6 The rule is described and analysed by Brooking J in *RWG Management Ltd v Commissioner for Corporate Affairs*¹, where his Honour said (at 397):

“...a balance is to be struck between what is due by way of compensation and what is due by way of indemnity and...if the balance is in favour of trustee he may recover from the estate to that extent.”

7 The clear accounts rule was described by Chief Justice Young more recently in *Warne v GDK Financial Solutions Pty Ltd*² as follows:

“it is good practice to assume that the trustee (whether bare or active) has a prima facie right of indemnity, but to order accounts if there is doubt about the entitlement of the trustee because of a default, and suspend the right of the claimant while those accounts are taken.”

8 The clear accounts rule is essentially a mathematical exercise setting off the trustee’s right to the indemnity against its liability with respect to previous breaches of trust. In other words, the quantum of the trustee’s right to indemnity may be diminished by breaches unrelated to the liabilities for which the right of indemnity is claimed.³

9 Although it is clear that TGCH and Twinview held the respective Glen Centre Property and Twinview Property as trustees, in order to determine the way in which the clear accounts rule is to apply, it is necessary to identify the “trust fund” or “estate” for which they are accountable as trustees.

10 The essential theme of the Bridgehead Submissions is that:

(a) the trust estates for TGCH and Twinview are confined to the Glen Centre

¹ [1985] VR 385

² [2006] NSWSC 259

³ For a helpful academic discussion of the clear accounts rule, see Nuncio D’Angelo ‘When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be “insolvent”?’ (2011) 39 ABLR 95 at 106; Nuncio D’Angelo ‘The unsecured creditor’s perilous path to a trust’s assets: Is a safer, more direct US-style route available?’ (2010) 84 ALJ 833 at 841-842

Property and the Twinview Property respectively;

- (b) TGCH and Twinview were not obliged, under the relevant Joint Venture Agreements (“**JVAs**”)⁴ or otherwise, to get in and receive Capital Contributions; and
- (c) there has been no relevant breach of trust or other conduct on the part of TGCH or Twinview that would give rise to an obligation to compensate that trust fund.

11 Bridgehead states that clauses 2.2 and 3.2 of the JVA’s are not defined to include the Capital Contributions or any other money paid by Investors.⁵ Similarly though, those clauses are not defined to exclude Capital Contributions. Indeed, the JVAs are unclear as to the definition of the assets. There is nothing in those clauses, or indeed the JVAs more generally, which supports the contention that the trust estates are confined solely to the Glen Centre Property and the Twinview Property respectively.

12 The distinction sought to be drawn on behalf of Bridgehead (between the real properties in the hands of Twinview and TGCH on the one hand, and the capital contributions in the hands of LGHA on the other hand), whilst superficially attractive, has an air of unreality about it, in the context of all of the circumstances surrounding the Letten Schemes, for the following reasons:

- (a) The controlling mind of each of Twinview, TGCH and LGHA was Mr Letten.
- (b) Investors give their money to Mr Letten on the assumption (and with the intention) that it would go to acquire (or improve) a specified piece of real property.
- (c) The real property was acquired (and/or improved) with a mixed fund which included (some) of the funds contributed for that intended purpose, but also with funds improperly diverted from other purposes.
- (d) Step (c) above involved clear breaches of trust by LGHA and “knowing receipt” on the part of the management companies, giving rise to a mixed express trust/constructive trust on the part of the management companies.
- (e) The beneficiaries of the “mixed trust”, referred to in (d) above are **all** of the Investors (who cannot be practicably identified) whose funds ended up (in a tracing sense) in the real property assets.
- (f) In addition, to the extent that **surplus** funds were received by LGHA for the intended projects, those funds should be regarded as having been received on behalf of the management companies; LGHA being, in effect, the central banker/treasurer of the group.

⁴ The Receivers note that a small number of JVAs in relation to the Glen Centre Joint Venture Scheme were executed by investors on one hand and Castello Holdings Pty Ltd on the other (as opposed to TGCH). In this regard, the Receivers refer to p13 of the disclosure report at DJT-17

⁵ Bridgehead submissions at [18(b)]

- (g) To the extent that the management companies knew (as they must be taken to) that LGHA was holding surplus funds “intended” for their respective projects, those companies had duties (as trustee) to secure those funds. No steps were in fact taken to “get in” those funds. In fact, the management companies didn’t even take steps to secure the surplus as a receivable from LGHA.
- (h) The “surplus” funds were diverted by LGHA (into other projects, payments of distributions to Investors, or otherwise) in breach of trust. The management companies (specifically Twinview and TGCH) were knowing accessories to those breaches, for the reasons set out in (g) above.
- 13 Bridgehead also cites clause 4.3(a) of the JVAs as support for the contention that TGCH and Twinview were only trustees for the assets that came under their direct control, namely the Glen Centre Property and the Twinview Property. Bridgehead contends that clause 4.3 somehow authorised the Capital Contributions to be held on trust by LGHA, and that those funds were under LGHA’s direction and control, not TGCH/Twinview’s.⁶ Again, this submission ignores the fact that TGCH/Twinview are the relevant parties to JVAs, such that the funds could only have been placed under LGHA’s control with TGCH/Twinview’s explicit or implied sanction. This in itself constitutes a misapplication of those funds, as TGCH and Twinview must be taken to have known of LGHA’s intention to misapply those funds.
- 14 Closer inspection of clause 4.3(a) suggests that the only authorised “third parties” with whom the Capital Contributions could be deposited include solicitor’s and accountant’s trust funds, both of whom would logically be acting as agents for, and on the instructions of, TGCH or Twinview. Clause 4.3(b) does not appear to contemplate the scenario that funds are directed to LGHA which is not a firm of solicitors or accountants. Accordingly, TGCH/Twinview were in breach of their obligations under the JVAs by allowing or directing the funds to be deposited with LGHA in the first place. In other words, **the receipt by LGHA of TGCH/Twinview Capital Contributions was itself a misapplication of funds (breach of trust) by TGCH and Twinview by reference to clause 4.3(a) of the JVAs.**
- 15 In any event, regardless of whether the Capital Contributions were deposited in a TGCH/Twinview bank account, a solicitor’s trust fund or, as was the case, the LGHA account, TGCH/Twinview would ultimately remain responsible for those funds. This is supported by clause 4.3(b) which requires TGCH and Twinview to account for all transactions in connection with the Project. This logically includes all Capital Contributions made in connection with the Projects and Capital Contributions which have, to TGCH and Twinview’s knowledge or direction, been deposited with LGHA.
- 16 In the circumstances, the Receivers’ submit that clause 4.3 does not support the contention that the trust fund is confined merely to the Glen Centre Property and the Twinview Property. On the contrary, it strongly suggests that it also extends to all monies contributed by the relevant

⁶ Bridgehead submissions at [18(c) & (d)]

Investors, given TGCH and Twinview were under a specific obligation to account, pursuant to clause 4.3(b)).

- 17 The Receivers submit that TGCH and Twinview were both under an obligation to get in and receive Capital Contributions and their failure to do so constituted a breach of trust. Firstly, the JVAs imposed the following obligation on TGCH and Twinview, which was not set out in Bridgehead's submissions:

"In carrying out its duties and obligations under or pursuant to this Agreement, the Manager shall:

- (a) faithfully, dutifully and punctually carry out its duties and exercise its responsibilities in the best interests of the Investors with all due skill, care and diligence;"
(Clause 4.2)

- 18 It is unarguable that it is in the best interests of the Project (as defined by the JVAs), and ipso facto the Investors, to get in and receive all Capital Contributions that are intended for that Project. It follows that TGCH and Twinview would not be carrying out their obligations under the JVAs faithfully, and in the best interest of the Investors, if they were knowingly failing to get in and receive Capital Contributions for the Project. Indeed, given Mr Letten was a director of TGCH, Twinview and LGHA, both TGCH and Twinview would have had knowledge of monies held by LGHA that were intended to be invested in the Projects.

- 19 Secondly, TGCH and Twinview were under a specific obligation pursuant to clause 4.3(b) to account for all transactions in connection with the Projects. Investor monies intended for the Glen Centre Joint Venture Scheme and Twinview Joint Venture Scheme which were misapplied by LGHA (with the knowledge of TGCH and Twinview, by reason of the common directorships) would constitute transactions in connection with the Projects which are to be accounted for.

- 20 The Receivers submit that, apart from a failure to get in and receive Capital Contributions as outlined above, and the misapplication of funds to LGHA, TGCH and Twinview have contravened clause 4.2(e) of the JVAs, which constitutes a further breach of trust. The clause provides:

"In carrying out its duties and obligations under or pursuant to this Agreement, the Manager shall:

...

- (e) use all reasonable endeavours to comply with all applicable laws, regulations and similar requirements in relation to the Project;"

- 21 In contravention of the above clause, at all material times TGCH and Twinview were operating illegal, unregistered managed investment schemes such that the Projects were not complying with all applicable laws.

- 22 In light of the above, the Receivers consider there is no foundation for the submission that TGCH and Twinview were not parties to a breach of trust for which they were, and remain,

accountable.⁷

- 23 Bridgehead contends that the proper characterisation of the relevant events is that Twinview and TGCH hold the relevant properties on trust for LGHA (Bridgehead Submissions, paragraph 20(a)). That characterisation ought to be rejected, for the reason alone that it turns the central wrongdoer, LGHA, into the central beneficiary. The better view is that LGHA holds (held) any “surplus” funds, received from Investors, on account of the relevant management companies to whom the Investors intended to direct their funds. It is that interest, of the management companies, which they held on trust for the Investors and failed (in breach of that trust) to “get in” or otherwise protect.
- 24 The Receivers accept what is said in paragraph 20(c) of the Bridgehead Submissions, to the effect that the Investors now have no more than their rights, under the Pooling Orders, to a claim against the “Pool”. However, the Pool is not a fund of which LGHA is a trustee. Rather, it is a fund, effectively managed by the Court through its appointed receivers, constituted by the Pooling Orders to do fairness and justice (in an expeditious and cost effective way). The effect, relevantly, of the Pooling Orders and the way distribution will occur, is that Investors are facing a return of 8-10 cents in the dollar on their initial investments. The “missing” 90-92 cents is the product of the breaches of trust, and the accessional breaches, referred to above. As noted in the Preliminary Submissions, that loss is more than sufficient to wholly extinguish any indemnity claims sought to be made by the trustees.

C Issue 2 - Is the right of indemnity available at all?

- 25 The judgment of Justice Gordon dated 11 November 2010 at [28] states:
- “Each Scheme was or is a separate unregistered managed investment scheme in which it appears that investors contributed money as consideration to acquire rights to benefits intended to be produced by the acquisition of a particular asset or assets.”
- 26 In light of this finding, it follows that the Schemes were unlawful enterprises. It is arguable that, having regard to the way the Schemes were conducted, and the manner in which investors were induced to invest funds, the Schemes can also be characterised as being fraudulent in nature.
- 27 In *RWG Management v Commissioner for Corporate Affairs* [1985] VR 385 at 396, Brooking J stated that the trustee is:
- “...entitled to be indemnified in respect of a liability improperly incurred to the extent to which, acting in good faith, he has benefited the trust estate. (emphasis added).”
- 28 The Receivers’ investigations to date give them no reason to deny that the various trade creditors of TGCH and Twinview themselves acted in good faith (and in ignorance of the illegality of the Schemes), the question must be asked as to whether any actions of Mr Letten and the Corporate

⁷ Bridgehead submissions at [8], [18(g)]

Defendants in furtherance of these Schemes can be characterised as being in good faith? The Receivers submit that they cannot as they constitute steps taken in furtherance of an illegal and (arguably) fraudulent enterprise. Accordingly, any liabilities incurred in furtherance of this enterprise should not be subject to a trustee's right of indemnity.

29 The Receivers submit that this is the case even if the liabilities can be characterised as expenses incurred to preserve trust property, as the liabilities were incurred in the absence of good faith.

30 Another way of looking at this issue is whether it can be said that any of the unsecured creditors have, in fact, provided the trust with a benefit in circumstances where all of the investors stand to lose the bulk of their investments. The Receivers submit that they have not.

31 Bridgehead does not appear to have addressed this specific issue, apart from its contention that TGCH and Twinview have not committed any applicable breach of trust.⁸

32 As discussed above in the context of Issue 1, TGCH and Twinview were involved in the broader illegal enterprise and had knowledge at all relevant times through the controlling mind and will of Mr Letten.

D Issue 3 - Investor damages claims

33 The Liquidators have received proofs of debt in the winding up of TGCH and Twinview which appear to be damages claims by investors. Those proofs of debt are as follows:

Table 1 - TGCH

Name	Amount	Page number in DJT-139
Louton Pty Ltd	\$100,000	00057
Robuck Metals Pty Ltd	\$235,000	00078
ABK Group Pty Ltd	\$108,850	00043 (also see NJK-23 to the 2nd Affidavit of Nicholas Kelton sworn 13.09.11)

Table 2 - Twinview

Name	Amount	Page number in DJT-140
Louton Pty Ltd	\$100,000	00033
Robuck Metals Pty Ltd	\$235,000	00054

34 There is some question whether, regardless of questions of a right of indemnity, the investor claims are eligible to be considered as trust creditor claims at all. One, lodged by Robuck Metals

⁸ Bridgehead submissions at [8], [18(g)]

Pty Ltd against both TGCH and Twinview annexed, by way of explanation, documents relating to a County Court proceeding issued in 2009 against seven defendants - none of which are Twinview or TGCH - which seeks to recover monies invested with LGH Holdings Ltd between 2001 and 2004. It is not apparent from these documents what, if any, connection these investments had with the Twinview Joint Venture or the Glen Centre Hawthorn Joint Venture. There is no suggestion in the lists included in the Disclosure reports that Robuck was an investor in either joint venture.

- 35 The other investor claims, lodged by Louton Pty Ltd (against both TGCH and Twinview) and ABK Group Pty Ltd (against TGCH only) do no more than annex a copy of the relevant joint venture agreement, from which it appears that the two claimants were investors who invested the amount they are claiming in the joint venture.
- 36 If, as appears to be the case, Louton Pty Ltd and ABK Group Pty Ltd are simply claiming as investors in the respective joint ventures, then the Receivers would submit that their claims would be inconsistent with the Pooling Orders, and would have to be made against the Common Fund that those orders directed to be established.
- 37 Alternatively, the alleged claims may actually, in broad summary, constitute misrepresentation claims for damages against the trustees resulting in the loss of the alleged creditor's investment. Presumably, on this basis, the investors will assert that, had they known that their funds would be deployed for purposes beyond that of the Glen Centre Joint Venture Scheme and Twinview Joint Venture Scheme, they would not have invested the monies.
- 38 The trustee's right of indemnity is not available in respect of a given liability if the activity which generated the liability involved a breach of trust or was beyond the powers given the trustee (or was criminal or fraudulent in nature): see *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd (in liq)* [2002] ATPR 41-864.
- 39 While the authorities do provide that a trustee can have a right for indemnity for damages claims, those damages must be incurred during the course of carrying on the trust business.⁹ Further, the claim for indemnity is also subject to the overarching consideration of whether the liability was properly incurred.
- 40 In the circumstances, the Receivers do not consider the investor damages claims are claims for which TGCH or Twinview could claim a right of indemnity as the liabilities were either:
- (a) incurred in breach of trust; and/or
 - (b) improperly incurred; and/or
 - (c) arguably unlawful in nature, at least to the extent that they relate to the raising of

⁹ *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd (in liq)* [2002] ATPR 41-864 at [46]

capital for an unregistered management investment scheme.

41 Furthermore, if the trustee's right of indemnity were found to be applicable to investor damages' claims, the Pooling Orders would, to a significant extent, be rendered nugatory. This is because all investors would simply submit proofs of debt in the liquidation of the various corporate entities as trust creditor claims as opposed to submitting claims to the Receivers in the investor proof of claim process.

E. Costs

42 Bridgehead has foreshadowed that it will be seeking an order relieving it of all or part of its costs of the application in due course and will provide further submissions on this in due course.

43 The Receivers do not propose to address the question of costs in these submissions, but reserve their right to do so upon receipt of the Court's ruling on the Receivers' application and Bridgehead's foreshadowed application.

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Date: 20 October 2011