

SUPREME COURT OF QUEENSLAND

REGISTRY: BRISBANE
NUMBER: 2000/16

First Applicant: **TRILOGY FUNDS MANAGEMENT LIMITED ACN 080 383 679
AS RESPONSIBLE ENTITY OF THE LM WHOLESALE FIRST
MORTGAGE INCOME FUND ARSN 099 857 511**
AND
Second Applicant: **THE TRUST COMPANY LIMITED ACN 004 027 749 AS
CUSTODIAN OF THE PROPERTY OF THE LM WHOLESALE
FIRST MORTGAGE INCOME FUND ARSN 099 857 511**
AND
Respondents: **THE MEMBERS OF THE LM WHOLESALE FIRST
MORTGAGE INCOME FUND ARSN 099 857 511**

AFFIDAVIT

Susan Goodman of Level 17, 88 Phillip Street, Sydney NSW 2000, states on oath:

1. I am a solicitor employed as Of Counsel at Squire Patton Boggs (**SPB**), and have conduct of these proceedings under the supervision of Amanda Kim Banton, the solicitor on the record for the First and Second Applicants.
2. Except where otherwise indicated, I depose to matters in this affidavit from my own knowledge. Where I depose to matters from information provided to me by other persons, I believe those matters to be true.
3. The parties to Supreme Court of Queensland proceeding 13534 of 2016 (**Feeder Fund Proceedings**) other than the Fourth Defendant have agreed to settle the dispute in those proceedings on the terms set out in Deed of Settlement and Release (the **Settlement Deed**).
4. I make this affidavit in support of the Applicants' application for judicial advice pursuant to section 96 of the *Trusts Act 1973* (Qld) filed 1 February 2019 (the **Application**) seeking an order that they are justified in entering and performing the obligations under the Settlement Deed.
5. I also refer to the affidavit of David Whyte sworn 31 January 2019 (the **Whyte First Affidavit**) the receiver of the LM First Mortgage Income Fund (**FMIF**). The First Whyte Affidavit was filed in Supreme Court of Queensland proceeding 3383 of 2013 and served on the Applicants. The documents exhibited to the

Whyte First Affidavit were previously provided to the Applicants pursuant to the orders of Jackson J dated 13 June 2018 in the Feeder Fund Proceedings.

6. I refer to the contents of the whole of the Whyte First Affidavit and specifically, at:

- a. page 93 of DW-61 is a copy of EY Proof of Debt dated 30 April 2013;
- b. page 206 of DW-69 is a copy of further EY Proof of Debt dated 20 December 2018.

EY Proceedings

- 7. On 2 March 2015, LM Investment Management Limited (**LMIM**) commenced Supreme Court proceeding 2166 of 2015 (the **EY Proceedings**) against Ernest and Young (**EY**) on behalf of LM First Mortgage Income Fund (**FMIF**), to recover damages on the basis of claims relating to EY's conduct of a series of financial audits and compliance plans.
- 8. The current Statement of Claim in the EY Proceedings is the Sixth Further Amended Statement of Claim filed 15 April 2015 (**6FASOC**). A copy of the 6FASOC is at pages 1 to 121 of Exhibit SG-1. A copy of the amended claim is at pages 122 to 124 of Exhibit SG-1.

Section 96 Statement

- 9. At pages 125 to 134 of Exhibit SG-1 is the Applicants' statement pursuant to s96 of the Trusts Act 1973 (QLD).

Estimate of Costs

- 10. At the commencement of the Proceeding, I instructed an employed solicitor under my supervision at Squire Patton Boggs to prepare a budget of the estimated legal costs of the Proceeding up to the conclusion of the Proceeding at first instance.
- 11. Since the commencement of the Proceeding, I have supervised updates to the budget where necessary in relation to the costs and tasks to be completed.
- 12. A copy of the budget for these proceeding is exhibited to the affidavit of Philip Ryan dated 1 February 2019, at pages 104 to 109 of the Exhibit.
- 13. I have reviewed the budget and based upon my 19 years of experience running complex commercial litigation, and having regard to the nature of the Feeder Fund Proceeding, I consider the estimated professional fees and disbursements in the budget to be reasonable, and to be a reasonable estimate



Susan Goodman

of the costs the Applicants would be likely to incur if the Feeder Fund Proceeding proceeded to trial.

Affirmed by Susan Goodman on 30 April 2019 at Sydney in the presence

Signed:

Deponent

AFFIRMED at SYDNEY

Signature of deponent

Susan Goodman

Name of witness

KATHERINE SANSWOOD

Address of witness

17/88 PHILLIP ST SYDNEY NSW

Capacity of witness

Solicitor

And as a witness, I certify the following matters concerning the person who made this affidavit (the **deponent**):

- 1 # I saw the face of the deponent.
- 2 # I have confirmed the deponent's identity using the following identification document:

Driver Licence
Identification document relied on (may be original or certified copy)¹

Signature of witness

Note: The deponent and witness must sign each page of the affidavit. See UCPR 35.7B.

^[1] "Identification documents" include current driver licence, proof of age card, Medicare card, credit card, Centrelink pension card, Veterans Affairs entitlement card, student identity card, citizenship certificate, birth certificate, passport or see Oaths Regulation 2011 or refer to the guidelines in the NSW Department of Attorney General and Justice's "Justices of the Peace Handbook" section 2.3 "Witnessing an affidavit" at the following address: <http://www.jp.nsw.gov.au/Documents/jp%20handbook%202014.pdf>]

SUPREME COURT OF QUEENSLAND

REGISTRY: BRISBANE
NUMBER: 2000/16

First Applicant: **TRILOGY FUNDS MANAGEMENT LIMITED ACN 080 383 679
AS RESPONSIBLE ENTITY OF THE LM WHOLESALE FIRST
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AND

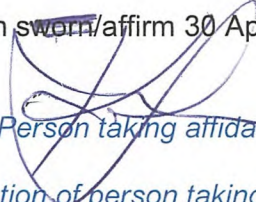
Respondents: **THE MEMBERS OF THE LM WHOLESALE FIRST
MORTGAGE INCOME FUND ARSN 099 857 511**

CERTIFICATE OF EXHIBIT

Exhibit SG-1 to the affidavit of Susan Goodman sworn/affirm 30 April 2019:


(Deponent to sign)

Deponent


(Person taking affidavit to sign)
(Description of person taking affidavit)

SUPREME COURT OF QUEENSLAND

REGISTRY: BRISBANE
NUMBER: 2166/15

Plaintiff: **LM INVESTMENT MANAGEMENT LIMITED (IN
LIQUIDATION) IN ITS CAPACITY AS RESPONSIBLE
ENTITY FOR THE LM FIRST MORTGAGE INCOME
FUND (RECEIVERS AND MANAGERS APPOINTED)
(RECEIVER APPOINTED) ARSN 089 343 288**

AND

First Defendant: **EY (ALSO KNOWN AS ERNST & YOUNG) (A FIRM)**

AND

Second Defendant **PAULA MCLUSKIE**

AND

Third Defendant **MICHAEL JAMES REID**

~~FIFTH~~SIXTH FURTHER AMENDED STATEMENT OF CLAIM

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Sixth Further Amended Statement of Claim
Filed on behalf of the Plaintiff
Form 16 v2 RR.22,146

GADENS LAWYERS
Level 11, 111 Eagle Street
BRISBANE QLD 4000
Tel No.: 07 3231 1666
Fax No: 07 3229 5850
SZC:JSO:201413563

Amended pursuant to the orders Justice Jackson made on

Dated:

Signed:

| | |
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This claim in this proceeding is made in reliance on the following facts:

Parties

1. The plaintiff:

- (a) at all times material to this action is and was a company duly incorporated and capable of suing in its own name;

- (b) at all times material to this action is and was the responsible entity (**RE**) of the LM First Mortgage Income Fund ARSN 089 343 288 (formerly known as the LM Mortgage Income Fund) (**the Fund**);
 - (c) at all times material to this action pursuant to section 601FA of the Corporations Act 2001 (Cth) (**Act**), was the holder of an Australian Financial Services Licence;
 - (d) at all times material to this action pursuant to section 601FC(2) of the Act and clauses 2.1 and 2.2 of the Fund's constitution, held the property and assets of the Fund on trust for the Fund's members (**the Members**);
 - (e) was placed into voluntary administration on 19 March 2013 and John Park and Ginette Muller of FTI Consulting were appointed voluntary administrators;
 - (f) had receivers and managers, Joseph Hayes and Anthony Connelly of McGrathNicol, appointed to certain of the property held in its capacity as responsible entity of the Fund on 11 July 2013 by Deutsche Bank AG; and
 - (g) was placed into liquidation on 1 August 2013 following a resolution of its creditors that it be placed into liquidation and that John Park and Ginette Muller be appointed liquidators.
2. By Order of this Honourable Court dated 21 August 2013 (**Fund Order**), the Fund was ordered to be wound up.
3. By the Fund Order, David Whyte (**Receiver**), Partner of BDO Business Recovery & Insolvency (Qld) Pty Ltd:
- (a) was appointed to take responsibility for ensuring that the Fund is wound up in accordance with its constitution (**Appointment**);
 - (b) was appointed as receiver of the property of the Fund;
 - (c) has, in relation to the property of the Fund for which he is appointed receiver, the powers set out in section 420 of the Act;
 - (d) without derogating in any way from the Appointment or the Receiver's powers pursuant to the Fund Order, was and is authorised to, inter alia:
 - (i) take all steps necessary to ensure the realisation of property of the Fund held by the plaintiff as responsible entity of the Fund by exercising any legal right of the plaintiff as responsible entity of the Fund in relation to the property including but not limited to:
 - (A) providing instructions to solicitors, valuers, estate agents or other consultants as are necessary to negotiate or finalise the sale of the property;

- (B) providing a response as appropriate to matters raised by receivers of property of the plaintiff as responsible entity of the Fund to which receivers have been appointed;
 - (C) dealing with any creditors with security over the property of the Fund including in order to obtain releases of security as is necessary to ensure the completion of the sale of the property;
 - (D) appointing receivers, entering into possession as mortgagee or exercising any power of sale; and
 - (E) executing contracts, transfers or releases or any such other documents as are required to carry out any of the above;
- (ii) bring, defend or maintain any proceedings on behalf of the Fund in the name of the plaintiff as is necessary for the winding up of the Fund in accordance with clause 16 of its constitution, including the execution of documents as required and providing instructions to solicitors in respect of all matters in relation to the conduct of such proceedings including, if appropriate, instructions in relation to the settlement of those actions; and
- (e) is entitled to bring and does bring these proceedings in the name of the plaintiff as responsible entity of the Fund.

4. At all material times to this action, the first defendant:

- (a) is and was an Australian partnership and a member firm of Ernst & Young Global Limited;
- (b) carried on business within Australia as professional accountants and auditors under the partnership name "EY" (also known as Ernst & Young);
- (c) held itself out as having expertise enabling it to provide professional audit services;
- (d) included, among its partners and employees practising in Queensland persons who were registered company auditors, including the second and third defendants; and
- (e) was engaged to:
 - (i) audit the Fund's annual financial reports;
 - (ii) review the Fund's half-year financial reports; and
 - (iii) audit the plaintiff's compliance with the Fund's compliance plans.

5. The second defendant was at all material times to this action:
 - (a) a partner of the first defendant; and
 - (b) a registered company auditor holding Australian Securities and Investments Commission (ASIC) Registered Auditor Number: 303752.
6. The third defendant was at all material times to this action:
 - (a) a partner of the first defendant; and
 - (b) a registered company auditor holding ASIC Registered Auditor Number: 208047.
7. For the purposes of this ~~Fourth~~ Sixth Further Amended Statement of Claim (**Statement of Claim**), unless stated otherwise, the following terms have the meaning specified below:
 - (a) Australian Accounting Standards has the meaning given in section 9 of the Act for “accounting standard”;
 - (b) Australian Auditing Standards has the meaning given in section 9 of the Act for “auditing standard” and other pronouncements issued by the Australian Auditing and Assurance Standards Board or other appropriate authority;

The plaintiff, the Fund and the Feeder Funds

8. On or about 28 September 1999, the Fund was registered with ASIC as a managed investment scheme in accordance with Chapter 5C of the Act.
9. The plaintiff sought investment for the Fund through the issue of prospectuses and/or public disclosure statements and then invested those monies principally in mortgage related investments, namely loans secured by a registered mortgage over real property (hereafter referred to as **Mortgage Investments**).
10. Members (**Members**) acquired units in the Fund (**Units**) for an initial issue price of \$1.00 for each unit.
11. At all material times to these proceedings, the Fund was governed by successive constitutions each of which was legally binding as a contract between the Members and the plaintiff, as follows:
 - (a) for the period 31 May 2007 to 10 April 2008, the Replacement Constitution executed by the plaintiff as a deed and dated 31 May 2007; and
 - (b) at all material times from 10 April 2008, the Replacement Constitution executed by the plaintiff as a deed and dated 10 April 2008.

(Together, the **Constitutions**).

12. The plaintiff was obliged to manage the Fund in accordance with the Act and the terms and conditions contained in the Constitutions.
13. At all relevant times the Constitutions provided that:
 - (a) pursuant to clauses 2.1 and 2.2, the plaintiff held and would at all times hold the assets of the Fund on trust for Members;
 - (b) pursuant to clause 4.1, the Constitutions were binding on the plaintiff and Members;
 - (c) pursuant to clause 3, each Member was entitled to a beneficial interest in the Fund as provided for in the Constitutions and by the Act; and
 - (d) pursuant to clause 13.2, the plaintiff was responsible for investing the monies held by the Fund in, amongst others, Mortgage Investments.
14. At all material times, there were three different classes of issued Units in the Fund, as follows:
 - (a) Class A Units, which were issued to ordinary unitholders of the Fund;
 - (b) Class B Units, all of which were:
 - (i) held for a Feeder Fund (as defined in paragraph 15 below);
 - (ii) Australian dollar investments with the same rights and obligations as Class A units;
 - (c) Class C Units, which were issued to unitholders of the Fund who had invested in foreign currencies.
15. The plaintiff was also:-
 - (a) at all material times until 16 November 2012, the RE of the LM Wholesale First Mortgage Income Fund ARSN 099 857 511 ("**Wholesale Fund**");
 - (b) at all material times, the RE of the LM Currency Protected Australian Income Fund ARSN 110 247 875 ("**Currency Fund**"); and
 - (c) at all material times, the RE of the LM Institutional Currency Protected Australian Income Fund ARSN 122 052 868 ("**Institutional Fund**"),

together, known as the "**Feeder Funds**", each of which was a registered managed investment scheme under Chapter 5C of the Act.
16. At all material times from 16 November 2012, the RE of the Wholesale Fund was Trilogy Funds Management Limited (**Trilogy**).

17. The assets of each of the Feeder Funds consisted predominantly of interests in units in the Fund.

Particulars

- (a) The units in the Fund held for the Feeder Funds were held from time to time either by the responsible entity for that Feeder Fund, or by a custodian appointed as the custodian of the assets of that Feeder Fund.
18. In the premises, the Feeder Funds were at all material times:
- (a) wholly dependent on the liquidity of the Fund, such that their solvency in each case was dependent upon the Fund continuing to be able to provide them with funds to meet their expenses; and
- (b) thereby reliant on the payment of distributions and/or redemptions by the Fund to meet their expenses.
19. As a registered scheme, pursuant to section 601HA of the Act the Fund was required to have a compliance plan that set out adequate measures that the plaintiff was to apply in operating the Fund in order to ensure:
- (a) compliance with the Act; and
- (b) compliance with the Constitutions,
- materially including the arrangements for:
- (c) ensuring that the scheme property is valued at regular intervals appropriate to the nature of the property;
- (d) ensuring that compliance with the plan is audited as required by section 601HG; and
- (e) ensuring adequate records of the Fund's operations were kept.
20. At all times material to this action, the compliance plans which were operative during the financial years ended 30 June 2008 to 30 June 2012 were the following:
- (a) Replacement Compliance Plan dated 31 May 2007;
- (b) Replacement Compliance Plan dated 10 April 2008;
- (c) Replacement Compliance Plan dated 28 November 2008;
- (d) Compliance Plan Modification dated 13 March 2009; and
- (e) Replacement Compliance Plan dated 16 March 2011.
- (Together, the **Compliance Plans**).

21. At all material times, the plaintiff and LM Administration as trustee for the LM Administration Trust (**LM Administration**) were parties to a series of services agreements ("**Services Agreements**"), in the following material terms:-

- (a) LM Administration agreed to supply all services necessary for the proper and efficient management and administration of the plaintiff's funds management businesses (including as responsible entity of the Fund);
- (b) the plaintiff agreed to pay service fees for LM Administration's services ("**Service Fees**"), which included recovery of a proportion of LM Administration's expenses, plus the entirety of the management fee charged by the plaintiff to the Fund under the Constitutions (the **RE Management Fee**); and
- (c) the plaintiff and LM Administration agreed that the Services Fees shall be calculated quarterly with the first of such quarterly payments being due and payable on the last day of the quarter.

Particulars.

- (i) Services Agreements dated 1 July 2003, 1 July 2009 and 1 July 2010, containing the pleaded material terms, or terms to that effect, were executed by the plaintiff and LM Administration respectively.
- (ii) The Services Agreements were varied by side-letter dated 24 September 2012 with effect from 1 July 2011.

22. At all material times, LM Administration:

- (a) had no business other than in relation to the managed investment schemes and trusts managed by the plaintiff as responsible entity and trustee, or trustee, as the case may be, including the Fund;
- (b) shared the same place of business as the plaintiff;
- (c) had as its sole director Mr Peter Drake, who was also:
 - (i) the Executive Director and Chief Executive Officer of the plaintiff; and
 - (ii) a beneficiary of the various trusts pursuant to which LM Administration carried out its operations, including the LM Administration Trust;
- (d) had as its sole shareholder Mr Peter Drake, who was also the sole ultimate owner of the plaintiff;
- (e) employed and paid the salaries of each of the directors of the plaintiff.

23. On 3 March 2009, the plaintiff declared that the Fund would not accept applications from new investors, and withdrawal requests would be paid up to 365 days after maturity.

The plaintiff's obligations

24. At all material times, the plaintiff was obliged:
- (a) pursuant to sections 331AAA and 331AAB in Division 7 of Chapter 2M of the Act, to appoint an auditor of the Fund within 1 month after the day on which the Fund was registered or any vacancy occurs in the office of auditor of the Fund; and
 - (b) pursuant to section 601HG(1) of the Act, to ensure that at all times a registered company auditor, an audit firm or an authorised audit company was engaged to audit the plaintiff's compliance with the Compliance Plans that were operative during each relevant financial year.
25. At all material times, pursuant to section 286(1) of the Act, the plaintiff was required to keep written financial records that:
- (a) correctly recorded and explained the Fund's transactions and financial position and performance; and
 - (b) would enable true and fair financial statements for the Fund to be prepared and audited.
26. Pursuant to:
- (a) sections 292, 301 and 319 of the Act, on behalf of the Fund the plaintiff was required to:
 - (i) prepare a financial report for the Fund for each financial year, consisting of the financial statements for the year, the notes to the financial statements and the directors' declaration about the statements and notes;
 - (ii) have the financial report audited in accordance with Division 3 of the Act and obtain an auditor's report; and
 - (iii) lodge the financial report and the auditor's report on the financial report with ASIC;
 - (b) sections 302 and 320 of the Act, on behalf of the Fund the plaintiff was required to:
 - (i) prepare a financial report for the Fund for each half-year;
 - (ii) have the financial report audited or reviewed in accordance with Division 3 and obtain an auditor's report; and

- (iii) lodge the financial report and the auditor's report on the financial report with ASIC.

- 27. Pursuant to sections 296 and 304 of the Act, each annual financial report and half-year financial report prepared by the plaintiff on behalf of the Fund was required to comply with the applicable Australian Accounting Standards.
- 28. Pursuant to sections 297 and 305 of the Act, each annual financial report and half-year financial report prepared by the plaintiff on behalf of the Fund was required to give a true and fair view of the financial position and performance of the Fund.

Engagement of the defendants to audit and review

Audits and Reviews

- 29. At all material times, the first defendant and/or the second defendant were the auditor of the Fund appointed under Division 7 of Chapter 2M of the Act.
- 30. In relation to the:
 - (a) 30 June 2008 financial audit of the Fund:
 - (i) by letter dated 18 February 2008 from the first defendant to the plaintiff and signed by the plaintiff on 26 February 2008, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake an audit of the Fund's end of financial year 30 June 2008 annual financial report (the **30 June 2008 Financial Report Audit Engagement**);

Particulars

- (A) Pursuant to the 30 June 2008 Financial Report Audit Engagement the first defendant was to be paid the sum of \$83,250.00 plus GST for undertaking the financial audit.
- (ii) the second defendant was the lead auditor who carried out the audit;
- (b) 31 December 2008 financial review of the Fund:
 - (i) by letter dated 19 February 2009 from the first defendant to the plaintiff, and signed by the plaintiff on 4 March 2009, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake a review of the Fund's 31 December 2008 half-year financial report (the **31 December 2008 Financial Report Review Engagement**);

Particulars

- (A) Pursuant to the 31 December 2008 Financial Report Review Engagement the first defendant was to be paid

the sum of \$31,500.00 plus GST for undertaking the financial review.

- (ii) the second defendant was the lead auditor who carried out the review;
- (c) 30 June 2009 financial audit of the Fund:
 - (i) by letter dated 11 August 2009 from the first defendant to the plaintiff and signed by the plaintiff on 21 August 2009, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake an audit of the Fund's end of financial year 30 June 2009 annual financial report (the **30 June 2009 Financial Report Audit Engagement**);

Particulars

- (A) Pursuant to the 30 June 2009 Financial Report Audit Engagement the first defendant was to be paid the sum of \$100,000.00 plus GST for undertaking the financial audit.
- (ii) the second defendant was the lead auditor who carried out the audit;
- (d) 31 December 2009 financial review of the Fund:
 - (i) by letter dated 22 February 2010 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake a review of the Fund's 31 December 2009 half-year financial report (the **31 December 2009 Financial Report Review Engagement**);

Particulars

- (A) Pursuant to the 31 December 2009 Financial Report Review Engagement, the first defendant advised that its budgeted fee for undertaking the half-year review was \$55,000.00 plus GST, but that the actual cost might exceed that amount based on changes to the business or out-of-scope work.
- (ii) the second defendant was the lead auditor who carried out the review;
- (e) 30 June 2010 financial audit of the Fund:
 - (i) by letter dated 4 August 2010 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake an audit of the Fund's 30 June 2010

annual financial report (the **30 June 2010 Financial Report Audit Engagement**);

Particulars

- (A) Pursuant to the 30 June 2010 Financial Report Audit Engagement, the first defendant was to be paid the sum of \$100,000.00 plus GST for undertaking the financial audit.
- (ii) the second defendant was the lead auditor who carried out the audit;
- (f) 31 December 2010 financial review of the Fund:
 - (i) by letter dated 10 March 2011 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake a review of the Fund's 31 December 2010 half-year financial report (the **31 December 2010 Financial Report Review Engagement**);

Particulars

- (A) Pursuant to the 31 December 2010 Financial Report Review Engagement the first defendant advised the plaintiff that the first defendant would advise the plaintiff of the fees to be charged by the first defendant for undertaking the financial review once those fees were finalised.
- (ii) the second defendant was the lead auditor who carried out the review;
- (g) 30 June 2011 financial audit of the Fund:
 - (i) by letter dated 10 March 2011 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake an audit of the Fund's 30 June 2011 annual financial report (the **30 June 2011 Financial Report Audit Engagement**);

Particulars

- (A) Pursuant to the 30 June 2011 Financial Report Audit Engagement the first defendant advised the plaintiff that the first defendant would advise the plaintiff of the fees to be charged by the first defendant for undertaking the financial audit once those fees were finalised.
- (ii) the second defendant was the lead auditor who carried out the audit;

- (h) 31 December 2011 financial review of the Fund:
 - (i) by letter dated 21 December 2011 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake a review of the Fund's 31 December 2011 half-year financial report (the **31 December 2011 Financial Report Review Engagement**);

Particulars

- (A) Pursuant to the 31 December 2011 Financial Report Review Engagement the first defendant was to be paid the sum of \$70,000.00 plus GST for undertaking the financial review.
- (ii) the second defendant was the lead auditor who carried out the review;
- (i) 30 June 2012 financial audit of the Fund:
 - (i) by letter dated 21 December 2011 from the first defendant to the plaintiff, and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the second defendant, for consideration to undertake an audit of the Fund's 30 June 2012 annual financial report (the **30 June 2012 Financial Report Audit Engagement**);

Particulars

- (A) Pursuant to the 30 June 2012 Financial Report Audit Engagement the first defendant was to be paid the sum of \$100,000.00 plus GST for undertaking the financial audit.
- (ii) the second defendant was the lead auditor who carried out the audit.

31. The:

- (a) 30 June 2008 Financial Report Audit Engagement, the 30 June 2009 Financial Report Audit Engagement, the 30 June 2010 Financial Report Audit Engagement, the 30 June 2011 Financial Report Audit Engagement and the 30 June 2012 Financial Report Audit Engagement are together the **Financial Report Audit Engagements**; and
- (b) 31 December 2008 Financial Report Review Engagement, the 31 December 2009 Financial Report Review Engagement, the 31 December 2010 Financial Report Review Engagement and the 31 December 2011 Financial Report Review Engagement are together the **Financial Report Review Engagements**.

Compliance Plan Audits

32. At all material times, the first defendant and/or the third defendant were the auditor of the Compliance Plans of the Fund under section 601HG(1) of the Act.
33. In relation to the:
- (a) 30 June 2008 audit of the plaintiff's compliance with the Compliance Plans that were operative during that financial year:
 - (i) by letter dated on or about 31 May 2008 from the first defendant to the plaintiff and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the third defendant, for consideration to undertake an audit of the plaintiff's compliance with the Fund's compliance plan in accordance with section 601HG(1) of the Act (the 30 June 2008 Compliance Plan Audit Engagement); and

Particulars

- (A) Pursuant to the 30 June 2008 Compliance Plan Audit Engagement, the first defendant was to be paid the sum of \$15,750.00 plus GST for undertaking the compliance plan audit.
- (ii) the third defendant was the lead auditor who carried out the audit;
- (b) 30 June 2009 audit of the plaintiff's compliance with the Compliance Plans that were operative during that financial year:
 - (i) by letter dated 11 August 2009 from the first defendant to the plaintiff and signed by the plaintiff on 21 August 2009, the plaintiff engaged the first defendant, and/or alternatively the third defendant, for consideration to undertake an audit of the plaintiff's compliance with the Fund's compliance plan in accordance with section 601HG(1) of the Act (the 30 June 2009 Compliance Plan Audit Engagement); and

Particulars

- (A) Pursuant to the 30 June 2009 Compliance Plan Audit Engagement, the first defendant was to be paid the sum of \$15,750.00 plus GST for undertaking the compliance plan audit.
- (ii) the third defendant was the lead auditor who carried out the audit;

- (c) 30 June 2010 audit of the plaintiff's compliance with the Compliance Plans that were operative during that financial year:
 - (i) by letter dated 4 August 2010 from the first defendant to the plaintiff and signed by the plaintiff on 17 August 2010, the plaintiff engaged the first defendant, and/or alternatively the third defendant, for consideration to undertake an audit of the plaintiff's compliance with the Fund's compliance plan in accordance with section 601HG(1) of the Act (the 30 June 2010 Compliance Plan Audit Engagement); and

Particulars

- (A) Pursuant to the 30 June 2010 Compliance Plan Audit Engagement, the first defendant was to be paid the sum of \$15,750.00 plus GST for undertaking the compliance plan audit.
- (ii) the third defendant was the lead auditor who carried out the audit;
- (d) 30 June 2011 audit of the plaintiff's compliance with the Compliance Plans that were operative during that financial year:
 - (i) by letter dated 28 July 2011 from the first defendant to the plaintiff and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the third defendant, for consideration to undertake an audit of the plaintiff's compliance with the Fund's compliance plan in accordance with section 601HG(1) of the Act (the 30 June 2011 Compliance Plan Audit Engagement); and

Particulars

- (A) Pursuant to the 30 June 2011 Compliance Plan Audit Engagement, the first defendant was to be paid the sum of \$16,350.00 plus GST for undertaking the compliance plan audit.
- (ii) the third defendant was the lead auditor who carried out the audit;

- (e) 30 June 2012 audit of the plaintiff's compliance with the Compliance Plans that were operative during that financial year:
 - (i) by letter dated 21 December 2011 from the first defendant to the plaintiff and signed by the plaintiff, the plaintiff engaged the first defendant, and/or alternatively the third defendant, for consideration to undertake an audit of the plaintiff's compliance with the Fund's compliance plan in accordance with section 601HG(1) of the Act (the 30 June 2012 Compliance Plan Audit Engagement); and

Particulars

- (A) Pursuant to the 30 June 2012 Compliance Plan Audit Engagement, the first defendant was to be paid the sum of \$24,000.00 plus GST for undertaking the compliance plan audit.
- (ii) the third defendant was the lead auditor who carried out the audit.

(Together, the **Compliance Plan Audit Engagements**).

Auditors' Obligations and Duties

Financial Report Audit Obligations

- 34. The first defendant and/or the second defendant had responsibility as auditor pursuant to section 308 of the Act to report to Members:
 - (a) whether they were of the opinion that the Fund's annual financial reports gave a true and fair view of the financial position and performance of the Fund in accordance with section 297 of the Act;
 - (b) whether they were of the opinion that the Fund's annual financial reports complied with the Australian Accounting Standards and/or the Regulations in accordance with section 296 of the Act; and
 - (c) if they were not of either or both of those opinions, to say why.
- 35. The first defendant and/or the second defendant had responsibility as auditor pursuant to sections 309(4) and (5) of the Act to report to the Members:
 - (a) whether they became aware of any matter in the course of the review of the Fund's half-year financial report that made them believe that the half-year financial report did not give a true and fair view of the financial position and performance of the Fund in accordance with section 305 of the Act;
 - (b) whether they became aware of any matter in the course of the review of the Fund's half-year financial report that made them believe that the half-year financial report did not comply with the applicable Australian

Accounting Standards and/or the Regulations in accordance with section 304 of the Act; and

- (c) if they were of such a belief to say why.
36. In carrying out the Audits, the first defendant and/or the second defendant, had the following obligations:
- (a) pursuant to section 307(a) of the Act, to form an opinion about whether the Fund's annual financial reports were prepared in accordance with the Act, including section 296 of the Act (regarding compliance with the Australian Accounting Standards and the Regulations) and section 297 of the Act (regarding true and fair view);
 - (b) pursuant to section 307(b) of the Act, to form an opinion about whether all the information, explanations and assistance necessary for the conduct of the audits of the Fund's annual financial reports had been provided by the plaintiff to them;
 - (c) pursuant to section 307(c) of the Act, to form an opinion about whether the Fund had kept financial records sufficient to enable the Fund's annual financial reports to be prepared and audited;
 - (d) pursuant to section 307(d) of the Act, to form an opinion about whether the Fund had kept other records and registers as required by the Act;
 - (e) pursuant to section 308 of the Act, to prepare a report to Members in accordance with that section on whether the first defendant and/or the second defendant were of the opinion that the Fund's annual financial reports were in accordance with the Act, including sections 296 and 297;
 - (f) pursuant to section 307A of the Act, to conduct the audit of each annual financial report in accordance with the Australian Auditing Standards; and
 - (g) pursuant to section 311 of the Act, to notify ASIC in writing as soon as practicable, and in any case within 28 days, if they became aware of circumstances that they had reasonable grounds to suspect amounted to a contravention of the Act provided that:
 - (i) the contravention was a significant one; or
 - (ii) if the contravention was not a significant one, the first defendant and/or the second defendant believed that the contravention had not been or would not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the plaintiff's directors.

37. In carrying out the Reviews, the first defendant and/or the second defendant, had the following obligations:
- (a) pursuant to section 307A of the Act, to conduct the review of each half-year financial report in accordance with the Australian Auditing Standards;
 - (b) pursuant to section 309 of the Act, to prepare a report to Members in accordance with that section on whether the first defendant and/or the second defendant had become aware of any matter in the course of the reviews of the half-year financial reports that made them believe that the Fund's half-year financial reports did not comply with Division 2 of Part 2M.3 of the Act, including sections 304 and 305 of the Act;
 - (c) as the auditor of the Fund pursuant to section 311 of the Act, to notify ASIC in writing as soon as practicable, and in any case within 28 days, if they became aware of circumstances that they had reasonable grounds to suspect amounted to a contravention of the Act provided that:
 - (i) the contravention was a significant one; or
 - (ii) if the contravention was not a significant one, the first defendant and/or the second defendant believed that the contravention had not been or would not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the plaintiff's directors.
38. Pursuant to section 310 of the Act, the first defendant and/or the second defendant:
- (a) had a right of access at all reasonable times to the books of the Fund including without limitation:
 - (i) its management accounts;
 - (ii) its loan files in relation to the Mortgage Investments it held; and
 - (b) could require any officers of the plaintiff to give to them information, explanations or assistance for the purpose of conducting the Audits and/or Reviews.

Reliance by the plaintiff on the first and/or second defendants' performance of the Audits and Reviews

39. At all times material to this action the first and/or second defendants were aware, as was the case that:
- (a) the plaintiff, by its directors, relied upon the first and/or second defendants in the performance of the Audits and/or Reviews to inform it as to whether:
 - (i) the Fund's financial reports were prepared in accordance with the Act, including sections 296 and 304 of the Act (regarding

compliance with the Australian Accounting Standards and the Regulations) and sections 297 and 305 of the Act (regarding true and fair view);

- (ii) all the information, explanations and assistance necessary for the conduct of the Audits and Reviews had been provided by the plaintiff to them;
- (iii) the Fund had kept financial records sufficient to enable the Fund's financial reports to be prepared and audited;
- (iv) the Fund had kept other records and registers as required by the Act;
- (v) the first defendant and/or the second defendant were of the opinion that the Fund's annual financial reports were prepared in accordance with the Act, including sections 296 and 297 of the Act;
- (vi) the first defendant and/or the second defendant had become aware of any matter in the course of the Reviews of the half-year financial reports that made them believe that the Fund's half-year financial reports did not comply with Division 2 of Part 2M.3 of the Act, including sections 304 and 305 of the Act;
- (vii) there was any matter arising in the course of the Audits and Reviews which was required to be reported to the plaintiff, ASIC or the Members under the Act;

Particulars

- (A) Australian Auditing Standard ASA260 Communication of Audit Matters with Those Charged With Governance required the first and/or second defendants to communicate audit matters of governance interest arising from the Audits with those charged with governance of the Fund.
- (b) the plaintiff, by its directors, relied upon the first and/or second defendants in the performance of the Audits and Reviews to comply with their obligations under the Act;
- (c) the plaintiff, by its directors, would make its decisions as to the future conduct of the Fund, including whether or not to continue the Fund, wind it up or recover the outstanding loans and receivables in reliance on the first and/or second defendants:
 - (i) having conducted the Audits and Reviews in accordance with the obligations referred to in paragraphs 36 and 37 hereof;
 - (ii) identifying any matter or issue in the Fund's financial reports, which might be discovered by the exercise of reasonable care, diligence and skill to the standard of a reasonably competent

auditor in the course of the Audits or Reviews, which did not comply with the Act or the Australian Accounting Standards;

- (d) ASIC and the Members would rely upon the Audits and Reviews by the first and/or second defendants in determining whether to take action in relation to the Fund, including whether to take steps to cause the Fund to be wound up;

Particulars

- (i) If the first and/or second defendants qualified the Financial Statements Reports in a significant or material way, ASIC and/or the Members would have the opportunity to take steps to wind up the Fund or take other steps so as to prevent loss to the Fund occurring in the future;
- (ii) If a matter required to be reported to ASIC and/or the Members by the first and/or second defendants were so reported, ASIC and/or the Members would have the opportunity to wind up the Fund or take other steps so as to prevent loss to the Fund occurring in the future.

Compliance Plans Audit Obligations

40. Pursuant to section 601HG(3) of the Act, as the auditor of the Compliance Plans, the first defendant and/or the third defendant were obliged within three months of the end of a financial year to:

- (a) examine the Compliance Plans that were operative during the relevant financial year;
- (b) carry out an audit of the plaintiff's compliance with the Compliance Plans during the financial year; and
- (c) provide the plaintiff with a report stating whether in the first defendant's and/or the third defendant's opinion:
 - (i) the plaintiff complied with the Compliance Plans during the financial year; and
 - (ii) the relevant Compliance Plans continued to meet the requirements of Part 5C.4 of the Act.

41. ~~41A~~—The obligation imposed by section 601HG(3)(c) of the Act on the auditor of the Compliance Plans, properly construed, is to provide a report expressing an opinion that was reasonable based on the circumstances of which the auditor has become aware in the course of their examination and audit carried out in accordance with sections 601HG(3)(a) and (b) of the Act.

41.42. Pursuant to section 601HG(4) and/or section 601HG(4B) of the Act, in conducting an audit of the Compliance Plans, the first defendant and/or the third defendant, were required to notify ASIC in writing as soon as practicable, and in any case within 28 days, if they became aware of circumstances that

they had reasonable grounds to suspect amounted to a contravention of the Act provided that:

- (a) the contravention was a significant one; or
- (b) if the contravention was not a significant one, the first defendant and/or the third defendant believed that the contravention had not been or would not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the plaintiff's directors.

~~42-43.~~ Pursuant to sections 601HG(5) and (6) of the Act, the first defendant and/or the third defendant:

- (a) had a right of access at all reasonable times to the books of the Fund;
- (b) could require any officers of the plaintiff to give to them information, explanations or assistance for the purpose of conducting the Compliance Plan Audits.

Reliance by the plaintiff on the first and/or third defendants' performance of the Compliance Plan Audits

~~43-44.~~ At all material times to this action the first and/or third defendants were aware, as was the case that:

- (a) the plaintiff, by its directors, relied upon the first and/or third defendants to carry out the Compliance Plan Audits in accordance with the Act and the Constitutions;
- (b) the plaintiff, by its directors, relied upon the first and/or third defendants in the performance of the Compliance Plan Audits to inform it as to whether:
 - (i) the Compliance Plans met the requirements of Part 5C.4 of the Act;
 - (ii) the plaintiff had complied with the requirements of the Compliance Plans, the Constitutions and the Act;
 - (iii) in any year the plaintiff did not comply with the requirements of the Compliance Plans, the Constitutions and the Act;
- (c) the plaintiff, by its directors, relied upon the first and/or third defendants to obtain all information, explanation or assistance required for the purposes of carrying out the Compliance Plan Audits;
- (d) the plaintiff, by its directors, relied upon the first and/or third defendants having undertaken the Compliance Plan Audits in accordance with the requirements of the Act in making its decisions as to the future conduct of the Fund, including whether or not to continue the Fund, wind it up or recover the outstanding loans and receivables;

- (e) ASIC and/or the Members would rely upon the Compliance Plan Audits by the first and/or third defendants in determining whether to take action in relation to the Fund;

Particulars

- (i) If the first and/or third defendants identified a material inadequacy in the compliance measures and/or non-compliance by the plaintiff during or following the Compliance Plan Audits, ASIC and/or the Members would have the opportunity to take steps to wind up the Fund or take other steps so as to prevent loss to the Fund occurring in the future.

~~44.45.~~ The duties and responsibilities pleaded in paragraphs 34, 35, 36, 37 and 40 to ~~4244~~ of this Statement of Claim are herein described as the **Auditors' Statutory Duties**.

Common Law Duty of Care

~~45.46.~~ At all relevant times:

- (a) the second defendant held herself out as a registered company auditor with the necessary knowledge, skills and experience to carry out an audit or review of, and report on, the Fund's financial reports in accordance with sections 307, 307A, 308 and 309 of the Act by permitting her name to be entered in the register of auditors kept by ASIC pursuant to section 1285 of the Act;

Particulars

- (i) The second defendant held ASIC Registered Auditor Number: 303752.
- (b) the third defendant held himself out as a registered company auditor with the necessary knowledge, skills and experience to examine the Compliance Plans and carry out an audit of, and report upon, the plaintiff's compliance with the Compliance Plans in accordance with section 601HG(3) of the Act by permitting his name to be entered in the register of auditors kept by ASIC pursuant to section 1285 of the Act.

Particulars

- (i) The third defendant held ASIC Registered Auditor Number: 208047.

~~46.47.~~ At all material times:

- (a) the first defendant and/or the second defendant, voluntarily accepted their appointment and engagement as the Fund's auditors, and by doing so accepted a general professional responsibility to ensure that the tasks of carrying out an audit or review of, and reporting on, the Financial Statements were undertaken with reasonable care, diligence and skill to the standard of a reasonably competent auditor; and

- (b) the first defendant and/or the third defendant, voluntarily accepted their appointment and engagement as the Fund's compliance plan auditors and by doing so accepted a general professional responsibility to ensure that the tasks of examining the Compliance Plans, carrying out an audit of, and reporting on, the plaintiff's compliance with the Compliance Plans and whether the Compliance Plans continued to meet the requirements of Part 5C.4 of the Act, were undertaken with reasonable care, diligence and skill to the standard of a reasonably competent auditor.

47-48. At all material times:

- (a) the first defendant and/or the second defendant, had exclusive control over the carrying out of the Audits and Reviews and reporting upon the Fund's financial reports; and
- (b) the first defendant and/or the third defendant, had exclusive control over the examining of the Compliance Plans, the carrying out of the Compliance Plan Audits and reporting upon the plaintiff's compliance with the Compliance Plans and whether the Compliance Plans continued to meet the requirements of Part 5C.4 of the Act.

48-49. At all material times the first and/or second defendants were aware, as was the case, that it was reasonably foreseeable that if they did not exercise reasonable care, diligence and skill to the standard of a reasonably competent auditor in carrying out the Audits and Reviews and reporting on the Fund's financial reports:

- (a) errors or misstatements in the financial reports of the Fund would not be detected;
- (b) the failure to properly measure impairment on the loans and receivables of the Fund would result in a material misstatement of the value of those assets and the Fund;
- (c) the plaintiff would not realise assets of the Fund when it would otherwise have done so;
- (d) breaches of the Act or the Constitution would not be detected;
- (e) the plaintiff would continue to operate the Fund when the plaintiff, the Members or ASIC would otherwise have caused the Fund to be wound up;
- (f) the Fund would continue to incur costs, including management, administrative and holding costs, when it would not otherwise have done so; and
- (g) the plaintiff would suffer loss or damage.

49-50. At all material times the first and/or third defendants were aware, as was the case, that it was reasonably foreseeable that if they did not exercise reasonable care, diligence and skill to the standard of a reasonably competent auditor in

carrying out the Compliance Plan Audits and reporting on the plaintiff's compliance with the Compliance Plans and/or whether they continued to meet the requirements of Part 5C.4 of the Act:

- (a) the Compliance Plans would not provide sufficient and effective mechanisms or arrangements to prevent breaches of the Act or the Constitution by the plaintiff;
- (b) the protections provided for by the Compliance Plans would not be fully complied with;
- (c) breaches of the Act or the Constitution by the plaintiff would occur or continue to occur, when they would otherwise have been prevented or stopped;
- (d) the plaintiff would not realise assets of the Fund when it would otherwise have done so;
- (e) the plaintiff would continue to operate the Fund when the plaintiff, the Members or ASIC would otherwise have caused the Fund to be wound up;
- (f) the Fund would continue to incur costs, including management, administrative and holding costs, when it would not otherwise have done so; and
- (g) the plaintiff would suffer loss or damage.

50.51. The plaintiff was vulnerable in that it was unable to protect itself from the consequences of:

- (a) the first defendant and/or the second defendant not exercising reasonable care, diligence and skill to the standard of a reasonably competent auditor in carrying out the Audits and Reviews and reporting on the Fund's financial reports; and
- (b) the first defendant and/or the third defendant not exercising reasonable care, diligence and skill to the standard of a reasonably competent auditor in examining the Compliance Plans and carrying out the Compliance Plan Audits and reporting on the plaintiff's compliance with the Compliance Plans in accordance with section 601HG(3) of the Act.

~~51.52.~~ By reason of the matters pleaded in paragraphs 34 to ~~51~~50, the relationship between the plaintiff on the one hand and the first defendant and/or the second defendant and/or the third defendant was such that the first defendant and/or the second defendant and/or the third defendant owed to the plaintiff a duty to exercise reasonable care, diligence and skill to the standard of a reasonably competent auditor when:

- (a) conducting the Audits and Reviews;
- (b) examining the Fund's Compliance Plans, carrying out the Compliance Plan Audits and reporting thereon in accordance with section 601HG(3) of the Act;
- (c) identifying circumstances that ought to be reported to ASIC, and reporting thereon, in accordance with sections 601HG(4) or section 601HG(4B) of the Act; and
- (d) identifying circumstances that ought to have been reported to ASIC, and reporting thereon, in accordance with section 311 of the Act.

~~52.53.~~ The duties set out in paragraph ~~52~~51 are herein described as the **Auditors' Duty of Care.**

Contractual Duties

~~53.54.~~ At all material times:

- (a) it was an express term of the:
 - (i) 30 June 2008 Financial Report Audit Engagement, the 31 December 2008 Financial Report Review Engagement and the 30 June 2009 Financial Report Audit Engagement that the first defendant and/or second defendant would, inter alia:
 - (A) exercise due care, competence and diligence in performing the Audits and the Reviews;
 - (B) in respect of the Audits, report whether in their opinion the financial reports are properly drawn up:
 - i. in accordance with the provisions of the Act, including the requirement to give a true and fair view of the financial position of the Fund at the end of the financial year and of the performance (as represented by the results of operations and cash flows) of the Fund for the year ended on that date; and
 - ii. in accordance with the applicable Australian Accounting Standards and the Regulations;
 - (C) in respect of the Reviews, report whether they have become aware of any matter in the course of the Reviews

that makes the auditor believe that the financial report is not drawn up:

- i. in accordance with the provisions of the Act, including the requirement to give a true and fair view of the financial position of the Fund at (balance date) and of the performance (as represented by the results of operations and cash flows) of the Fund for the half year ended on that date; and
 - ii. complying with Australian Accounting Standard AASB134 "Interim Financial Reporting", and the Regulations;
- (ii) 31 December 2009 Financial Report Review Engagement, the 31 December 2010 Financial Report Review Engagement and the 31 December 2011 Financial Report Review Engagement that the first defendant and/or second defendant would, inter alia, conduct the Reviews in accordance with the Standard on Review Engagements 2410 Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity as promulgated by the Auditing and Assurance Standards Board in order to provide a basis for reporting and/or concluding whether anything had come to their attention that caused them to believe that the half-year financial report of the Fund was not prepared in all material respects, in accordance with Accounting Standard AASB134 Interim Financial Reporting and the Act;
- (iii) the 30 June 2010 Financial Report Audit Engagement, the 30 June 2011 Financial Report Audit Engagement and the 30 June 2012 Financial Report Audit Engagement that the first defendant and/or second defendant would, inter alia, conduct the Audits in accordance with the Australian Auditing Standards with the objective of the Audit to be to express an opinion on whether the financial reports give a true and fair view of the financial position and performance of the Fund in accordance with the Act, including complying with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the Regulations;

The plaintiff will rely upon the full terms and effect of the Financial Report Audit Engagements and the Financial Report Review Engagements at the trial of this action;

- (b) it was an express term of the:
- (i) Compliance Plan Audit Engagements that the first defendant and/or third defendant would, inter alia:
 - (A) in respect of the 30 June 2008 Compliance Plan Audit Engagement and the 30 June 2009 Compliance Plan

Audit Engagement, exercise due care, competence and diligence in performing the Compliance Plan Audits for each financial period ended 30 June 2008 and 30 June 2009;

- (B) in respect of the 30 June 2010 Compliance Plan Audit Engagement, the 30 June 2011 Compliance Plan Audit Engagement and the 30 June 2012 Compliance Plan Audit Engagement, perform the Compliance Plan Audits for each financial period ended 30 June 2010, 30 June 2011 and 30 June 2012 using reasonable care, diligence and skill to the standard of a reasonable competent auditor;
- (C) report whether, in their opinion:
 - i. the plaintiff has complied with the relevant Compliance Plans for the Fund in all material respects for each financial period ended 30 June 2008, 30 June 2009, 30 June 2010, 30 June 2011 and 30 June 2012; and
 - ii. the Compliance Plans continued to meet the requirements of Part 5C.4 of the Act as at those dates;

The plaintiff will rely upon the full terms and effect of the Compliance Plan Audit Engagements at the trial of this action;

- (c) further and/or in the alternative to paragraph (a) above, it was an implied term of the Financial Report Audit Engagements and the Financial Report Review Engagements that the first defendant and/or the second defendant would exercise the reasonable care, diligence and skill of a reasonably competent auditor in carrying out the Audits and Reviews and reporting on the financial reports; and

Particulars

The said terms to exercise reasonable care, diligence and skill were implied because they are either:

- (i) terms implied by law; or
- (ii) terms which are:
 - (A) reasonable and equitable;
 - (B) necessary to give business efficacy to the respective Audits and Reviews; and
 - (C) so obvious as to go without saying.

- (d) further and/or in the alternative to paragraph (b) above, it was an implied term of the Compliance Plan Audit Engagements that the first defendant and/or the third defendant would exercise the reasonable care, diligence and skill of a reasonably competent auditor in examining the Compliance Plans, carrying out the Compliance Plan Audits and reporting on the plaintiff's compliance with the Compliance Plans and whether the Compliance Plans continued to meet the requirements of the Act.

Particulars

The said terms to exercise reasonable care, diligence and skill were implied because they are either:

- (i) terms implied by law; or
- (ii) terms which are:
 - (A) reasonable and equitable;
 - (B) necessary to give business efficacy to the Compliance Plan Audits; and
 - (C) so obvious as to go without saying.

(Together, the **Auditors' Contractual Duty**).

Preparation of the Financial Statements, the Financial Statements Reports and the Directors' Declarations, and their provision to the Members and to ASIC

54.55. The plaintiff prepared the Fund's financial statements and the notes to the financial statements following the end of each of the following financial years and half-years:

- (a) the financial year ended 30 June 2008 (the **30 June 2008 Financial Statements**);
- (b) the half-year ended 31 December 2008 (the **31 December 2008 Financial Statements**);
- (c) the financial year ended 30 June 2009 (the **30 June 2009 Financial Statements**);
- (d) the half-year ended 31 December 2009 (the **31 December 2009 Financial Statements**);
- (e) the financial year ended 30 June 2010 (the **30 June 2010 Financial Statements**);
- (f) the half-year ended 31 December 2010 (the **31 December 2010 Financial Statements**);

- (g) the financial year ended 30 June 2011 (the **30 June 2011 Financial Statements**);
- (h) the half-year ended 31 December 2011 (the **31 December 2011 Financial Statements**); and
- (i) the financial year ended 30 June 2012 (the **30 June 2012 Financial Statements**).

(The financial statements and notes referred to in (a), (c), (e), (g) and (i) will hereinafter be referred to as the **30 June Financial Statements**; those referred to in (b), (d), (f) and (h) will be referred to as the **31 December Financial Statements**, and together they will be referred to as the **Financial Statements**).

55-56. Pursuant to the Financial Report Audit Engagements, the first defendant and/or the second defendant carried out an audit of the:

- (a) 30 June 2008 Financial Statements including the notes thereto (the **30 June 2008 Financial Statements Audit**);
- (b) 30 June 2009 Financial Statements including the notes thereto (the **30 June 2009 Financial Statements Audit**);
- (c) 30 June 2010 Financial Statements including the notes thereto (the **30 June 2010 Financial Statements Audit**);
- (d) 30 June 2011 Financial Statements including the notes thereto (the **30 June 2011 Financial Statements Audit**); and
- (e) 30 June 2012 Financial Statements including the notes thereto (the **30 June 2012 Financial Statements Audit**).

(Together, the **Audits**).

56-57. Pursuant to the Financial Report Review Engagements, the first defendant and/or the second defendant carried out a review of the:

- (a) 31 December 2008 Financial Statements including the notes thereto (the **31 December 2008 Financial Statements Review**);
- (b) 31 December 2009 Financial Statements including the notes thereto (the **31 December 2009 Financial Statements Review**);
- (c) 31 December 2010 Financial Statements including the notes thereto (the **31 December 2010 Financial Statements Review**); and
- (d) 31 December 2011 Financial Statements including the notes thereto (the **31 December 2011 Financial Statements Review**).

(Together, the **Reviews**).

57.58. On or about:

- (a) 10 March 2009, the first defendant and/or the second defendant provided to the plaintiff an audit report with respect to the 30 June 2008 Financial Statements Audit which was signed by the second defendant (**the 30 June 2008 Financial Statements Report**);
- (b) 16 June 2009, the first defendant and/or the second defendant provided to the plaintiff a review report with respect to the 31 December 2008 Financial Statements Review which was signed by the second defendant (**the 31 December 2008 Financial Statements Report**);
- (c) 30 September 2009, the first defendant and/or the second defendant provided to the plaintiff an audit report with respect to the 30 June 2009 Financial Statements Audit, which was signed by the second defendant (**the 30 June 2009 Financial Statements Report**);
- (d) 7 June 2010, the first defendant and/or the second defendant provided to the plaintiff a review report with respect to the 31 December 2009 Financial Statements Review which was signed by the second defendant (**the 31 December 2009 Financial Statements Report**);
- (e) 6 October 2010, the first defendant and/or the second defendant provided to the plaintiff an audit report with respect to the 30 June 2010 Financial Statements Audit which was signed by the second defendant (**the 30 June 2010 Financial Statements Report**);
- (f) 27 June 2011, the first defendant and/or the second defendant provided to the plaintiff a review report with respect to the 31 December 2010 Financial Statements Review which was signed by the second defendant (**the 31 December 2010 Financial Statements Report**);
- (g) 16 September 2011, the first defendant and/or the second defendant provided to the plaintiff an audit report with respect to the 30 June 2011 Financial Statements Audit which was signed by the second defendant (**the 30 June 2011 Financial Statements Report**);
- (h) 15 March 2012, the first defendant and/or the second defendant provided to the plaintiff a review report with respect to the 31 December 2011 Financial Statements Review which was signed by the second defendant (**the 31 December 2011 Financial Statements Report**); and
- (i) 16 November 2012, the first defendant and/or the second defendant provided to the plaintiff an audit report with respect to the 30 June 2012 Financial Statements Audit which was signed by the second defendant (**the 30 June 2012 Financial Statements Report**).

(Together, the **Financial Statements Reports**).

~~58-59.~~ By the Financial Statements Reports, the first defendant and/or the second defendant stated and represented to the plaintiff that:

- (a) in relation to the Audits, in their opinion the 30 June 2008 Financial Statements, the 30 June 2009 Financial Statements, the 30 June 2010 Financial Statements, the 30 June 2011 Financial Statements and the 30 June 2012 Financial Statements:
 - (i) gave a true and fair view of the financial position of the Fund, respectively, at 30 June 2008, 30 June 2009, 30 June 2010, 30 June 2011 and 30 June 2012 and of its performance for the financial years ended on those dates; and
 - (ii) complied with the Australian Accounting Standards and the Regulations;
- (b) in relation to the Audits:
 - (i) they had obtained sufficient and appropriate audit evidence to provide a basis for the Audit Representations; and
 - (ii) they had conducted the Audit in accordance with Australian Auditing Standards;
- (c) in relation to the Reviews, they had not become aware of any matter that made them believe the 31 December 2008 Financial Statements, the 31 December 2009 Financial Statements, the 31 December 2010 Financial Statements and the 31 December 2011 Financial Statements did not:
 - (i) give a true and fair view of the financial position of the Fund, respectively, at 31 December 2008, 31 December 2009, 31 December 2010 and 31 December 2011 and of its performance for the half-years ended on those dates; and
 - (ii) comply with Australian Accounting Standard AASB 134 Interim Financial Reporting and the Regulations;
- (d) in relation to the Reviews, they had conducted the Review in accordance with Auditing Standard on Review Engagements ASRE2410 *Review of Interim and other Financial Reports Performed by the Independent Auditor of the Entity*.

(Together, the **Audit Representations**).

~~59-60.~~ The first defendant and/or the second defendant further represented to the plaintiff that:

- (a) they had exercised reasonable care, diligence and skill to the standard of a reasonably competent auditor in undertaking the Audits and Reviews and in making the Audit Representations in the Financial Statements Reports;

- (b) they had a reasonable basis for making the Audit Representations in the Financial Statements Reports; and
- (c) in relation to the Reviews, they had conducted the Reviews in accordance with the applicable Australian Auditing Standard, namely Australian Auditing Standard on Review Engagements ASRE2410.

(Together, the **Further Audit Representations**).

Particulars

- (i) The Further Audit Representations were implied from the conduct of the first defendant and/or the second defendant in making the Financial Statements Reports coupled with the absence of any, or any adequate relevant, reservations qualifying the Audit Representations.

~~60-61.~~ In relation to each of the Financial Statements, and in reliance on the matters referred to in paragraphs ~~5655~~ and ~~5756~~ hereof, the directors of the plaintiff provided a declaration (**Directors' Declaration**) stating that in their opinion the Financial Statements:

- (a) in the case of the 30 June Financial Statements:
 - (i) gave a true and fair view of the Fund's financial position and of its performance as at 30 June, as represented by the results of its operations and its cash flows, for the financial year ended on that date; and
 - (ii) complied with the Australian Accounting Standards and the Regulations; or
- (b) in the case of the 31 December Financial Statements:
 - (i) gave a true and fair view of the Fund's financial position as at 31 December and of its performance, as represented by the results of its operations and its cash flows, for the half-year ended on that date; and
 - (ii) complied with Australian Accounting Standard AASB 134. Interim Financial Reporting and the Regulations and other mandatory professional reporting requirements.

~~61-62.~~ Following the provision of each of the Financial Statements Reports and the making of the Directors' Declarations as pleaded in paragraphs ~~5857~~ and ~~6160~~ above, the plaintiff lodged the Financial Statements, the Financial Statements Report and the Directors' Declaration with ASIC.

~~62-63.~~ Following the provision of at least each of the 30 June Financial Statements and the 31 December 2009 Financial Statements, the plaintiff made available to Members copies of the Financial Statements, the Financial Statements Report and the Directors' Declaration.

The deficiencies in the Financial Statements

63.64. In relation to each of the Financial Statements:

- (a) the plaintiff in preparing the Financial Statements, and contrary to the requirements of the Australian Accounting Standard AASB 139 Financial Instruments: Recognition and Measurement (**AASB 139**), in many cases did not identify Mortgage Investments as impaired where there was objective evidence of impairment;

Particulars

- (i) The Mortgage Investments which were impaired but which were not properly recorded as such on a timely basis included but were not limited to the Northshore Bayview St Pty Ltd loan, the Eden Apartments Pty Ltd loan, the Bezzina Developers Pty Ltd loan, the Source Student Lodge Pty Ltd loan, the St Crispin's Property Pty Ltd loan, the Townsville Commercial Pty Ltd loan, the OVST Pty Ltd loan, the Bridgewater Lake Estate Pty Ltd loan, the Bellpac Pty Ltd loan, the Young Land Corporation Pty Ltd (Yeppoon) loan, the Carrington Management Pty Ltd (Caboolture) loan and the Greystanes Projects Pty Ltd loan.
- (ii) The objective evidence of impairment included:
 - (A) the economic consequences of the global financial crisis, including the significant uncertainty in the credit and property markets, and the general decline in the general property market, from late 2007;
 - (B) the high exposure of the Fund to property development loans;
 - (C) the sale by the plaintiff of real property assets securing Mortgage Investments for materially less than had been previously estimated by the plaintiff; and
 - (D) the decline in the fair value of a significant number of the real property security assets securing loans and receivables made by the plaintiff on behalf of the Fund.
- (b) the plaintiff, in a significant number of cases when identifying or calculating impairment, and contrary to the requirements of AASB 139:
 - (i) did not use up to date and relevant valuations of the underlying real property securities, in circumstances where there was objective evidence that the relevant market had changed from the date of the existing valuation on file;

- (ii) utilised instead estimates of value determined by LM Administration, or by the plaintiff (following the review and input of the first defendant and/or the second defendant during the audit or review process), in circumstances where:
 - (A) the estimates of value provided did not have a reasonable basis;
 - (B) the persons making the estimates for LM Administration were not qualified to determine such values;
 - (C) the Compliance Plans required valuations to be obtained from independent valuers; and
 - (D) it was not properly able to assess management bias;
- (iii) in their calculations of impairment, applied valuations or estimates of value to circumstances which were beyond the scope of the assumptions and qualifications thereto;
- (c) further to sub-paragraph (b), in many cases when calculating impairment for the purpose of ascribing a value to the Mortgage Investments, and also contrary to the requirements of AASB 139, the plaintiff did not:
 - (i) discount the estimated future cash flows to present value;
 - (ii) properly estimate the amount and timing of estimated future cashflows; and
 - (iii) take into account the cost of holding and realising real property securities underlying those loans;
- (d) in the premises, the Financial Statements materially overstated the value of the Mortgage Investments held by the Fund, and materially understated the impairment expenses nominally incurred by the Fund;
- (e) in the premises, the accounts of the Fund had not been prepared in accordance with AASB 139; and
- (f) in the premises, proper and adequate allowances for impairment losses on loans and receivables had not been made in accordance with AASB 139.

64.65. By reason of the matters referred to in paragraph 64.63 above, the Financial Statements:

- (a) did not give a true and fair view, in all material respects, of the financial position of the Fund as at, respectively:
 - (i) 30 June 2008 and its financial performance for the year ended 30 June 2008;

- (ii) 31 December 2008 and its financial performance for the half-year ended 31 December 2008;
- (iii) 30 June 2009 and its financial performance for the year ended 30 June 2009;
- (iv) 31 December 2009 and its financial performance for the half-year ended 31 December 2009;
- (v) 30 June 2010 and its financial performance for the year ended 30 June 2010;
- (vi) 31 December 2010 and its financial performance for the half-year ended 31 December 2010;
- (vii) 30 June 2011 and its financial performance for the year ended 30 June 2011;
- (viii) 31 December 2011 and its financial performance for the half-year ended 31 December 2011; and
- (ix) 30 June 2012 and its financial performance for the year ended 30 June 2012;

(b) did not comply with the Australian Accounting Standards.

Claims relating to the Audits and Reviews

Breaches with respect to the Audits and Reviews

~~65-66.~~ The Australian Auditing Standards included at material times the following:

- (a) Australian Auditing Standard ASA200 Objective and General Principles Governing an Audit of a Financial Report or other equivalent pronouncements (**ASA200**);
- (b) Australian Auditing Standard ASA220 Quality Control for Audits of Historical Financial Information or other equivalent pronouncements (**ASA220**);
- (c) Australian Auditing Standard ASA240 The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report or other equivalent pronouncements (**ASA240**);
- (d) Australian Auditing Standard ASA250 Consideration of Laws and Regulations in an audit of a Financial Report or other equivalent pronouncements (**ASA250**);
- (e) Australian Auditing Standard ASA260 Communication of Audit Matters with Those Charged With Governance or other equivalent pronouncements (**ASA260**);

- (f) Australian Auditing Standard ASA300 Planning an Audit of a Financial Report or other equivalent pronouncements (**ASA300**);
- (g) Australian Auditing Standard ASA315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement or other equivalent pronouncements (**ASA315**);
- (h) Australian Auditing Standard ASA330 The Auditor's Procedures in Response to Assessed Risks or other equivalent pronouncements (**ASA330**);
- (i) Australian Auditing Standard ASA450 Evaluation of Misstatements Identified during the Audit or other equivalent pronouncements (**ASA450**);
- (j) Australian Auditing Standard ASA500 Audit Evidence or other equivalent pronouncements (**ASA500**);
- (k) Australian Auditing Standard ASA540 Audit of Accounting Estimates or other equivalent pronouncements (**ASA540**);
- (l) Australian Auditing Standard ASA620 Using the Work of an Expert or other equivalent pronouncements (**ASA620**);
- (m) Australian Auditing Standard ASA700 The Auditor's Report on a General Purpose Financial Report or other equivalent pronouncements (**ASA700**);
- (n) Australian Auditing Standard ASA701 Modifications to the Auditor's Reports or other equivalent pronouncements (**ASA701**);
- (o) Australian Auditing Standard on Review Engagements ASRE2410 Review of an Interim Financial Report Performed by the Independent Auditor of the Entity or other equivalent pronouncements (**ASRE2410**).

~~66:67.~~ In breach of the Auditors' Duty of Care and the Auditors' Contractual Duty, the first defendant and/or the second defendant:

- (a) failed to exercise reasonable care, diligence and skill to the standard of a reasonably competent auditor in carrying out the Audits and Reviews by:
 - (i) failing to take adequate account of the fact that the proper impairment of loans and receivables required special consideration because of the economic consequences of the global financial crisis as well as the Fund's high exposure to property development loans which the plaintiff had made;
 - (ii) failing to take reasonable care to determine whether the identification of impairment and the recording by the Fund of impairment losses in relation to its loans and receivables:
 - (A) was materially accurate;

- (B) was in accordance with paragraphs 58, 59, 63 and AG84 of AASB 139;

Particulars

The first defendant and/or second defendant failed to take reasonable care to determine that the plaintiff properly measured the level of impairment losses on the Fund's loans and receivables on a timely basis, including but not limited to the Northshore Bayview St Pty Ltd loan, the Eden Apartments Pty Ltd loan, the Bezzina Developers Pty Ltd loan, the Source Student Lodge Pty Ltd loan, the St Crispin's Property Pty Ltd loan, the Townsville Commercial Pty Ltd loan, the OVST Pty Ltd loan, the Bridgewater Lake Estate Pty Ltd loan, the Bellpac Pty Ltd loan, the Young Land Corporation Pty Ltd (Yeppoon) loan, the Carrington Management Pty Ltd (Caboolture) loan and the Greystanes Projects Pty Ltd loan;

- (iii) failing to take reasonable care to test the robustness of the plaintiff's process for measuring impairment, including by failing to critically consider:
- (A) the plaintiff's systems and processes for identifying impairment and conducting the impairment calculation, and whether there was any material weakness in the plaintiffs' internal control structures in relation thereto;
 - (B) the credentials of the persons who had performed the estimates of value upon which the plaintiff was relying;
 - (C) the credentials of the persons identifying impairment and performing the impairment calculation for the plaintiff, and whether they had sought appropriate advice in performing those roles;
- (iv) failing to take reasonable care to ensure that the accounting policy and significant judgments, estimates and assumptions reported or adopted by the plaintiff in the Financial Statements for making allowance for impairment losses on loans and receivables properly and accurately reflected the accounting policy and significant judgments and estimates in fact used by the plaintiff in preparing the Financial Statements, in accordance with AASB 101 (for the 30 June Financial Statements) or AASB134 (for the 31 December Financial Statements);

- (v) failing to take reasonable care in accordance with ASA620 (for Audits) and ASRE2410 (for Reviews) to determine whether the valuations used for the purposes of ascertaining the underlying value of real property securities supporting the loans and receivables held by the Fund:
 - (A) were up to date and relevant, taking into account any changes in the relevant market from the date of the existing valuation on file; and/or
 - (B) were appropriate to the nature of the property and the strategy adopted by the plaintiff in relation to its realisation;
- (vi) failing to use staff who were sufficiently familiar with and experienced in the application of AASB139 to loans and receivables of the type held by the Fund, as required by ASA220 (for Audits) and ASRE2410 (for Reviews);
- (vii) failing for the purposes of the Audits or the Reviews to undertake appropriate technical consultations until 7 November 2012 in relation to the identification of the manner in which the measurement of impairment losses on the Fund's loans and receivables should be undertaken, including as required by ASA220;
- (viii) (in relation to the Audits) failing to obtain sufficient appropriate audit evidence in relation to the values of the securities for, and the accounting estimates made in relation to the impairment of, the Fund's loans and receivables at the relevant dates as required by the ASA500, ASA540 and ASA220;
- (ix) failing to undertake any adequate review of the work of persons who were carrying out the Audits and Reviews as required, including by ASA220;
- (x) failing to exercise professional scepticism with respect to the matters and materials which were provided to them for the purposes of conducting the Audits and Reviews, as required by ASA200 (for Audits) and ASRE 2410 (for Reviews);
- (xi) following significant changes in, or outcomes significantly different to, accounting estimates from a prior period, including in particular accounting estimates relating to impairment losses of the Fund's loans and receivables, failing adequately to:
 - (A) review the outcome or the re-estimation of the estimates used for the prior period financial report, to identify and assess any risk of material misstatement of accounting estimates made in the current period financial report (including due to possible management bias), and thereby also obtain audit evidence pertinent to the re-

estimation of prior period accounting estimates in the current period financial report, and of matters that had not been but were required to be recognised and disclosed in the current period financial report, including misstatements in the prior periods financial reports, including as required by ASA540;

- (B) review management judgements and assumptions related to those estimates used for the financial report of the prior year for biases, or to evaluate whether the circumstances producing the bias represent a risk of material misstatement, including as required by ASA240;
- (C) (in relation to the Audits) obtain a high level of assurance that there were no material prior period errors in relation to those estimates, which had not been properly recognised and disclosed in the current period financial report;
- (D) (in relation to the Audits) obtain a high level of assurance that the level of impairment of all impaired loans and receivables had been properly assessed and recognised in accordance with AASB139 in the current period financial report,

and to report any significant or adverse findings to management and/or those charged with governance in accordance with the requirements of ASA260 and ASA450, or ASRE2410 (as applicable);

Particulars

- (A) There were significant impairments first identified in the 31 December 2010 Financial Statements, amongst other things the most significant contribution to which was management's adjusted valuations of underlying real property securities based on sales of securities for materially less than the valuations previously relied upon by the plaintiff.
- (B) Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.
- (xii) failing to design audit procedures to adequately address the risks of material misstatement relating to the loans and receivables of the Fund as required by ASA315, ASA330 and ASA540 (for Audits) and ASRE2410 (for Reviews);
- (xiii) failing to adequately consider as required by Australian Auditing Standard ASA250:
 - (A) whether the payments made by the Fund to the plaintiff as fees and/or expenses were correctly payable and in

accordance with the requirements of the Act and the Constitutions; and/or

- (B) whether the distributions and/or redemptions paid to Class B unitholders of the Fund were correctly payable and in accordance with the requirements of the Act and the Constitutions.
- (b) in carrying out the Audits and Reviews, failed to report to those charged with governance of the plaintiff significant matters of which they were or became aware in carrying out the Audits and Reviews, as required by ASA260 and ASA 450 (in the case of the Audits) and ASRE2410 (in the case of the Reviews);

Particulars

- (i) The matters of which they were aware include those pleaded in paragraphs 159(a)145(a) to 159(g)145(g) and 168(a)154(a) to 168(e)154(e) below.
- (ii) Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.
- (c) failed to report properly to those charged with governance of the plaintiff that, because of the matters referred to in sub-paragraph (b) above of which they were or became aware, changes were required to, or additional information was necessary to be included in, the Financial Statements to give a true and fair view of the Fund's financial position;
- (d) in providing the Financial Statements Reports, failed in accordance with sections 308 and 309 of the Act to report to Members by the issue of a qualified audit opinion or review conclusion:
 - (i) any of the matters referred to in sub-paragraph (b) and (c) above;
 - (ii) that they had not and/or had been unable to obtain sufficient appropriate audit evidence including as to the valuation of the underlying security properties at the relevant dates; and
 - (iii) that additional information was necessary to be included in the Financial Statements to give a true and fair view of the Fund's financial position;

Particulars

- (A) Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.
- (e) in carrying out the Audits and Reviews, failed to report to ASIC in accordance with section 311 of the Act circumstances of which they were or became aware in carrying out the Audits and Reviews that they

had reasonable grounds to suspect amounted to a significant contravention of the Act.

Particulars

- (i) In the premises of the matters set out in paragraphs ~~159(a)~~~~145(a)~~ to ~~159(g)~~~~145(g)~~ and ~~168(a)~~~~154(a)~~ to ~~168(e)~~~~154(e)~~ below, that contrary to the requirements of section 296 and 304 of the Act the Financial Statements were not prepared in accordance with the requirements of Australian Accounting Standards, in particular AASB 139;
- (ii) Further particulars will be provided upon completion of interlocutory steps.

Misleading and Deceptive Conduct with respect to the Audits and Reviews

~~67-68.~~ The second defendant is and was at all material times a:

- (a) person for the purposes of section 18 of the Australian Consumer Law (Queensland), applying pursuant to section 16 of the *Fair Trading Act 1989* (Qld) and as in force on and from 1 January 2011 (**ACL (Qld)**);
- (b) person for the purposes of section 1041H and 1041I of the Act;
- (c) person for the purposes of section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**);
- (d) person within the meaning of section 6(2)(h) and section 6(3) of the *Trade Practices Act 1952* (Cth) (**TPA**), as in force until 1 January 2011, which sections give the TPA extended application to the conduct of persons in certain circumstances for the purposes of section 52 of the TPA; and
- (e) person within the meaning of section 6(2)(h) and section 6(3) of the *Competition and Consumer Act 2010* (Cth) (**CCA**), as in force on and from 1 January 2011, which sections give the CCA extended application to the conduct of persons in certain circumstances for the purposes of section 131 of the CCA, which gives force including to section 18 of the Australian Consumer Law in Schedule 2 of the CCA (**ACL**).

~~68-69.~~ The first defendant, by itself and/or through the second defendant, by conducting the Audits and Reviews and preparing and completing the Financial Statements Reports pursuant to the Financial Report Audit Engagements and the Financial Report Review Engagements:

- (a) provided services in trade or commerce to the plaintiff within the meaning of section 52 of the TPA as in force until 1 January 2011, and of section 18 of the ACL (Qld) and section 18 of the ACL as in force thereon and after;

- (b) provided services to the plaintiff in trade or commerce among the States, within the meaning of section 6(2)(a) of the TPA and section 6(2)(a) of the CCA;
- (c) in the alternative, provided services using postal, telegraphic and telephonic services within the meaning of section 6(3) of the TPA and section 6(3) of the CCA; and

Particulars

- (i) Further particulars will be provided upon completion of interlocutory steps.
- (d) provided auditing services in relation to a financial product (being the units in the Fund) within the meaning of Part 7.10 Division 2 of the Act and Part 2, Division 2, Subdivision D of the ASIC Act.

69-70. In the premises of the matters set out in paragraphs 6463 to 6766 above, the Audit Representations and the Further Audit Representations were false in that at the time of making each of the Financial Statements Reports:

- (a) the first defendant and/or the second defendant had not exercised reasonable care, diligence and skill to the standard of a reasonably competent auditor in undertaking the Audits and Reviews;
- (b) the first and/or second defendant had not exercised reasonable care, diligence and skill to the standard of a reasonably competent auditor in making the Audit Representations and the Further Audit Representations;
- (c) the first and/or second defendant had not obtained sufficient and appropriate audit evidence to provide a basis for the Audit Representations;
- (d) the first and/or second defendant had not conducted the Audits and Reviews in accordance with the Australian Auditing Standards; and
- (e) the first defendant and/or the second defendant did not have a reasonable basis for making the Audit Representations.

70-71. In making the Audit Representations and/or the Further Audit Representations, the first defendant and/or the second defendant engaged in misleading and deceptive conduct or conduct which was likely to mislead or deceive, contrary to:

- (a) in relation to the Audit Representations and/or Further Audit Representations made in the course of the 31 December 2010 Financial Report Review Engagement, the 30 June 2011 Financial Report Audit Engagement, the 31 December 2011 Financial Report Review Engagement and the 30 June 2012 Financial Report Audit Engagement, section 18 of the ACL (Qld);
- (b) section 1041H and section 1041I of the Act;

- (c) section 12DA of the ASIC Act;
- (d) in relation to the Audit Representations and/or Further Audit Representations made in the course of the 30 June 2008 Financial Report Audit Engagement, the 31 December 2008 Financial Report Review Engagement, the 30 June 2009 Financial Report Audit Engagement, the 31 December 2009 Financial Report Review Engagement and the 30 June 2010 Financial Report Audit Engagement, section 52 of the TPA; and
- (e) in relation to Audit Representations and/or Further Audit Representations made in the course of the 31 December 2010 Financial Report Review Engagement, the 30 June 2011 Financial Report Audit Engagement, the 31 December 2011 Financial Report Review Engagement and the 30 June 2012 Financial Report Audit Engagement, section 18 of the ACL,

(the Financial Auditors' Misleading Conduct).

Reliance

71-72. At all material times until the Fund was wound up, the plaintiff relied on each of the Audit Representations and the Further Audit Representations in continuing to operate and to not either wind up or otherwise make significant changes to its management of the Fund.

The consequences of the first and/or second defendants' negligence, breach of contract and misleading or deceptive conduct

72-73. Had the first defendant and/or the second defendant not breached the Auditors' Duty of Care and the Auditors' Contractual Duties in the conduct of the Audits and Reviews:

- (a) the first defendant and/or the second defendant would have become aware of the following significant matters:
 - (i) the matters referred to in paragraphs 6463 and 6564 above;
 - (ii) from and including the 31 December 2008 Financial Statements, the existence of material prior period errors in the failure in previous Financial Statements to recognise or properly calculate levels of impairment;
 - (iii) that the plaintiff was pre-paying management fees and other expenses to itself and LM Administration in breach of the Act and the Constitution, as pleaded in 7978 to 8382 below;
 - (iv) that the plaintiff was paying loan management fees to itself and/or LM Administration in breach of the Act and the Constitution, as pleaded in paragraphs 8483 to 9796 below;
 - (v) that the distributions and/or redemptions paid to Class B unitholders of the Fund were made otherwise than in accordance

with the Act and the Constitutions, as pleaded in paragraphs ~~9897~~ to ~~105412~~ below;

- (b) the first defendant and/or the second defendant would have reported the matters referred to in paragraphs ~~67(b)66(b)~~ and ~~67(c)66(c)~~ and sub-paragraph (a) above to those charged with governance of the plaintiff, as required by ASA260 and ASA 450 (in the case of the Audits) and ASRE2410 (in the case of the Reviews);
- (c) further and in the alternative, the first defendant and/or the second defendant would have done any one or more of the following:
 - (i) provided to the plaintiff a qualified audit or review report identifying the matters referred to in sub-paragraph (b) above;
 - (ii) if necessary, notified ASIC of those matters in compliance with section 311 of the Act;
- (d) further and in the alternative, the first defendant and/or the second defendant would have provided to the plaintiff a qualified audit or review report identifying the matters referred to in paragraph ~~67(d)66(d)~~ hereof;
- (e) further to sub-paragraph (a) above, the first defendant and/or the second defendant would have become aware of the following circumstances that they would have had reasonable grounds to suspect amounted to significant contraventions of the Act:
 - (i) that contrary to the requirements of sections 296 and 304 of the Act, the Financial Statements had not been prepared in accordance with the requirements of Australian Accounting Standards, in particular AASB 139;
 - (ii) that contrary to the requirements of sections 297 and 305 of the Act, the Financial Statements did not give a true and fair view of the financial position and performance of the Fund;
 - (iii) that contrary to the requirements of the Act and the Constitutions, the plaintiff continued to pay distributions and redemptions to Class B unitholders of the Fund, as pleaded in paragraphs ~~9897~~ to ~~105412~~ below;
 - (iv) that contrary to the requirements of the Act and the Constitutions, the plaintiff continued to prepay management fees and to pay loan management fees from the Fund, as pleaded in paragraphs ~~7978~~ to ~~9796~~ below;
- (f) the first defendant and/or the second defendant would have notified ASIC of the matters referred to in paragraph ~~67(e)66(e)~~ and sub-paragraph (e) above in accordance with section 311 of the Act.
- ~~(g) upon notification to ASIC of any of the matters referred to in paragraphs ~~66(b)~~, ~~66(c)~~ and ~~66(e)~~ and sub-paragraphs (a) and (e)~~

~~hereof, ASIC would have been aware of, or by carrying out its own further investigations become aware of, all of those matters as well as the matters referred to in paragraphs 118 to 120 hereof;~~

~~(h)~~(g) the plaintiff would have voluntarily or have been required to take steps to:

- (i) properly recognise and calculate impairment of the Mortgage Investments of the Fund, including by obtaining up to date and relevant valuations of the real property assets securing them;
- (ii) realise Mortgage Investments (in a fashion and at times substantially the same as that as upon a winding up as set out at paragraph ~~76(h)~~75(h) below);
- (iii) stop the pre-payment of management fees and other expenses to itself and LM Administration;
- (iv) stop the payment of loan management fees to itself and/or LM Administration;
- (v) stop the payment of redemptions to Class B unitholders after 11 May 2009;
- (vi) stop the recognition of distributions to Class B unitholders after 1 January 2011;

~~(i)~~(h) further and in the alternative, in relation to the breaches referred to in paragraph ~~67~~66 above arising from the Audits and Reviews from and including the 31 December 2008 Financial Statements Review, those authorised to commence legal proceedings on behalf of the plaintiff would, having become aware of the omissions and misstatements referred to in paragraph ~~64~~63 above in each of the prior Financial Statements, thereafter have:

- (i) become aware of the prior breaches and the prior contraventions committed by the first defendant and/or second defendant in their conduct of prior Audits and Reviews and their preparation of the prior Financial Statement Reports, as pleaded in this Statement of Claim; and
- (ii) promptly commenced legal proceedings and recovered the damages caused by such breaches and the losses suffered by or because of such contraventions, plus interest and costs, as pleaded in this Statement of Claim.

~~73-74.~~ Further, but for the Financial Auditors' Misleading Conduct:

- (a) the first defendant and/or the second defendant would not have provided the Financial Statements Reports;

- (b) the first defendant and/or the second defendant would promptly have completed the Audits and Reviews in compliance with the Australian Auditing Standards and the Act;
- (c) the matters set out in paragraphs 73(a)72(a) to 73(h)72(i) above would have occurred.

74.75. Further to each of paragraphs 7372 and 7473 above:

- (a) the management of the plaintiff, ASIC and/or the Members would promptly have caused the Fund to be wound up;

Particulars

- (i) ASIC would have so caused the Fund to be wound up by applying to the Court under section 601ND(2)(d) of the Act for the necessary relief, on the just and equitable ground.
 - (ii) The management of the plaintiff would have so caused the Fund to be wound up by causing the plaintiff to take the necessary steps to do so under section 601NC(1), on the basis that the purpose of the Fund cannot be accomplished.
 - (iii) Alternatively, the management of the plaintiff would have caused the Fund to be wound up by causing the plaintiff to apply to the Court under section 601ND(2)(a) of the Act, or by one of the directors of the plaintiff applying to the Court under section 601ND(2)(b) of the Act, for the necessary relief on the just and equitable ground.
 - (iv) The Members would have so caused the Fund to be wound up either calling a members' meeting to consider and vote on an extraordinary resolution directing the RE to wind up the fund under section 601NB of the Act, by one or more of them applying to the Court under section 601ND(2)(c) of the Act for the necessary relief on the just and equitable ground, or by Members in sufficient number making withdrawal requests from the Fund such that the plaintiff or ASIC would in turn have taken steps to cause it to be wound up.
 - (v) ASIC, the plaintiff and/or the Members would thereby have caused the winding up of the Fund to be commenced within around three months of becoming so aware of the matters pleaded.
- (b) in the alternative, the creditors of the Feeder Funds would have caused the Fund to be wound up.

Particulars

- (i) Upon the plaintiff ceasing to pay redemptions to the Class B Unitholders, the Feeder Funds would have been unable to indemnify LMIM for its liabilities including to pay fees to LM

Administration and (in the case of the Currency Fund and the Institutional Fund) under foreign exchange derivative contracts.

- (ii) One or more of the external creditors of the Feeder Funds ~~Currency Fund and the Institutional Fund~~ would have taken steps to cause the assets of those Feeder Funds to be realised so as to recover their debt or debts, and either:
 - (A) if secured, appointed a receiver over their assets, who would in turn have caused the RE to take steps as a Member to cause the Fund to be wound up; or
 - (B) applied to the Court as a creditor of the Feeder Fund for orders that it be wound up on the just and equitable ground, following which the person or persons responsible for the winding up would have caused the plaintiff as RE of the Feeder Fund to take steps as a Member to cause the Fund to be wound up.

Loss and Damage flowing from breaches and contraventions relating to the Financial Statements Audits and Reviews

~~75.76.~~ Following the commencement of any winding up of the Fund, as referred to in paragraphs ~~75(a)74(a)~~ and ~~75(b)74(b)~~ above:

- (a) the plaintiff would not have paid or directed others on its behalf to pay money to Class B unitholders for the purposes of redeeming units from those unit holders;

Particulars

The plaintiff paid or directed others to pay on its behalf money to Class B unitholders for the redemption of units in the following amounts, reported in the financial records of the Fund and/or the Financial Statements:

- (i) in the half year ended 31 December 2009, approximately \$12,889,000;
- (ii) in the half year ended 30 June 2010, approximately \$10,323,000;
- (iii) in the half year ended 31 December 2010, approximately \$14,286,000;
- (iv) in the half year ended 30 June 2011, approximately \$9,324,000;
- (v) in the half year ended 31 December 2011, approximately \$2,172,000;
- (vi) in the half year ended 30 June 2012, approximately \$2,325,000;

- (vii) in the half year ended 31 December 2012, approximately \$2,362,000;
 - (viii) in the half year ended 30 June 2013 up to 31 January 2013, approximately \$25,000.
- (b) the plaintiff would not have accepted investments in the Fund by Class B unitholders;

Particulars

The plaintiff received money from or on behalf of Class B unitholders for the investment of units in the following amounts, reported in the financial records of the Fund and/or the Financial Statements:

- (i) in the half year ended 31 December 2009, approximately \$50,000;
 - (ii) in the half year ended 30 June 2010, approximately \$2,314,000;
 - (iii) in the half year ended 31 December 2010, approximately \$70,000;
 - (iv) in the half year ended 30 June 2011, approximately \$35,000;
 - (v) in the half year ended 31 December 2011, approximately \$2,651,000;
 - (vi) in the half year ended 30 June 2012, approximately \$353,000;
 - (vii) in the half year ended 31 December 2012, approximately \$12,000.
- (c) the plaintiff would not have paid money to Class A or Class C unitholders for the purposes of redeeming units from those unit holders;

Particulars

The plaintiff paid money to Class A and C unitholders for the redemption of units in the following amounts, reported in the financial records of the Fund and/or the Financial Statements:

- (i) in the half year ended 31 December 2009, approximately \$1,909,000;
- (ii) in the half year ended 30 June 2010, approximately \$949,000;
- (iii) in the half year ended 31 December 2010, approximately \$245,000;
- (iv) in the half year ended 30 June 2011, approximately \$330,000;
- (v) in the half year ended 31 December 2011, approximately \$1,662,000;

- (vi) in the half year ended 30 June 2012, approximately \$458,000;
 - (vii) in the half year ended 31 December 2012, approximately \$382,000.
- (d) the plaintiff would not have accepted investments in the Fund by Class A and C unitholders;

Particulars

The plaintiff received money from Class A and C unitholders for the investment of units in the following amounts, reported in the financial records of the Fund and/or the Financial Statements, but not including re-investments of income distribution:

- (i) in the half year ended 31 December 2009, approximately \$534,000;
 - (ii) in the half year ended 30 June 2010, approximately \$708,000.
- (e) the plaintiff would not have paid any further income distributions to unitholders;

Particulars

The plaintiff paid cash income distributions to Members in the following amounts, as reported in the financial records of the Fund and/or the Financial Statements:

- (i) in the half year ended 31 December 2009, approximately \$3,826,000;
 - (ii) in the half year ended 30 June 2010, approximately \$233,000;
 - (iii) in the half year ended 31 December 2011, approximately \$2,030,000;
 - (iv) in the half year ended 30 June 2012, approximately \$395,000;
 - (v) in the half year ended 31 December 2012, approximately \$34,000; and
 - (vi) in the half year ended 30 June 2013, approximately \$2,427,000.
- (f) the plaintiff would not have paid any advisor commissions to brokers of the Fund in the year ended 30 June 2010;

Particulars

- (i) The plaintiff paid advisor commissions to brokers of the Fund in the half years ended 31 December 2009 and 30 June 2010 in the amounts of around \$1,084,000 and \$541,000, respectively, reported in the financial records of the Fund and/or the Financial Statements.

- (g) the plaintiff would have realised the real property assets securing the loans and receivables of the Fund much earlier than they were in fact realised;

Particulars

- (i) The plaintiff would promptly upon the commencement of the winding up of the Fund have begun to sell the real property assets securing the loans and receivables of the Fund.
 - (ii) The plaintiff would have sold between around 60% to 70% by value of the real property assets securing the loans and receivables of the Fund in the 12 months immediately following the commencement of a winding up of the Fund.
 - (iii) Further particulars will be provided by way of an expert's report.
- (h) by the earlier sale of the real property assets securing the loans and receivables of the Fund as part of a winding up of the Fund, the Fund would have:
- (i) avoided substantial ongoing costs associated with their continued management, care and preservation including, in some cases, further development;
 - (ii) forgone any income generated by those real property assets once sold;
 - (iii) in some cases, sold those real property assets at a discount or, in the case of multiple unit developments, in some instances in one line instead of individually;
- (i) the Fund would have forgone any interest received on the loans and receivables of the Fund once and to the extent they were repaid from the proceeds of the sale of the real property assets securing them;

Particulars

The plaintiff received interest income in the following amounts, as recorded in the Fund's statements of cash flow:

- (i) in the half year ended 31 December 2009, approximately \$3,549,000;
- (ii) in the half year ended 30 June 2010, approximately \$4,959,000;
- (iii) in the half year ended 31 December 2010, approximately \$1,813,000;
- (iv) in the half year ended 30 June 2011, approximately \$3,194,000;
- (v) thereafter, negligible amounts.

- (j) the plaintiff would not have:
- (i) continued to engage LM Administration to operate the Fund on the same terms;
 - (ii) continued to incur and pay the same fees and expenses from the Fund in relation to the provision of responsible entity services;

Particulars

The management fees paid from the Fund to the RE and/or LM Administration were reported in the financial records of the Fund and/or the Financial Statements, as being:

- (A) in the half year ended 31 December 2009, approximately \$5,591,000;
 - (B) in the half year ended 30 June 2010, approximately \$3,541,000;
 - (C) in the half year ended 31 December 2010, approximately \$6,385,000;
 - (D) in the half year ended 30 June 2011, approximately \$4,612,000;
 - (E) in the half year ended 31 December 2011, approximately \$4,939,000;
 - (F) in the half year ended 30 June 2012, approximately \$4,165,000;
 - (G) in the half year ended 31 December 2012, approximately \$3,805,000;
 - (H) in the half year ended 30 June 2013, approximately \$714,000.
- (iii) continued to pay any fees in advance from the Fund to the RE and/or LM Administration;

Particulars

- (A) The 31 December 2009 Financial Statements reported a receivable of approximately \$6,000,000 owing from a related party, namely LM Administration.
- (B) The 30 June 2010 Financial Statements reported a further \$2,200,000 as having been advanced, as an increased receivable of approximately \$8,200,000 owing from LM Administration (the **LMA Receivable**).

- (C) The 31 December 2011 Financial Statements reported a reduction in the LMA Receivable by approximately \$4,906,000, that amount having been applied in payment of services purportedly provided by LM Administration.
- (D) The financial statements of the Fund for the year ended 30 June 2012 reported a further reduction in the LMA Receivable to nil, the balance having been applied in payment of services purportedly provided by LM Administration.
- (iv) continued to pay any further loan management fees from the Fund to the RE and/or LM Administration.

Particulars

The further loan management fees paid from the Fund to the RE and/or LM Administration were reported in the financial records of the Fund and/or the Financial Statements as being:

- (A) in the half year ended 31 December 2010, approximately \$1,485,000;
- (B) in the half year ended 30 June 2011, approximately \$3,896,000;
- (C) in the half year ended 31 December 2011, approximately \$2,590,000;
- (D) in the half year ended 30 June 2012, approximately \$2,227,000;
- (E) in the half year ended 31 December 2012, approximately \$1,698,000;
- (F) in the half year ended 30 June 2013, approximately \$1,387,000.
- (k) the plaintiff would instead have incurred the costs of winding up the Fund;

Particulars

- (i) The costs thereof would have been, at most, the costs of a receiver appointed to conduct the winding up of the Fund, and would have included the cost of the assistance of LM Administration at most on the terms and at the cost as were in fact negotiated and charged in the eventual winding up of the Fund.
- (ii) The majority of the costs thereof would have been incurred over four years in the approximate ratio of 40% to 30% to 20% to 10%.

- (l) the plaintiff would have recovered from LM Administration the amount by which it had been paid in advance;
- (m) the additional cash available to the Fund by reason of the matters set out in paragraphs ~~76(a)~~~~75(a)~~ to ~~76(l)~~~~75(l)~~ above would have been applied such that:
 - (i) the debts of the Fund would have been satisfied earlier than they were in fact satisfied, and within 12 months;

Particulars

The plaintiff was indebted to its financiers in the following approximate amounts as at the end of each half-year from 31 December 2009, as reported in the financial records of the Fund and/or the Financial Statements:

- (A) as at 30 June 2009, approximately \$133,000,000;
 - (B) as at 31 December 2009, approximately \$105,795,000;
 - (C) as at 30 June 2010, approximately \$81,014,000;
 - (D) as at 31 December 2010, approximately \$81,131,000;
 - (E) as at 30 June 2011, approximately \$62,400,000;
 - (F) as at 31 December 2011, approximately \$53,806,000;
 - (G) as at 30 June 2012, approximately \$39,601,000;
 - (H) as at 31 December 2012, approximately \$28,000,000;
 - (I) as at 30 June 2013, approximately \$25,500,000;
 - (J) as at 31 December 2013, approximately \$4,000,000.
- (ii) the Fund would have avoided payments of interest on those debts from an earlier date;

Particulars

The plaintiff paid interest on its debts in the following amounts:

- (A) in the half year ended 30 June 2010, approximately \$6,486,000;
- (B) in the half year ended 31 December 2010, approximately \$7,011,000;
- (C) in the half year ended 30 June 2011, approximately \$7,062,000;

- (D) in the half year ended 31 December 2011, approximately \$4,743,000;
 - (E) in the half year ended 30 June 2012, approximately \$3,851,000;
 - (F) in the half year ended 31 December 2012, approximately \$2,788,000;
 - (G) in the half year ended 30 June 2013, approximately \$2,225,000;
 - (H) in the half year ended 31 December 2013, approximately \$1,830,000;
 - (I) in the half year ended 30 June 2014, approximately \$25,000.
- (iii) the Fund would have earned interest on its surplus cash assets;

Particulars

The Fund would have earned interest at least at the following rates of interest:

- (A) three percent in the financial years ended 30 June 2010 and 30 June 2011;
 - (B) two and a half percent in the financial year ended 30 June 2012;
 - (C) two percent in the financial year ended 30 June 2013;
 - (D) one and a half percent in the financial years ended 30 June 2014, 30 June 2015 and 30 June 2016.
- (n) the plaintiff would have avoided further net expenses as a result of the reduction and ultimately the cessation of the activities of the Fund, at the latest from the completion of the winding up of the Fund.

Particulars

The net other expenses over other income of the Fund, net of unrealised foreign exchange losses or gains (where it is expected that losses will not be realised), were:

- (i) for the half year ended 30 June 2013, net expenses over income of \$2,060,000, less unrealised foreign exchange losses of \$759,000, namely \$1,301,000;
- (ii) for the half year ended 31 December 2013, net expenses over income of \$1,161,000, less unrealised foreign exchange losses of \$942,000, namely \$219,000;

- (iii) for the half year ended 30 June 2014, net income over expenses of \$70,000, plus unrealised foreign exchange gains of \$208,000, namely net expenses over income of \$138,000;
 - (iv) for the half year ended 31 December 2014, net expenses over income of \$1,121,000, less unrealised foreign exchange losses of \$264,000, namely \$857,000;
 - (v) for the half year ended 30 June 2015, net income over expenses of \$322,000;
 - (vi) for the half year ended 31 December 2015, net expenses over income of \$1,533,000, less unrealised foreign exchange losses of \$1,276,000, namely \$257,000;
 - (vii) for the half year ended 30 June 2016, net expenses over income of \$255,000, plus unrealised foreign exchange gains of \$222,000, namely \$477,000.
- (o) the plaintiff would have recovered damages from the first defendant and/or the second defendant on the causes of action set out in this Statement of Claim, by proceedings commenced on an earlier date.

~~76-77.~~ In the premises, the first and/or second defendants are liable to the plaintiff for loss and damage caused by the breaches referred to in paragraph ~~6766~~ of this Statement of Claim and the contraventions referred to in paragraph ~~7170~~ of this Statement of Claim.

Particulars

- (a) The plaintiff suffered loss and damage in the amount of management fees which would have been avoided as pleaded in paragraph ~~76(j)(ii)~~~~75(j)(ii)~~ above, as follows:
- (i) if payment had ceased on 1 July 2009, approximately \$33,752,000;
 - (ii) if payment had ceased on 1 January 2010, approximately \$28,161,000;
 - (iii) if payment had ceased on 1 July 2010, approximately \$24,620,000;
 - (iv) if payment had ceased on 1 January 2011, approximately \$18,235,000;
 - (v) if payment had ceased on 1 July 2011, approximately \$13,623,000;
 - (vi) if payment had ceased on 1 January 2012, approximately \$8,684,000;

- (vii) if payment had ceased on 1 July 2012, approximately \$4,519,000;
 - (viii) if payment had ceased on 1 January 2013, approximately \$714,000.
- (b) The plaintiff suffered further loss and damage in the amount of loan management fees which would have been avoided as pleaded in paragraph ~~76(j)(iv)~~~~75(j)(iv)~~ above, as follows:
- (i) if payment had ceased on 1 July 2009, approximately \$13,283,000;
 - (ii) if payment had ceased on 1 January 2010, approximately \$13,283,000;
 - (iii) if payment had ceased on 1 July 2010, approximately \$13,283,000;
 - (iv) if payment had ceased on 1 January 2011, approximately \$11,798,000;
 - (v) if payment had ceased on 1 July 2011, approximately \$7,902,000;
 - (vi) if payment had ceased on 1 January 2012, approximately \$5,312,000;
 - (vii) if payment had ceased on 1 July 2012, approximately \$3,085,000;
 - (viii) if payment had ceased on 1 January 2013, approximately \$1,387,000.
- (c) The plaintiff suffered further loss and damage in the amount of finance costs, which would have been avoided as pleaded in paragraph ~~76(m)(ii)~~~~75(m)(ii)~~ above, as follows:
- (i) if the winding up had been commenced on 1 July 2009, approximately \$31,236,000;
 - (ii) if the winding up had been commenced on 1 January 2010, approximately \$24,337,000;
 - (iii) if the winding up had been commenced on 1 July 2010, approximately \$17,669,000;
 - (iv) if the winding up had been commenced on 1 January 2011, approximately \$12,511,000;
 - (v) if the winding up had been commenced on 1 July 2011, approximately \$7,663,000;

- (vi) if the winding up had been commenced on 1 January 2012, approximately \$4,528,000;
 - (vii) if the winding up had been commenced on 1 July 2012, approximately \$2,319,000;
 - (viii) if the winding up had been commenced on 1 January 2013, approximately \$125,000.
- (d) The plaintiff suffered further loss or damage in the amount of net expenses which would have been avoided, as pleaded in paragraph 76(n)~~75(n)~~ above, as follows:
- (i) if the winding up had been commenced on 1 July 2009, approximately \$2,927,000;
 - (ii) if the winding up had been commenced on 1 January 2010, approximately \$1,626,000;
 - (iii) if the winding up had been commenced on 1 July 2010, approximately \$1,407,000;
 - (iv) if the winding up had been commenced on 1 January 2011, approximately \$1,269,000;
 - (v) if the winding up had been commenced on 1 July 2011, approximately \$412,000;
 - (vi) if the winding up had been commenced on 1 January 2012, approximately \$734,000;
 - (vii) if the winding up had been commenced on 1 July 2012, approximately \$477,000.
- (e) The plaintiff suffered further loss and damage in the amount of redemptions paid which would not otherwise have been paid, net of reinvestments, as pleaded in paragraphs 76(a)~~75(a)~~ to 76(d)~~75(d)~~ above, as follows:
- (i) if payment had ceased on 1 July 2009, approximately \$52,914,000;
 - (ii) if payment had ceased on 1 January 2010, approximately \$38,700,000;
 - (iii) if payment had ceased on 1 July 2010, approximately \$30,450,000;
 - (iv) if payment had ceased on 1 January 2011, approximately \$15,989,000;
 - (v) if payment had ceased on 1 July 2011, approximately \$6,370,000;

- (vi) if payment had ceased on 1 January 2012, approximately \$5,187,000;
- (vii) if payment had ceased on 1 July 2012, approximately \$2,757,000;
- (viii) if payment had ceased on 1 January 2013, approximately \$25,000,

less in each case:

- (ix) the amount which would ultimately have been paid on the redeemed units at the conclusion of a winding up of the Fund;
- (x) any amount ultimately withheld from distributions to the Class B unitholders, following any relief obtained in Supreme Court proceedings 13534 of 2016;

plus in each case

- (xi) the cost to the Fund of securing the relief sought in Supreme Court proceedings 13534 of 2016.
- (f) The plaintiff has suffered further loss and damage as a result of being exposed to the risk of claims being made by Members for loss suffered by reason of their decision to reinvest income distributions from the Fund in additional Units at an Issue Price calculated using an incorrect Net Fund Value, insofar as such claim or claims are met by the Fund upon admission or reasonable settlement by the Receiver.
- (g) The plaintiff suffered further loss and damage in the amount of advisor commissions which would not otherwise have been paid, as pleaded in paragraph 76(f)~~75(f)~~ above, as follows:
- (i) if the winding up had been commenced on 1 July 2009, approximately \$1,625,000;
 - (ii) if the winding up had been commenced on 1 January 2010, approximately \$541,000.
- (h) The plaintiff suffered further loss and damage in the amount of interest income forgone, which would otherwise have been earned by the Fund as pleaded in paragraph 76(m)(iii)~~75(m)(iii)~~ above, as follows:
- (i) if the winding up had been commenced on 1 July 2009, approximately \$48,901,000;
 - (ii) if the winding up had been commenced on 1 January 2010, approximately \$34,739,000;
 - (iii) if the winding up had been commenced on 1 July 2010, approximately \$26,542,000;

- (iv) if the winding up had been commenced on 1 January 2011, approximately \$16,195,000;
 - (v) if the winding up had been commenced on 1 July 2011, approximately \$10,043,000;
 - (vi) if the winding up had been commenced on 1 January 2012, approximately \$6,708,000;
 - (vii) if the winding up had been commenced on 1 July 2012, approximately \$4,905,000;
 - (viii) if the winding up had been commenced on 1 January 2013, approximately \$2,655,000.
- (i) The plaintiff suffered further loss or damage in the amount of the loss of the benefit of the earlier sale of the real property assets securing the Fund's loans and receivables in a winding up context, as pleaded in paragraphs 76(g)~~75(g)~~ and 76(h)~~75(h)~~ above, as follows:
- (i) if the winding up had been commenced on 1 July 2009, approximately \$20,931,000;
 - (ii) if the winding up had been commenced on 1 January 2010, approximately \$12,438,000;
 - (iii) if the winding up had been commenced on 1 July 2010, approximately \$5,476,000;
 - (iv) if the winding up had been commenced on 1 January 2013, approximately \$317,000.
- (j) The plaintiff's loss or damage would in some cases have been offset by the earlier sale of the real property assets securing the Fund's loans and receivables in a winding up context, as follows:
- (i) if the winding up had been commenced on 1 January 2011, by approximately \$2,802,000;
 - (ii) if the winding up had been commenced on 1 July 2011, by approximately \$813,000;
 - (iii) if the winding up had been commenced on 1 January 2012, approximately \$396,000;
 - (iv) if the winding up had been commenced on 1 July 2012, approximately \$5,161,000.

- (k) The plaintiff's loss or damage would in some cases have been offset by mortgage loan interest that would have been forgone, as pleaded in paragraph ~~76(i)~~~~75(i)~~ above, as follows:
 - (i) if the winding up had been commenced on 1 July 2009, by approximately \$3,633,000;
 - (ii) if the winding up had been commenced on 1 January 2010, by approximately \$2,318,000;
 - (iii) if the winding up had been commenced on 1 July 2010, by approximately \$309,000.
- (l) The plaintiff's claim to recover the loss and damage particularised above is not pressed on the causes of action arising from the Financial Auditors' Misleading Conduct relating to the 30 June 2008 and 30 June 2009 Audits and the 31 December 2008 Review and involving paragraphs ~~67(a)(xiii)(B)~~~~66(a)(xiii)(B)~~, ~~73(a)(v)~~~~72(a)(v)~~, ~~73(e)(iii)~~~~72(e)(iii)~~ and/or ~~75(b)~~~~74(b)~~ above, unless claimable as a result of the counterfactual pleaded in paragraph ~~76(o)~~~~75(e)~~ above.
- (m) Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.

~~77.~~78. Further and in the alternative:

- (a) the second defendant personally carried out the Audits and the Reviews, gave the Financial Statements Reports and expressed the Audit Representations and/or the Further Audit Representations;
- (b) the second defendant was at all material times acting:
 - (i) in the ordinary course of business of the first defendant; or, alternatively
 - (ii) with the authority of her co-partners of the first defendant;
- (c) in the premises, by reason of the matters pleaded in paragraphs 4 and 5 above the first defendant is liable to the plaintiff for its loss and damage to the same extent as the second defendant in committing those acts and omissions, pursuant to section 13 of the *Partnership Act 1891* (Qld) or the general law.

Other breaches of the Act and/or the Constitutions

Prepayment of fees and expenses to the plaintiff and LM Administration

~~78.~~79. From time to time from at least 1 July 2007, the plaintiff caused to be paid at its direction from the property of the Fund amounts to itself or LM Administration in advance and on account of:

- (a) the RE Management Fee; or

- (b) other liabilities to LM Administration for Service Fees or other fees or expenses in relation to the Fund.

79-80. The plaintiff:

- (a) was not under any obligation, under the Services Agreements or otherwise, to pay Service Fees or other fees or expenses to LM Administration in advance;
- (b) further caused amounts to be paid in circumstances where there was already a debit balance in LM Administration's favour.

80-81. Pursuant to section 601GA(2)(b) of the Act, and upon that section's true construction, the plaintiff's rights under the Act and the Constitution to payment of the RE Management Fee and to be indemnified out of the property of the Fund for liabilities or expenses incurred in relation to the performance of its duties are only for its duties which have been properly performed and for its liabilities which have been properly incurred, and not in relation to duties yet to be performed or liabilities yet to be incurred.

81-82. In the premises of the matters set out in paragraphs 79-78 to 81-80 above, the payments referred to in paragraph 79-78 above were not authorised by and were not in accordance with the Constitution or the Act.

82-83. Further and in the alternative, a reasonable and prudent trustee in the plaintiff's position would not have paid the amounts referred to in paragraph 79-78 above.

Payment of additional loan management fees

Material terms of the Constitution and the Act

83-84. At all material times, the Constitutions relevantly provided to the following effect:-

- (a) by clause 1.1:-
 - (i) the "Custodian" means Permanent Trustee Australia Limited ACN 008 412 913, which company is now known as "The Trust Company (PTAL) Limited" ("**Custodian**");
 - (ii) the "Responsible Entity", or "RE" means the company named in ASIC's records as the responsible entity of the Scheme and referred to in this document as the RE who is also the Trustee of the Scheme;
 - (iii) the "Scheme" means the Fund;
 - (iv) the "Scheme Property" means assets of the Scheme;
- (b) by clause 13.4, where a loan of Scheme funds involves a Development Loan, the RE shall ensure that it has included amongst its officers or employees persons with relevant project management experience who are competent to manage loans of this kind;

- (c) by clause 18.4, the duties for which the RE shall be entitled to receive the RE Management Fee include the following duties:-
 - (i) (sub-clause e) loan management;
 - (ii) (sub-clause h) the sale of real estate or assets of the Scheme Property;
 - (iii) (sub-clause k) the winding-up of the Scheme; and
 - (iv) (sub-clause l) the performance of its duties and obligations pursuant to the Act and this Constitution;
- (d) by clause 18.5, the RE shall be indemnified out of the Scheme Property for liabilities or expenses incurred in relation to the performance of its duties, including:-
 - (i) (sub-clause v) reasonable costs incurred in protecting or preserving all assets offered as security;
 - (ii) (sub-clause w) all liability, loss, cost, expense or damage arising from the proper performance of its duties in connection with the Scheme performed by the RE or by an agent appointed pursuant to s601FB(2) of the [Act];
 - (iii) (sub-clause y) fees and expenses of any agent or delegate appointed by the RE;
- (e) upon the true construction of the Constitution, the plaintiff had no entitlement to be paid out of the property of the Fund (save to the extent of the RE Management Fee) for the cost of engaging other persons to perform the duties set out in clause 18.4 of the Constitution.

84.85. As to the Custodian:

- (a) by clauses 2.3, 13.7 and 21.1 of the Constitution, the Custodian holds the assets of the Fund on behalf of and as the agent for the plaintiff on the terms and conditions of the Custody Agreement between the Custodian and the plaintiff dated 4 February 1999, as amended from time to time;
- (b) by clause 4.1 of the Custody Agreement, the plaintiff is responsible for taking all decisions in relation to the assets of the Fund held by the Custodian, and properly communicating to the Custodian Instructions in relation to those assets. Subject to the Custody Agreement, the Custodian must act on the plaintiff's Instructions in relation to any of those assets; and
- (c) by clause 13.7 of the Constitution, the plaintiff must direct the Custodian to deal with the Scheme Property in accordance with the Constitution.

~~85.~~86. Further, upon the true construction of section 601 GA(2)(a) of the Act, the plaintiff has no right to be paid any fee, or to be indemnified for any liability or expense which in all the circumstances is properly characterised as an additional fee, out of the property of the Fund unless the following are specified in the Constitution:

- (a) the performance to which the fee relates; and
- (b) the way in which the fee is to be calculated.

Relevant appointments and contracts

~~86.~~87. From about 2010, the plaintiff in relation to each loan of the Fund where the Custodian was in possession or had control of security for that loan, the plaintiff caused the Custodian to execute:

- (a) a document entitled "Appointment of Agent" ("**Agent Appointment**"), by which the Custodian appointed the plaintiff as its agent to exercise all of its rights, powers, privileges, benefits, discretions and authorities under the security;
- (b) a further associated document entitled "Agent's Indemnity" ("**Agent's Indemnity**") by which the Custodian agreed:
 - (i) to indemnify the plaintiff against liabilities for or arising out of all actions, proceedings, claims, suits and demands, and all payments, costs and expenses incurred by the plaintiff in or arising out of the due exercise or purported exercise rights, powers, discretions or authorities vested in the plaintiff by the associated Agent's Appointment; and
 - (ii) to pay to the plaintiff all reasonable charges, costs, fees and expenses payable to or incurred by the plaintiff in relation to the agency ("**Agency Payments**").

~~87.~~88. The Agency Payments were payments to be made to the plaintiff:

- (a) for the performance by it of the duties set out in clause 18.4 of the Constitution; or
- (b) to indemnify it against the cost and expense incurred by it in engaging others to perform the duties of the plaintiff set out in clause 18.4 of the Constitution.

88-89. On about 1 July 2011, and from time to time thereafter, and in respect of loans of the Fund where the Custodian or the plaintiff as RE of the Fund on its behalf was in possession, or had control, of security for that loan, the plaintiff caused the Custodian as custodian to enter into a further series of Management Services Agreements ("**Management Services Agreements**") with itself and LM Administration, pursuant to which:-

- (a) LM Administration was engaged to perform services, including as an agent exercising powers under the security for the loan in question ("**Loan Management Services**"); and
- (b) the Custodian agreed to pay service fees ("**MSA Loan Management Fees**"), comprising one or more of the following fees:
 - (i) in every case, general administrative fees charged on an hourly rate basis (based on the fee earner's title, as scheduled); and
 - (ii) in some but not all cases, a development management fee, as a percentage of 'total development build cost', which varied between 2.5% and 3% thereof; and
 - (iii) in some but not all cases, a marketing and sales management fee of 2% of gross sales proceeds where LM Administration undertakes the sale of assets directly on behalf of the Custodian and/or the RE, or one per cent where the Custodian and/or the RE elects to appoint an external real estate agent;
- (c) LM Administration, the Custodian and the plaintiff agreed that the Custodian was entitled to terminate the agreement by 7 days written notice to LM Administration, at any time.

89-90. The MSA Loan Management Fees were payments to be made to LM Administration:

- (a) for the performance by it of the duties set out in clause 18.4 of the Constitution; or
- (b) to indemnify the plaintiff against the cost and expense incurred by it in engaging others to perform the duties of the plaintiff set out in clause 18.4 of the Constitution.

90-91. The way in which the Agency Payments and the MSA Loan Management Fees were to be calculated was not specified in the Constitution.

Payments of fees

91-92. In each financial year from and including the financial year ended 30 June 2011, the plaintiff caused LM Administration to be paid amounts from the assets of the Fund that were either MSA Loan Management Fees or Agency Payments.

Particulars

(a) The payments are particularised to paragraph 76(j)(iv)~~75(j)(iv)~~ above.

92-93. In the premises, the payment of those amounts ("**Loan Management Fees**") from the assets of the Fund was not authorised by the Constitutions or the Act.

Breach – Agency Payments and MSA Loan Management Fees Not Properly Incurred

93-94. Prior to entering into the Agency Indemnities and the Management Services Agreements:

- (a) in the premises of paragraphs 21, 84(c)(i)~~83(e)(i)~~ and 84(c)(ii)~~83(e)(ii)~~ above, LM Administration was already engaged to provide loan management services and services relating to the sale of real estate assets for the Fund pursuant to the Services Agreements; and
- (b) LM Administration was already providing to the plaintiff for the Fund the services which were provided for by the Agency Indemnities and the Management Services Agreements.

94-95. Further:

- (a) the Loan Management Fees that were charged were not calculated by reference to the cost to the plaintiff or LM Administration of providing the services for which they were charged;
- (b) in relation to each loan in relation to which Loan Management Fees were charged, the plaintiff was aware, or ought reasonably to have been aware, when charging the fee that there was a real risk that there would be a shortfall in recovery under that loan such that the said Loan Management Fees would not ultimately be recovered from the said Borrower.

95-96. In the premises of the matters set out in paragraphs 93-94 to 95-96 above, a reasonable and prudent trustee in the plaintiff's position would not have or caused the Custodian to have entered into or continued any of the Agent's Indemnities or any of the Management Services Agreements in terms permitting the Loan Management Fees to be paid from the property of the Fund.

96-97. In the premises, in making and not varying or terminating each of the Agent's Indemnities and Management Services Agreements, and paying the Loan Management Fees the plaintiff, in breach of section 601FC(1) of the Act:

- (a) preferred its own interests or the interests of LM Administration to the interests of the members of the Fund;
- (b) failed to act in the best interests of the members of the Fund; and
- (c) did not exercise the degree of care and diligence that a reasonable person would exercise if they were in the plaintiff's position.

Payment of redemptions to Class B unitholders

97-98. In accordance with Part 5C.6 of the Act, the Constitutions made provision for Members to withdraw from the Fund if (but only if) the Fund was liquid, meaning that liquid assets account for at least 80% of the value of the property of the Fund, in terms to the following effect:

- (a) by clause 7.1, any Member may request that some or all of their Units be redeemed by giving the RE a Withdrawal Notice by the start of or within the relevant Withdrawal Notice Period (as required by the relevant definition of Withdrawal Notice);
- (b) by clause 7.2(a), the RE must, subject to clause 7.2(b), redeem Units the subject of a request made by any Member under clause 7.1 out of the Scheme Property for the Withdrawal Price (being the Net Fund Value divided by the total number of Units issued) within 365 days or 180 days (as provided therein), or within a shorter period in its absolute discretion (the "**Withdrawal Offer**");
- (c) by clause 7.2(b), the RE may suspend the Withdrawal Offer as detailed in clause 7.2(a) for such periods as it determines in certain stated circumstances;
- (d) by clause 7.3(b), a Unit is cancelled when the Member holding the Unit is paid the Withdrawal Price by the RE.

98-99. On or about 11 May 2009, the plaintiff suspended the Withdrawal Offer under clause 7.2(b) of the Constitution, purportedly with the exception of:

- (a) those approved under hardship provisions, and

Particulars

- (i) At all material times from 14 April 2009, the plaintiff was the recipient of hardship relief from ASIC under s.601QA(1) of the Act, namely ASIC Instrument 09-00278 dated 14 April 2009 and ASIC Instrument 09-00963 dated 11 November 2009 ("**ASIC Relief**");
- (ii) The effect of the ASIC Relief was to permit withdrawals by Members of the Fund where they were experiencing

circumstances of hardship, and by a holder of Class B units for a Feeder Fund insofar as a member of the Feeder Fund was experiencing such circumstances.

- (b) those requested by a holder of Class B units for a Feeder Fund for distributions to investors in the Feeder Funds or for the expenses of the Feeder Funds, as the cash flow of the Fund allowed.

~~99-100.~~ At no time after 11 May 2009, did the plaintiff:

- (a) lift the suspension referred to in paragraph ~~99~~98 above; or
- (b) re-instate the Withdrawal Offer.

~~100-101.~~ On the proper construction of clause 7.2 of the Constitutions, any suspension of the Withdrawal Offer had to operate as to all Members, and there was no power to exempt Class B unitholders from such a suspension.

~~101-102.~~ In the premises, the exception to the suspension of the Withdrawal Offer referred to in paragraph ~~99(b)~~98(b) above was not authorised by the Constitution.

~~102-103.~~ Further and in the alternative, on and from at least 11 May 2009 the Fund was not liquid within the meaning of s.601KA(4) of the Act.

~~103-104.~~ Between 11 May 2009 and 31 January 2013 the plaintiff made or caused to be made withdrawal requests to redeem Class B units held for the Feeder Funds and, in satisfaction thereof, caused amounts to be paid from the assets of the Fund to the Feeder Funds, or recognised or reconciled payments which had previously been made from the assets of the Fund to their benefit.

~~104-105.~~ In the premises, by satisfying such withdrawal requests as it had made or caused to be made to redeem Class B units held for the Feeder Funds, the plaintiff, in breach of section 601FC(1) of the Act:

- (a) made payments out of the property of the Fund which were not authorised by the Constitution or the Act;
- (b) gave priority to its own interests as a holder of interests in Class B units in the Fund over the interests of the members of the Fund as a whole;
- (c) preferred the interests of the members of the Feeder Funds over the interests of the members of the Fund;
- (d) failed to treat members who hold interests of different classes, namely Class A and Class B units, fairly; and
- (e) failed to act in the best interests of the Members of the Fund as a whole.

Recognition of distributions to Class B unitholders

~~105.106.~~ The Constitution made provision for making income distributions to members of the Fund, to the following effect:

- (a) by clause 11.1, the Income of the Scheme for each Financial Year will be determined in accordance with the applicable Accounting Standards;
- (b) by clause 11.2, for each Financial Year:
 - (i) (sub-paragraph a) the expenses of the Scheme will be determined in accordance with the applicable Accounting Standards; and
 - (ii) (sub-paragraph b) provisions or other transfers to or from reserves may be made in relation to such items as the RE considers appropriate in accordance with applicable Accounting Standards including, but not limited to, provisions for income equalisation and capital losses;
- (c) by clause 11.3, the Distributable Income of the Scheme for a month, a Financial Year or any other period will be such amount as the RE determines. Distributable Income is paid to Members after taking into account any Adviser fees or costs associated with individual Members' investments, to the extent those fees or costs have not otherwise been taken into account;
- (d) on the proper construction of clauses 11.1, 11.2 and 11.3:
 - (i) the power to distribute income of the Fund was conditional on the plaintiff making a determination of the Distributable Income for the relevant Distribution Period;
 - (ii) the Distributable Income could be no greater than the difference between the income and expenses of the Fund determined in accordance with the Australian Accounting Standards;
 - (iii) further and in the alternative, in making a determination of the Distributable Income the RE was required to act in good faith and for a proper purpose, and to consider and take into account the income and expenses of the Fund, determined in accordance with the Australian Accounting Standards;
- (e) by clause 12.1, the Distribution Period is one calendar month for Australian dollar investments or as otherwise determined by the RE in its absolute discretion;
- (f) by clause 12.2, the RE must distribute the Distributable Income relating to each Distribution Period within 21 days of the end of each Distribution Period;
- (g) by clause 12.3, unless otherwise agreed by the RE and subject to the rights, restrictions and obligations attaching to any particular Unit or

Class, the Members on the Register will be presently entitled to the Distributable Income of the Scheme on the last day of each Distribution Period;

- (h) by clause 12.6:
 - (i) (sub-paragraph a) the RE may invite Members to reinvest any or all of their distributable income entitlement by way of application for additional Units in the Scheme;
 - (ii) (sub-paragraph b) The terms of any such offer of reinvestment will be determined by the RE in its discretion and may be withdrawn or varied by the RE at any time;
 - (iii) (sub-paragraph c) The RE may determine that unless the Member specifically directs otherwise they will be deemed to have accepted the reinvestment offer;
 - (iv) (sub-paragraph d) The Units issued as a result of an offer to reinvest will be deemed to have been issued on the first day of the next Distribution Period immediately following the Distribution Period in respect of which the distributable income being reinvested was payable;
- (i) by clause 3.2, the RE may distribute the Distributable Income for any period between different Classes on a basis other than proportionately, provided that the RE treats the different Classes fairly.

~~106.~~107. The plaintiff suspended income distributions from the Fund as from 1 January 2011, and did not between 1 January 2011 and 1 November 2012 make any determination that the Fund had any Distributable Income.

~~107.~~108. At all material times between 1 January 2011 and 1 November 2012 the expenses of the Fund exceeded the income of the Fund, determined in accordance with the applicable accounting standards.

Particulars

Without taking into account the matters set out in paragraph ~~64~~63 above:

- (a) the Financial Statements of the Fund for the year ended 30 June 2011 recorded a net loss before distributions to unitholders of \$77,418,896;
- (b) the Financial Statements of the Fund for the year ended 30 June 2012 recorded a net loss before distributions to unitholders of \$88,615,577;
- (c) the unaudited draft management accounts of the Fund for the half year ended 31 December 2012 recorded a net loss before distributions to unitholders of \$19,117,976.

~~108,109.~~ Between 31 July 2011 and 1 November 2012:

- (a) the plaintiff from time to time recognised further income distributions to the Class B unitholders;

Particulars

The income distributions were recorded in the ledgers maintained by LMIM as RE of the FMIF in respect of the each of the Feeder Funds, as follows:

- (i) it was recorded that the Currency Fund received distributions in the aggregate amount of \$12,231,875.90;
 - (ii) it was recorded that the Wholesale Fund received distributions in the aggregate amount of \$6,219,464.37; and
 - (iii) it was recorded that the Institutional Fund received distributions in the aggregate amount of \$1,131,173.50.
- (b) the plaintiff recognised a re-investment of each of the distributions referred to in sub-paragraph (a) in further units in the Fund on the first day of the next Distribution Period in the ledger which it maintained in respect of the relevant Feeder Fund, and in the register of the members of the Fund;

Particulars

- (i) The Currency Fund increased its investment in the FMIF by an aggregate of 16,036,932.56 units therein;
 - (ii) The Wholesale Fund increased its investment in the FMIF by aggregate of 8,190,010.02 units therein, the latest of which were issued on 1 November 2012; and
 - (iii) The Institutional Fund increased its investment in the FMIF by aggregate of 1,484,259.16 units therein.
- (c) the plaintiff did not recognise any further distributable income payable to Class A unitholders.

~~109,110.~~ In the premises, the plaintiff acted outside the scope of any power conferred on it by any provisions of the Constitution or the Act.

~~110.~~111. Further and in the alternative:

- (a) the purpose of the plaintiff in recognising each of the distributions to and re-investments by Class B (but not Class A) unitholders referred to in paragraph ~~109~~108 above was to increase the value of units in each of the Feeder Funds so that they remained the same as the value of units in the Fund.

Particulars

The plaintiff's purpose may be inferred from the following facts:

- (i) The statement in the notes to the financial statements of the FMIF for the year ended 30 June 2012 that "These distributions were declared to enable the feeder funds to recognise distribution income to match expenses incurred".
 - (ii) On 20 August 2012, Mr Grant Fischer, Executive Director and Chief Financial Officer of LMIM agreed in an email to Eryn Vannucci, Financial Controller of LMIM, that "we planning on running a Feeder Fund distribution from FMIF to the Feeder Funds for the period Jan to Jun 2012 to align their unit prices once the impairment figures are finalized like we did at December 11".
- (b) that purpose was not a proper purpose to make a determination to:
 - (i) recognise distributions to and re-investments by Class B and not Class A unitholders;
 - (ii) increase the beneficial interest of one class of unitholders over another.

~~111.~~112. Further and in the alternative:

- (a) the effect of the plaintiff recognising each of the distributions to and re-investments by Class B (but not Class A) unitholders referred to in paragraph ~~109~~108 above was to increase the beneficial interest in the Fund of one class of unitholders over another.
- (b) The recognition of the distributions to and re-investments by Class B and not Class A unitholders having the effect set out in sub-paragraph (a) above, was not fair to the Class A unitholders.

~~112.~~113. In the premises, by recognising each of the distributions to and re-investments by Class B and not Class A unitholders the plaintiff, in breach of section 601FC(1) of the Act:

- (a) gave priority to its own interests as a holder of interests in Class B units in the Fund over the interests of the members of the Fund as a whole;
- (b) preferred the interests of the members of the Feeder Funds over the interests of the members of the Fund;

- (c) failed to treat members who hold interests of different classes, namely Class A and Class B units, fairly.

Compliance Plan Audits

~~113.~~114. Pursuant to the Compliance Plan Audit Engagements and sections 601HG(3)(a) and (b) of the Act, the first defendant and/or the third defendant examined the Fund's Compliance Plans (as in operation from time to time) and carried out audits of the plaintiff's compliance therewith during, respectively:

- (a) the financial year ended 30 June 2008 (the **30 June 2008 Compliance Plan Audit**);
- (b) the financial year ended 30 June 2009 (the **30 June 2009 Compliance Plan Audit**);
- (c) the financial year ended 30 June 2010 (the **30 June 2010 Compliance Plan Audit**);
- (d) the financial year ended 30 June 2011 (the **30 June 2011 Compliance Plan Audit**); and
- (e) the financial year ended 30 June 2012 (the **30 June 2012 Compliance Plan Audit**).

(Together, the **Compliance Plan Audits**).

~~114.~~115. During each of the Compliance Plan Audits, the first defendant and/or the third defendant had access to the plaintiff's information and documentation as it existed as at the date of each of the Compliance Plan Audit Reports, including:

- (a) the Constitutions to date;
- (b) the Compliance Plans to date;
- (c) the product disclosure statements for the Fund to date;
- (d) the financial reports of the Fund and the Feeder Funds for each previous financial year ended 30 June as lodged with ASIC;
- (e) the financial reports of the Fund for each previous half-year ended 31 December as lodged with ASIC;
- (f) the working papers for each of the previous Audits and the Reviews;
- (g) the Related Party Investment Register;
- (h) the Register of Conflicts;
- (i) the Conflicts Management Policy;
- (j) the Breaches Register;

- (k) the Complaints Register; and
- (l) the Compliance Committee Minutes.

~~115.~~116. Upon completing the Compliance Plan Audits, and purportedly pursuant to section 601HG(3)(c) of the Act, the first defendant and/or the third defendant issued:

- (a) an Independent Audit Report dated 11 May 2009 for the financial year ended 30 June 2008 (the **30 June 2008 Compliance Plan Audit Report**) that was signed by the third defendant;
- (b) an Independent Auditor's Compliance Plan Audit Report dated 30 September 2009 for the financial year ended 30 June 2009 (the **30 June 2009 Compliance Plan Audit Report**) that was signed by the third defendant;
- (c) an Independent Auditor's Compliance Plan Audit Report dated 6 October 2010 for the financial year ended 30 June 2010 (the **30 June 2010 Compliance Plan Audit Report**) that was signed by the third defendant;
- (d) an Independent Auditor's Compliance Plan Audit Report dated 16 September 2011 for the financial year ended 30 June 2011 (the **30 June 2011 Compliance Plan Audit Report**) that was signed by the third defendant; and
- (e) an Independent Auditor's Compliance Plan Audit Report dated 29 November 2012 for the financial year ended 30 June 2012 (the **30 June 2012 Compliance Plan Audit Report**) that was signed by the third defendant.

(Together, the **Compliance Plan Audit Reports**).

~~116.~~117. In the Compliance Plan Audit Reports the first defendant and/or the third defendant expressed the opinion that in all material respects:

- (a) the plaintiff had complied with the Compliance Plans for the financial year ended 30 June 2008, the financial year ended 30 June 2009, the financial year ended 30 June 2010, the financial year ended 30 June 2011 and the financial year ended 30 June 2012; and
- (b) the Compliance Plans in operation as at 30 June 2008, 30 June 2009, 30 June 2010, 30 June 2011 and 30 June 2012 continued to meet the requirements of Part 5C.4 of the Act as at those respective dates,

(Together the **Compliance Plan Audit Opinions**).

~~117.~~118. The Compliance Plans provided to the following effect:

- (a) Part 6(**Audit**) – *The RE has an internal compliance audit function within the Business Standards and Business Standards and Compliance Department that works with the Plan Auditor and Compliance*

Committee in monitoring compliance with the Act, the Plan and the Constitution. A risk based methodology is used in the yearly audit program. The Plan Auditor will also assist to develop and maintain a program of annual assessment of effectiveness of the Plan.

- (b) **Part 6(Accounts and Record Keeping)** – *The Accountants, overseen by the Chief Financial Officer, will ensure that the records of the Scheme and the RE are appropriately established and maintained separately from those of other interests of the RE. Scheme accounts are provided to the Scheme Auditor for audit including certification that the accounting and taxation standards applied are adequate for the purpose required by the Scheme. ... The Senior Accountant is responsible for the accounting of gross income received, commissions and fees and any other Scheme expenses or reimbursements that are properly incurred and allowable under the Constitution. The Scheme accounts are prepared on a monthly basis with a reconciliation of the funds in accordance with accounting procedures.*
- (c) **Part 6(Fees and Expenses)** – *It is intended that the RE be entitled to fees for the performance of services where it has performed them properly and to an indemnity in respect of liabilities and expenses incurred in the proper performance of its duties. The rights of the RE to fees and indemnities are set out in the Constitution. The Chief Financial Officer is familiar with the Constitution in determining the types and quantum of fees and expense reimbursements allowable. The Chief Financial Officer monitors any unusual fee payment and seeks advice from the Business Standards and Compliance Manager or the Committee as appropriate. ...*
- (d) **Part 6(Related Party Issues)** – *The Chief Financial Officer monitors service agreements between the RE or the Scheme and any related parties to either the RE or the Scheme. An annual review is performed by the Chief Financial Officer which includes consultation with independent accountants to verify that the agreements are commercial. The results of the review are reported to the Board annually.*
- (e) **Part 6(Related Party Transactions)** – The RE must comply with Section 601FG regarding the acquisition of interests in the Scheme. Acquisitions of interests in the Scheme by the RE, other Schemes managed by the RE or its Officers, Employees or authorised representatives must be made on an identical basis to all other Investors as regards the consideration and the terms and conditions of issuance. There may be a differential fee arrangement in place.
- (f) Any other proposal for the acquisition or withdrawal of an interest in the Scheme requires the consent of the Committee or the Board. The Committee may obtain independent advice on whether the proposal complies with the Act and the Constitution.
- (g) A related party transaction register is maintained which documents all related party investment transactions.

- ~~(e)~~(h) **Part 6(Conflict of Interest)** – *The RE has a Conflict of Interest Policy which describes how the RE manages Conflicts which comprises of a 3 step process: (1) Identifying Conflicts (2) Assessing and evaluating Conflicts; and (3) Taking appropriate action which may or may not include disclosure.*
- ~~(f)~~(i) **Part 6(External Service Providers)** – *The RE has determined to use external service providers to attend to a number of functions in situations where it believes that by doing so it can obtain the most cost effective delivery of services. ... Service providers will be selected having regard to the cost of their services, their quality and their comprehensiveness and compliance requirements. In relation to each significant transaction, the RE may obtain legal advice to receive confirmation that the contracts or terms of engagement for each service provider are appropriate for the intended purpose and contain adequate compliance related measures. ...*
- (j) **Part 6(Scheme Valuation)** – *The Scheme valuation policy must be in accordance with relevant Accounting Standards, applicable in Australia, at the time of valuation and have the endorsement of the Audit Committee of The RE which includes representatives of the Scheme's auditors.*
- ~~(g)~~(k) **Part 6(External Service Providers)** – *Valuation of the Scheme is the responsibility of the Senior Accountant and occurs each month as part of the monthly accounting process for the Scheme. Generally accepted accounting principles are applied in the preparation of the accounts in accordance with the Constitution.*
- ~~(h)~~(l) **Part 6(Collections and Arrears Management)** – *Given the nature of loans within the loan portfolio, the RE adopts a case by case approach to arrears management, reflected in the individual management plans for each arrears loan. ... In the formulation of an arrears management plan the Arrears Committee considers the following factors:*
- *Current value of the security property;*
 - *Whether updated valuation ought to be obtained;*
 - *...*
- For construction loans:*
- *Status of construction;*
 - *Cost to complete;*
 - *Sales achieved;*
 - *Review of presales.*
- For all arrears loans, a detailed recoverability analysis is prepared and regularly updated as part of the arrears management plan. External consultants (valuers, lawyers, insolvency practitioners, sales consultants etc) are engaged where appropriated throughout the arrears management process.*

~~(i)~~(m) **Part 6(Lending Criteria)** - *The RE has determined and documented a lending policy for guidance in the approval and management of mortgage applications. For all mortgage applications:...*

- *The Credit Committee applies the loan to value ratio to the valuation amount generally exclusive of GST, unless there are substantial positive factors such as high presales, high net worth of the borrower etc...*
- *Commercial Lending carries out regular reviews of all current loans...*

~~(i)~~(n) *The constitution of the First Mortgage Income Fund does not allow the RE to exceed a loan to valuation ratio of 85% of any one loan except in the event of default. Notwithstanding the provisions of the constitution, the RE has a policy of generally not exceeding the following loan to value ratios:*

- *65% for vacant land;*
- *75% for commercial loans;*
- *66.67% for construction and development loans of the gross realisation, calculated on a cost to complete basis...*

~~(i)~~(o) *An updated valuation will generally be required where a loan term is extended or a loan is otherwise varied. The requirement for an updated valuation may be waived where the RE considers that an updated valuation would serve no useful purpose...*

~~(i)~~(p) **Part 6(Valuation Policy – Mortgage Lending)** – *Valuations may only be carried out by panel valuers. ... The valuer must certify they are independent of both the borrower and security property.*

~~(m)~~(q) *An updated valuation will generally be required where a loan term is extended or a loan is otherwise varied. An updated valuation will also generally be required for commercial loans at 24 month intervals and construction loans at 12 month intervals. The requirements for an updated valuation may be waived where the RE considers that an updated valuation would serve no useful purpose.*

~~(n)~~(r) *In relation to Developments, separate valuations (which may be within the one valuation report) are required in relation to “as is” and “on completion” valuations. ... The “on completion” value is the market value of the property at the completion of the development. The valuation methodology required is as follows:*

- *“Feasibility analysis” including demolition, sub-divisional, construction, and other development costs, allowances for sales and marketing expenses, interest and an allowance for profit and risk to arrive at a base value for the land. ...*

- *"Gross realisation" based on comparable sales evidence for the individual components. E.g. houses, units, allotments etc.*

... The "on-completion" value is the valuation figure used in the cost to complete calculations during the development phase. The "on completion" value may be revised during the terms of development to reflect changes as approved by the RE."

~~(e)~~(s) *Members of the valuation panel are accepted and removed in accordance with the RE's panel guidelines. A register of panel valuers is maintained and held with Property Asset Management Development.*

Breaches by the plaintiff of the Compliance Plans and the Act

~~118.~~119. At the time of the conduct by the first defendant and/or third defendant of each of the Compliance Plan Audits, the following circumstances amounted to contraventions by the plaintiff of the measures specified by the Compliance Plans:

- (a) the plaintiff did not apply generally accepted accounting principles in the preparation of the accounts in accordance with the Constitution, and particularly in the valuation of the real property assets securing the loans and receivable of the Fund, in breach of the Scheme Valuation measures of the Compliance Plans;

Particulars

- (i) The plaintiff did not have a process in place for properly identifying and assessing objective evidence of impairment of each of its loans and receivables at the end of each reporting period that was in accordance with paragraphs 58 and 59 of AASB 139.
- (ii) The plaintiff, when assessing as at the end of each reporting period the present value of the estimated future cash flows of each of its loans and receivables by reference to the underlying real property securities, did not have a process in place, in accordance with paragraphs 63 and AG84 of AASB 139, to properly:
 - (A) account for the expected rate and timing of cash inflows from the sale of real property securities;
 - (B) assess the impact of expected delays to the receipt of cash inflows, in circumstances where there was a decision to adopt a "hold" strategy in respect of a real property security, or to take further steps before engaging in an active sale process;
 - (C) identify and account for all of the costs of holding and realising the real property securities;

- (D) discount expected future cash flows at the loan's original effective interest rate.
- (iii) The plaintiff, when assessing the fair value of the underlying real property securities, did not adopt a valuation technique that took account of the inapplicability of existing valuations:
 - (A) by requiring updated current valuations, in circumstances that included the general fall in the property market in Australia from late 2007 and the occurrence of the global financial crisis;
 - (B) by requiring updated current valuations, in circumstances that included the sale of real property securities for materially less than existing valuations;
 - (C) by requiring an "as is" valuation, where the plaintiff adopted a "hold" strategy in respect of a real property security.
- ~~(i) The deficiencies in the preparation of the accounts is to be inferred from the deficiencies in the Financial Statements as pleaded in paragraph 63 above.~~
- (b) a number of the valuations of the real property securities relied on by the plaintiff from time to time were not compliant with the Valuation Policy measures of the Compliance Plans;

Particulars

- (i) Many of the valuations used by the plaintiff to calculate the value of underlying real property securities were not carried out by valuers on the valuation panel or properly qualified valuers;
- (ii) Instead of obtaining valuations prepared by independent, qualified and registered valuers from 2008, the plaintiff in many cases relied upon valuations or estimates of value prepared by its own in-house management personnel;
- ~~(iii) In many instances, the valuation of Developments did not include the "Feasibility analysis" required by the Valuation Policy measures, and were on a Gross realisation basis only.~~
- ~~(iii) In many instances the valuations relied upon from 2008 did not assess the current market value of relevant security properties, and/or were not based on reasonable assumptions and appropriate valuation methodologies.~~
- (c) a number of loans were varied or extended without an updated valuation when an updated valuation was required in accordance with the Lending Criteria and the Valuation Policy measures of the Compliance Plans and when there were indicators that the discretion not

to obtain an updated valuation, if it had been exercised, should not have been exercised by the plaintiff.

Particulars

- (i) The loans in relation to which the variations or extensions occurred otherwise than in accordance with the requirements of the Compliance Plans included but were not limited to the Northshore Bayview St Pty Ltd loan, the Eden Apartments Pty Ltd loan, the Bezzina Developers Pty Ltd loan, the St Crispin's Property Pty Ltd loan, the OVST Pty Ltd loan, the Bellpac Pty Ltd loan and the Young Land Corporation Pty Ltd (Yeppoon) loan;
- (ii) The general fall in the property market in Australia from late 2007 and the occurrence of the global financial crisis was sufficient reason to conclude that:
 - (A) there was a reason to believe that an updated valuation should be obtained; and
 - (B) it was not appropriate to determine that the obtaining of an updated valuation would serve no useful purpose;
- (iii) Further particulars of the indicators that the discretion should not have been exercised will be provided.
- ~~(iii) The RE did not properly consider whether or not the obtaining of an updated valuation would serve no useful purpose.~~
- (d) in relation to a number of loans that comprised commercial loans or construction loans for which no valuation had been obtained within 24 months or 12 months respectively, the real property securities had not been valued in accordance with the Valuation Policy measures of the Compliance Plans when there were indicators that the discretion not to obtain an updated valuation, if it had been exercised, should not have been exercised by the plaintiff;

Particulars

- (i) The plaintiff refers to and repeats particulars (c)(ii) and (c)(iii) above.

- (e) — in relation to a number of loans that were in default, the plaintiff adopted a “hold strategy” for the real property securities securing those loans without obtaining current as is market valuations from a properly qualified and registered valuer in the preparation or the regular updating of the detailed recoverability analysis required by the Collections and Arrears Management measures of the Compliance Plans;

Particulars

- (i) — The plaintiff refers to and repeats particulars (c)(ii) and (c)(iii) above.
- (ii) — Further in relation to some loans, the sale of some of the properties securing that loan for materially less than the estimates of value contained in the existing valuations held by the plaintiff was a further reason to conclude that an updated valuation should be obtained.
- ~~(f)(e)~~ the plaintiff’s internal audit function and/or procedures were significantly reduced from around 2009 onwards despite the financial position of the Fund and the pressures of the global financial crisis increasing the risks of potential non-compliance with the Act, the Compliance Plan and the Constitution, in breach of the Audit measures of the Compliance Plan;
- ~~(g)(f)~~ the plaintiff did not adequately consider the propriety of the fees (including their amount) paid management fees to itself and/or LM Administration in advance in breach of the Fees and Expenses, the Conflict of Interest, the Related Party Issues, and the External Service Providers measures of the Compliance Plans; and
- ~~(g)~~ the plaintiff did not adequately consider the propriety of the payment of Loan Management Fees to itself and/or LM Administration in and following the financial year ended 30 June 2011, in breach of the Fees and Expenses, the Related Party Issues, and the External Service Providers measures of the Compliance Plans;
- (h) the plaintiff did not adequately consider the propriety of paying redemptions to Class B unitholders after the suspension of redemptions from the Fund on 11 May 2009, or of paying income distributions to Class B unitholders after 1 January 2011, in breach of the Conflict of Interest measures, Related Party Transaction and the Conflict of Interest measures of the Compliance Plans;
- (i) the plaintiff did not adequately consider the propriety of paying recognising income distributions and reinvestments to Class B unitholders after the suspension of distributions from the Fund from 1 January 2011, in breach of the Related Party Transaction and the Conflict of Interest measures of the Compliance Plans.

~~119,120.~~ At the time of the conduct by the first defendant and/or third defendant of each of the Compliance Plan Audits, the Compliance Plans did not satisfy the requirements of section 601HA(1) of the Act, in the following ways:

- (a) the provisions of the Compliance Plans in relation to obtaining updated valuations were insufficient to ensure compliance by the plaintiff with the requirements of the Act and/or the Constitutions in relation to matters requiring appropriate valuations;

Particulars

- (i) The Compliance Plans provided the plaintiff with a discretion to waive the requirements for an updated valuation where the plaintiff considered that an updated valuation would serve no useful purpose without limitation as to when the exercise of the discretion would be appropriate and/or proper;
 - (ii) The statement in the Compliance Plans as to the use of the discretion was vague, imprecise and ambiguous;
 - (iii) The Compliance Plans did not identify any method or process by which it might be determined whether or not the discretion was applied or applied correctly.
- (b) the provisions of the Compliance Plans in relation to training, recruitment and experience were insufficient to ensure that the plaintiff's and/or its agent's officers and employees were adequately qualified, experienced and received appropriate training to enable them to comply with the Act and/or the Constitutions in relation to matters requiring appropriate valuations and the application of Australian Accounting Standards including the application of the impairment requirements of AASB 139;

Particulars

- (i) The Compliance Plans' training, recruitment and experience compliance measures did not require the plaintiff's and/or its agent's officers and employees to undertake appropriate training in their specific area of responsibility;
- (ii) The plaintiff's and/or its agent's officers and employees responsible for the ongoing assessment of security property valuations were not required to be appropriately qualified and registered property valuers;
- (iii) The plaintiff's and/or its agent's officers and employees responsible for the ongoing assessment of security property valuations were not required to have any formal training in relation to the understanding of property valuations;
- (iv) The Compliance Plans' training, recruitment and experience compliance measures did not require the plaintiff's and/or its agent's chief financial officer, or any other person reporting to

the chief financial officer, to undertake appropriate training and/or have appropriate experience in the application of Australian Accounting Standard AASB 139.

- (c) the provisions of the Compliance Plans concerning the valuation of the scheme property, for the purpose of the preparation of the accounts and collections and arrears management, -were insufficient to ensure that the valuation of the scheme property, which was dependent upon the value of the real property assets securing the Fund's loans and receivables, was conducted in accordance with AASB 139;

Particulars

- (i) The Compliance Plans' Scheme Valuation, Collections and Arrears Management and Valuation Policy measures did not specify any or any adequate measures for the identification and measurement of impairment of the Fund's loans and receivables in accordance with AASB 139.
- (d) the provisions of the Compliance Plans in relation to internal controls, in particular the internal audit function, were insufficient to ensure that the plaintiff complied with its duties in accordance with the Act and/or the Constitutions.

Particulars

- (i) The plaintiff's internal audit function, at least in part, relied on self-certification by certain officers and/or employees of the plaintiff.

~~120, 121.~~ At the time of the conduct by the first defendant and/or third defendant of each of the Compliance Plan Audits, the following circumstances amounted to further contraventions by the plaintiff of the Act and/or the Constitutions:

- (a) that contrary to the requirements of sections 296 and 304 of the Act, the Financial Statements had not been prepared in accordance with the requirements of AASB 139;
- (b) that contrary to the requirements of sections 297 and 305 of the Act, the Financial Statements did not give a true and fair view of the financial position and performance of the Fund;
- (c) as to each Compliance Plan Audit from and including the 2009 Compliance Plan Audit, that contrary to the requirements of the Act and the Constitutions, the plaintiff continued to pay distributions and paid redemptions to Class B unitholders of the Fund, as pleaded in paragraphs 98-105 above;
- (d) as to the 2012 Compliance Plan Audit, that contrary to the requirements of the Act and the Constitutions, the plaintiff recognised income distributions to Class B unitholders of the Fund, as pleaded in paragraphs 106 to 113 above;

~~(d)~~(e) that contrary to the requirements of the Act and the Constitutions, the plaintiff continued to prepay paid management fees and to pay further loan management fees from the Fund in advance, as pleaded in paragraphs 7978 to 8396 above;

(f) as to each Compliance Plan Audit from and including the 2011 Compliance Plan Audit, that contrary to the requirements of the Act and the Constitutions, the plaintiff paid Loan Management Fees from the Fund, as pleaded in paragraphs 84 to 97 above; and

~~(e)~~(g) that contrary to the requirements of section 601FC(1)(h), the plaintiff had not complied with the Compliance Plans, as pleaded in paragraph 119118 above; and

~~(f)~~ that contrary to the requirements of section 601FC(1)(g), the plaintiff had not ensured that the Compliance Plans met the requirements of section 601HA of the Act, as pleaded in paragraph 119 above.

~~121.122.~~ 120A—The plaintiff's and/or its agent's officers and employees were not adequately qualified, experienced and did not receive appropriate training to enable them to comply with the Act and/or the Constitutions in relation to:

(a) the valuation of the real property securities supporting the loans and receivables held by the Fund, including how to obtain, understand and correctly apply property valuations from qualified and registered property valuers; and

(b) the application of the impairment requirements of AASB 139.

~~122.~~ It is to be inferred that the first defendant (by the third defendant or other persons the plaintiff cannot at present particularise) and/or third defendant, in conducting the Compliance Plan Audits and preparing and completing the Compliance Plan Audit Reports, became aware of the circumstances set out in paragraphs 118 and 119 hereof, in the premises of the following matters:

~~(a)~~ As to the circumstances set out in paragraph 118 as a whole, the third defendant gave evidence in the examinations conducted under section 597 of the Act (the **Public Examinations**) agreeing that, as the auditor conducting the Compliance Plans, he had been required to "give a report about whether or not the responsible entity's complied with the compliance plan".

~~(b)~~ As to the circumstances set out in paragraphs 118(a), 118(b), 118(c), 118(d) and 118(e) above, and the particulars thereto:

~~(i)~~ the third defendant acknowledged in the Public Examinations that he was aware of the pressures of the global financial crisis, including credit tightening, and that that usually leads to uncertainty for the property market;

~~(ii)~~ it is to be inferred from the third defendant's qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor that he was aware

of the content of AASB Guidance Statement G014 issued on 12 August 2009, which relevantly stated that:

- (A) — (at [14]) “Similarly, the compliance plan auditor who conducts the audit of a scheme’s compliance plan under section 601HG, is required under ASAE 3100 Compliance Audits to obtain an understanding of the scheme’s compliance plan (the subject matter) and other engagement circumstances sufficient to identify and assess the risks of non-compliance, either of the responsible entity with the compliance plan or of the compliance plan with the Act, and be mindful of the compliance related expectations set out in RG 144, RG 45 and the other relevant ASIC regulatory guides, including those regulatory guides applicable to managed investment schemes generally.”
- (B) — (at [17]) “In addition to the issues normally considered when undertaking financial report audits and compliance plan audits, auditors of mortgage schemes will need to consider several matters that are particularly important to the operation of such schemes. These matters include whether: ... (b) appropriate documentation is available in respect of all loans made by the scheme, including detailed loan agreements, securities held, guarantees, terms of repayments and external independent valuations; ...”
- (iii) — it is to be inferred from the third defendant’s qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor that he was aware of the content of ASIC Regulatory Guide 119 (Commentary on compliance plans: Pooled mortgage schemes), issued in April 2004, relevantly including:
 - (A) — ASIC’s stated belief that “prudential loan management, i.e. poor valuation procedures, inadequate security, and poor procedures and responses to defaults on mortgage payments” was an area that was systemically weak in the market;
 - (B) — The examples provided of appropriate compliance measures, including that valuations be updated every three years, and every 12 months for development loans where the draw down period continues over 12 months;
- (iv) — it is to be inferred from the third defendant’s qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor that he was aware of the terms of ASIC Regulatory Guide 45 (Mortgage schemes—improving disclosure for retail investors), issued in September

2008, which emphasised the significance of independent and up to date valuations, by stating in relevant part:

- (A) ~~(at RG45.1) "Since mid 2007, Australia has experienced debt market turbulence flowing from the US sub-prime crisis, together with successive interest rate increases and a cyclical softening in property markets. Some mortgage schemes have experienced financial stress under these economic conditions..."~~
- (B) ~~(at RG45.166) "We expect compliance plan auditors to be aware of the disclosure and advertising obligations in this guide. In determining whether a plan continues to meet the requirements of the Corporations Act, compliance plan auditors should consider whether the compliance plan is adequate to ensure compliance with these disclosure and advertising guidelines"~~
- (C) ~~(at RG45.64(b)) "The responsible entity should have a clear policy on how often they obtain valuations..."~~
- (D) ~~(at RG45.67) "Robust and objective valuations are needed to ensure that the scheme's financial position is correctly stated in the PDS and ongoing disclosures."~~
- (E) ~~(at RG45.69) "We expect that, where possible, responsible entities will only use professional valuers who are registered or licensed in the relevant state or territory or overseas jurisdiction and who subscribe to overseas jurisdictions. We also expect that responsible entities will be careful to ensure that their instructions to valuers are comprehensive and contain reasonable assumptions"~~
- (v) ~~The third defendant gave evidence in the Public Examination that he would have reviewed the accounts, specifically the Financial Statements, as part of his conduct of the Compliance Plan Audits.~~
- (vi) ~~The first defendant and/or the third defendant had access to and had reference to the audit papers of the first defendant and/or the second defendant from the Audits and Reviews in conducting the Compliance Plan Audits.~~
- (vii) ~~The first defendant and/or the third defendant had access to the books and records of the Fund for the purpose of conducting the Compliance Plan Audits.~~
- (viii) ~~The third defendant was also at various times the engagement quality review partner of the first defendant in relation to some of the Audits and Reviews, and he gave evidence in the Public~~

Examinations that in that role “he went through with the engagement partner the impairment testing work”.

- (ix) — In the premises of the matters set out above in this sub-paragraph, it is to be inferred that the third defendant would have reviewed and consulted the Financial Statements, the valuations of the real property securities of the Fund, its record of all variations and extensions of its loans, and the impairment testing work referred to in sub-paragraph (viii) above, which evidenced on their face and/or by omission the matters set out in paragraphs 118(a), 118(b), 118(c), 118(d) and 118(e) above and the particulars thereto.
- (c) — As to the circumstances set out in paragraph 118(f) above:
 - (i) — the third defendant acknowledged in the Public Examinations that he was aware of the pressures of the global financial crisis, including credit tightening, and that that usually leads to uncertainty for the property market, and he would thereby have been aware of the increased risk of potential non-compliance with the Act, the Compliance Plans and the Constitutions;
 - (ii) — the third defendant would have been aware of the pleaded reduction in internal controls by reason of his awareness of the controls previously in place pursuant to his engagements as the compliance plan auditor in earlier financial years;
- (d) — As to the circumstances set out in paragraphs 118(g) and 118(h) above:
 - (i) — The third defendant gave evidence in the Public Examinations agreeing that he was aware “at some point” that the fund had pre-paid the RE for the services that it was to perform.
 - (ii) — The third defendant gave evidence in the Public Examinations that he recalled that in 2012 there were redemptions and reinvestments by the B-Class unit holders, despite the Fund being closed.
 - (iii) — Further, the nature and quantum of fees paid to LMIM and/or LM Administration, and their pre-payments, as well as the payment of redemptions and the declaration of further income distributions, were referred to in the Financial Statements.
 - (iv) — In the premises of the matters set out above in this sub-paragraph, and in sub-paragraphs (b)(v) and (b)(vii) above, it is to be inferred that the third defendant would have reviewed and consulted the Financial Statements, the Compliance Committee Minutes, the Related Party Investment Register, the Register of Conflicts and the Breaches Register, which evidenced by omission the matters set out in paragraphs 118(g) and 118(h) above.

(e) — ~~As to the circumstances set out in paragraph 119 above:~~

(i) — ~~the third defendant gave evidence in the Public Examinations agreeing that he knew that it was his obligation as the auditor conducting the Compliance Plan Audits to make sure that the Compliance Plans complied with the Act, which included making sure that the Compliance Plans had adequate measures in place to ensure compliance with the Act and the Constitution, including the arrangements for ensuring that the scheme property was valued at regular intervals appropriate to the nature of the property.~~

(ii) — ~~the third defendant was aware of the matters set out in sub-paragraphs (b)(i) and (b)(iv) above.~~

(iii) — ~~the third defendant was aware of the matters set out in paragraph 118, as set out in sub-paragraphs (b) to (d) above.~~

(iv) — ~~in the premises, the inadequacy of the measures and procedures included in the Compliance Plans to ensure compliance by the plaintiff with the Constitutions and the Act were manifest.~~

(f) — ~~Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.~~

— ~~121A In the premises of the matters set out in paragraph 121 above, the first and/or third defendants had reasonable grounds to suspect that the circumstances set out in paragraphs 118 and 119 hereof amounted to the contraventions of the Constitutions and/or the Act pleaded in paragraph 120 hereof.~~

Breaches with respect to the Compliance Plan Audits

123. It is to be inferred from the third defendant's qualification as a registered company auditor and his decision to take on the responsibilities of the compliance plan auditor of the Fund, that the first defendant and/or the third defendant was aware at all material times:

(a) of the terms of the Constitutions;

(b) of the terms of the Compliance Plans;

(c) of the obligations of a responsible entity under section 601FC(1) of the Act, including:

(i) to treat the members who hold interests of different classes fairly;

(ii) to ensure that the scheme property is valued at regular intervals appropriate to the nature of the property;

(d) that paragraph 58 of AASB139 required the plaintiff to assess at the end of each reporting period whether there was any objective evidence that

any of the Fund's loans and receivables or any group of its loans and receivables was impaired, by considering objective evidence of impairment, which would include:

- (i) the fair value of the real estate assets securing the Fund's loans and receivables;
- (ii) levels of and trends in delinquencies for similar financial assets; and
- (iii) national and local economic trends and conditions;
- (e) that paragraphs 63 and AG84 of AASB139 required an impairment loss on a loan to be measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the loan's original effective interest rate, except that cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial.

124. It is to be inferred from the third defendant's qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor of a mortgage scheme that he was aware at all material times of the content of ASIC Regulatory Guide 119 (Commentary on compliance plans: Pooled mortgage schemes), issued in April 2004, relevantly including:

- (a) ASIC's stated belief that "prudential loan management, i.e. poor valuation procedures, inadequate security, and poor procedures and responses to defaults on mortgage payments" was an area that was systemically weak in the market; and
- (b) The examples provided of appropriate compliance measures, including that valuations be updated every three years, and every 12 months for development loans where the draw down period continues over 12 months.

125. It is to be inferred from the third defendant's qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor of a mortgage scheme that he was aware of the terms of ASIC Regulatory Guide 45 (Mortgage schemes – improving disclosure for retail investors) from around the time of its issue in September 2008, prior to his completion of the 2008 Compliance Plan Audit, which emphasised the significance of independent and up to date valuations, by stating:

- (a) (at RG45.1) "Since mid-2007, Australia has experienced debt market turbulence flowing from the US sub-prime crisis, together with successive interest rate increases and a cyclical softening in property markets. Some mortgage schemes have experienced financial stress under these economic conditions..."
- (b) (at RG45.64(b)) "The responsible entity should have a clear policy on how often they obtain valuations ..."

- (c) (at RG45.67) “Robust and objective valuations are needed to ensure that the scheme’s financial position is correctly stated in the PDS and ongoing disclosures.”
- (d) (at RG45.69) “We expect that, where possible, responsible entities will only use professional valuers who are registered or licensed in the relevant state or territory or overseas jurisdiction and who subscribe to overseas jurisdictions. We also expect that responsible entities will be careful to ensure that their instructions to valuers are comprehensive and contain reasonable assumptions”.

126. It is to be inferred from the third defendant’s qualification as a registered company auditor and his decision to take on the responsibilities of a compliance plan auditor that he was aware of the content of AASB Guidance Statement G014, from around the time of its issue on 12 August 2009, prior to his completion of the 2009 Compliance Plan Audit, which stated that:

- (a) (at [14]) “the compliance plan auditor who conducts the audit of a scheme’s compliance plan under section 601HG, is required under ASAE 3100 Compliance Audits to obtain an understanding of the scheme’s compliance plan (the subject matter) and other engagement circumstances sufficient to identify and assess the risks of non-compliance, either of the responsible entity with the compliance plan or of the compliance plan with the Act, and be mindful of the compliance related expectations set out in RG 144, RG 45 and the other relevant ASIC regulatory guides, including those regulatory guides applicable to managed investment schemes generally.”
- (b) (at [17]) “In addition to the issues normally considered when undertaking financial report audits and compliance plan audits, auditors of mortgage schemes will need to consider several matters that are particularly important to the operation of such schemes. These matters include whether: ... (b) appropriate documentation is available in respect of all loans made by the scheme, including detailed loan agreements, securities held, guarantees, terms of repayments and external independent valuations; ...”

127. At all times from the 2008 Compliance Plan Audit, the third defendant was aware of the pressures of the global financial crisis, including credit tightening, and uncertainty for the property markets.

128. In the course of the 2008 Compliance Plan Audit, the third defendant (by himself or by others assisting him in the conduct of the audit):

- (a) reviewed the 30 June 2008 Financial Statements, which:
 - (i) disclosed significant accounting policies, judgements, estimates and assumptions regarding the allowance for impairment loss on loans and receivables that were not in accordance with paragraphs 58, 59, 63 and AG84 of AASB 139;

- (ii) reported prepayments of management fees of \$6,716,960 as at 30 June 2008, and that the balance was non-interest bearing;
- (b) reviewed the work paper of the first defendant and/or second defendant prepared in connection with the 30 June 2008 Financial Statements Audit identified as [J3] and entitled "Valuation of MORT loans in LM First Mortgage Income Fund", which:
 - (i) recorded the fact that the first defendant had:
 - (A) as to each loan on management's "Arrears Calculation for loans in Arrears/Default" list or on management's "Action List", "[d]iscussed with management the basis of the recoverable amount assigned to the loan security";
 - (B) "Review[ed] the Arrears Committee minutes for any other loans that may require an impairment assessment at balance date";
 - (ii) recorded management's recoverability assessment for each loan that was thereby reviewed, which:
 - (A) did not include any process to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;
 - (B) referred (in respect of some loans) to estimates of value not carried out by valuers on the valuation panel or properly qualified valuers, including by the plaintiff's in-house personnel;
 - (C) adopted valuations conducted on a gross realisation basis, without the "Feasibility analysis" required by the Valuation Policy measures;
 - (D) did not document or refer to any valuation technique that took account of the inapplicability of existing valuations as referred to in paragraph 119(a)(iii) above;
- (c) reviewed a document provided by the plaintiff identified as "08 E11.0 Mort loans LVR testing.xls", in which the sheet entitled "Loan listing PBC" included a column calculating for each loan of the Fund the "Assessed Security Value" as the "Current debt" divided by the current Loan to Value Ratio, and did not record or reflect any process to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;
- (d) reviewed the minutes of the credit committee of the plaintiff, which documented the plaintiff's consideration of all requests for variations or extensions of loans;
- (e) reviewed a sample of five loans to determine whether the valuation held in respect of those loans was less than 2 years old, identified one loan

(to Basic No 2 Pty Ltd) where the valuation was more than 2 years old, but nonetheless concluded (without further documentation) “per discussion with credit and lending an updated valuation is not required”;

(f) noted in the “Compliance Audit Testing / Findings 30 June 2008” that LM Administration was one of the “related parties” of the Fund.

129. In the course of the 2009 Compliance Plan Audit, the third defendant (by himself or by others assisting him in the conduct of the audit):

(a) reviewed the 30 June 2009 Financial Statements, which:

(i) disclosed significant accounting policies, judgements, estimates and assumptions regarding the allowance for impairment loss on loans and receivables that were not in accordance with paragraphs 58, 59, 63 and AG84 of AASB 139;

(ii) reported prepayments of management fees of \$6,000,000 as at 30 June 2009, and that the balance was non-interest bearing;

(b) reviewed the spreadsheet provided by the plaintiff and forming part of the working papers of the first defendant and/or second defendant prepared in connection with the 30 June 2009 Financial Statements Audit identified as [J2.0] and entitled “Summary of Valuations 30 June 2009”, which for each of the Fund’s loans and receivables:

(i) identified the valuation date of the valuation presently being relied on by the plaintiff for that loan;

(ii) identified an amount as “Assessed Valuation as at 30.6.09”, as well as the basis for that assessment, which:

(A) was, in many cases, on a gross realisation basis, without the “Feasibility analysis” required by the Valuation Policy measures;

(B) did not include any process to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;

(C) in respect of some loans, referred to estimates of value not carried out by valuers on the valuation panel or properly qualified valuers, including by the plaintiff’s in-house personnel;

(iii) did not document or refer to any valuation technique that took account of the inapplicability of existing valuations as referred to in paragraph 119(a)(iii) above;

(c) reviewed the minutes of the credit committee of the plaintiff, which documented the plaintiff’s consideration of all requests for variations or extensions of loans;

- (d) reviewed the minutes of the meetings of the plaintiff's Compliance Committee, which:
 - (i) included the minutes of the meeting on 25 August 2009 which recorded that "First Mortgage Income Fund and the feeder funds are not paying redemptions except for investor hardship redemptions and for the transfer of funds for feeder fund expenses and distributions", but which did not document any consideration by the Committee of the propriety of the allowing redemptions for feeder fund expenses and distributions while redemptions were otherwise suspended;
 - (ii) did not otherwise document any consideration by the Committee of the propriety of the allowing redemptions for feeder fund expenses and distributions while redemptions were otherwise suspended;
 - (e) noted in the "Compliance Audit Testing / Findings 30 June 2009" that "the Schemes" (including the Feeder Funds) and LM Administration were "related parties";
 - (f) was aware of the contents of the Financial Statements of the Currency Fund, Institutional Fund and Wholesale Fund for the year ended 30 June 2009, having reviewed the same in the course of a compliance plan audit conducted for those schemes, each of which stated that:
 - (i) "the manager suspended redemptions except for ... feeder fund payments for investor distributions and fund expenses."
 - (ii) "[d]uring the period and to the date of this Report, the Scheme has received all distributions receivable and redemptions requested from the LM First Mortgage Income Fund";
 - (g) reviewed the results of the redemption testing carried out by the first defendant and/or second defendant in connection with the 30 June 2009 Financial Statements Audit on a sample of 25 applications and redemptions across the Feeder Funds, as recorded in audit workpaper 09 T200.2, which included two redemptions granted after 11 May 2009, namely:
 - (i) a redemption granted on 19 May 2009 in the amount of \$345,000 to the Wholesale Fund; and
 - (ii) a redemption granted on 18 June 2009 in the amount of \$115,000 to the Institutional Fund.
130. In the course of the 2010 Compliance Plan Audit, the third defendant (by himself or by others assisting him in the conduct of the audit):
- (a) reviewed the 30 June 2010 Financial Statements, which:
 - (i) disclosed significant accounting policies, judgements, estimates and assumptions regarding the allowance for impairment loss on

loans and receivables that were not in accordance with paragraphs 58, 59, 63 and AG84 of AASB 139;

- (ii) reported prepayments of management fees of \$8,200,000 as at 30 June 2010, and that the balance was non-interest bearing;
- (iii) identified substantial redemptions by the Feeder Funds;
- (b) noted in the "Compliance Audit Testing / Findings 30 June 2010" that "no new valuations have been performed during the year. EY has therefore looked at recent sales prices within the properties and valued the properties accordingly. Other sales data such as those in surrounding buildings and streets have also been used";
- (c) noted in the "Compliance Audit Testing / Findings 30 June 2010" that "EY has reviewed recoverability assessments by management in relation to the loans", with reference to "work performed on the schemes at J section in the GAMx", which included the Internal Memoranda prepared by the first defendant and/or second defendant in the course of the 30 June 2010 Financial Report Audit Engagement that assessed the security valuation and recoverability of each loan of the Fund;
- (d) reviewed the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (c) above, which recorded management's recoverability assessment for the loan, and independently considered the security valuations and recoverability of the loan, but which:
 - (i) did not document or refer to any process or any consistent process for each loan to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;
 - (ii) did not document or refer to any valuation technique that took account of the inapplicability of existing valuations as referred to in paragraph 119(a)(iii) above;
 - (iii) in respect of many loans, used estimates of value not carried out by valuers on the valuation panel or properly qualified valuers, including in some cases by the plaintiff's in-house personnel and/or by the first defendant and/or second defendant's staff;
 - (iv) in respect of many loans, referred to valuations conducted on a gross realisation basis, without the "Feasibility analysis" required by the Valuation Policy measures;
- (e) reviewed the minutes of the credit committee of the plaintiff, which documented the plaintiff's consideration of all requests for variations or extensions of loans;
- (f) noted in the "Compliance Audit Testing / Findings 30 June 2010" that "the Schemes" (including the Feeder Funds) and LM Administration were "related parties";

(g) was aware of the contents of the Financial Statements of the Currency Fund, Institutional Fund and Wholesale Fund for the year ended 30 June 2010, having reviewed the same in the course of a compliance plan audit conducted for those schemes, each of which stated that:

(i) “the manager suspended redemptions except for ... feeder fund payments for investor distributions and fund expenses.”

(ii) “[d]uring the period and to the date of this Report, the Scheme has received all ... redemptions requested from the LM First Mortgage Income Fund”;

(h) reviewed the minutes of the meetings of the plaintiff’s Compliance Committee, which did not document any consideration by the Committee of the propriety of the allowing redemptions for feeder fund expenses and distributions while redemptions were otherwise suspended.

131. In the course of the 2011 Compliance Plan Audit, the third defendant (by himself or by others assisting him in the conduct of the audit):

(a) reviewed the 30 June 2011 Financial Statements, which:

(i) disclosed significant accounting policies, judgements, estimates and assumptions regarding the allowance for impairment loss on loans and receivables that were not in accordance with paragraphs 58, 59, 63 and AG84 of AASB 139;

(ii) reported prepayments of management fees of \$8,200,000 as at 30 June 2011, and that the balance was non-interest bearing;

(iii) identified substantial redemptions by the Feeder Funds;

(iv) identified the payment of Loan Management Fees “for loan management and controllership services provided by the Responsible Entity on behalf of the Scheme in replacement of appointing external receivers” in the amount of \$5,381,516, and that the amount of such fees paid in the previous financial year was nil;

(b) noted in the “Compliance Audit Testing / Findings 30 June 2011” that “EY has reviewed recoverability assessments by management in relation to the loans”, with reference to “work performed on the schemes at J section in the GAMx”, which included the Internal Memoranda prepared by the first defendant and/or second defendant in the course of the 30 June 2011 Financial Report Audit Engagement that assessed the security valuation and recoverability of each loan of the Fund;

(c) reviewed the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above, which recorded management’s recoverability

assessment for the loan, and independently considered the security valuations and recoverability of the loan, but which:

- (i) did not document or refer to any process or any consistent process for each loan to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;
 - (ii) did not document or refer to any valuation technique that took account of the inapplicability of existing valuations as referred to in paragraph 119(a)(iii) above;
 - (iii) in respect of many loans, used estimates of value not carried out by valuers on the valuation panel or properly qualified valuers, including in some cases by the plaintiff's in-house personnel and/or by the first defendant and/or second defendant's staff;
 - (iv) in respect of many loans, referred to valuations conducted on a gross realisation basis, without the "Feasibility analysis" required by the Valuation Policy measures;
- (d) further and in the alternative, having reviewed the impairment testing work performed by the first defendant and/or second defendant of the Fund in his role as the Engagement Quality Review Partner for the 30 June 2011 Financial Statements Audit, was aware:
- (i) of the contents of the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above;
 - (ii) of the age of the valuations relied on in preparing the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above
- (e) reviewed the minutes of the credit committee of the plaintiff, which documented the plaintiff's consideration of all requests for variations or extensions of loans;
- (f) noted in the "Compliance Audit Testing / Findings 30 June 2011" that "the Schemes" (including the Feeder Funds) and LM Administration were "related parties";
- (g) was aware of the contents of the Financial Statements of the Currency Fund, Institutional Fund and Wholesale Fund for the year ended 30 June 2011, having reviewed the same in the course of a compliance plan audit conducted for those schemes, each of which stated that:
- (i) "the manager suspended redemptions except for ... feeder fund payments for investor distributions and fund expenses."
 - (ii) "[d]uring the period and to the date of this Report, the Scheme has received all ... redemptions requested from the LM First Mortgage Income Fund";

- (h) reviewed the minutes of the meetings of the plaintiff's Compliance Committee, which did not document any consideration by the Committee of the propriety of the allowing redemptions for feeder fund expenses and distributions while redemptions were otherwise suspended;
 - (i) reviewed the results of the redemption testing carried out by the first defendant and/or second defendant in connection with the 30 June 2011 Financial Statements Audit, as recorded in audit workpaper 11 T200.2, which included a note applicable to 4 of the reviewed redemptions that "These amounts were a running total comprised of many expenses which were paid on behalf of the feeder fund by MPF and are cleared through FMIF's receivable from MPF."
132. In the course of the 2012 Compliance Plan Audit, the third defendant (by himself or by others assisting him in the conduct of the audit):
- (a) reviewed the 30 June 2012 Financial Statements, which:
 - (i) reported substantial redemptions by the Feeder Funds;
 - (ii) identified substantial income distributions to the Feeder Funds;
 - (iii) identified the payment of Loan Management Fees "for loan management and controllership services provided by the Responsible Entity on behalf of the Scheme in replacement of appointing external receivers" in the amount of \$4,817,414;
 - (b) noted in the "Compliance Audit Testing / Findings 30 June 2012" that "EY has reviewed recoverability assessments by management in relation to the loans", with reference to "work performed on the schemes at J section in the GAMx", which included the Internal Memoranda prepared by the first defendant and/or second defendant in the course of the 30 June 2011 Financial Report Audit Engagement that assessed the security valuation and recoverability of each loan of the Fund;
 - (c) reviewed the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above, which recorded management's recoverability assessment for the loan, and independently considered the security valuations and recoverability of the loan, but which:
 - (i) did not document or refer to any process or any consistent process for each loan to comply with paragraphs 63 and AG84 of AASB 139, as referred in paragraph 119(a)(ii) above;
 - (ii) did not document or refer to any valuation technique that took account of the inapplicability of existing valuations as referred to in paragraph 119(a)(iii) above;
 - (iii) in respect of many loans, used estimates of value not carried out by valuers on the valuation panel or properly qualified valuers,

including in some cases by the plaintiff's in-house personnel and/or by the first defendant and/or second defendant's staff;

- (iv) in respect of many loans, referred to valuations conducted on a gross realisation basis, without the "Feasibility analysis" required by the Valuation Policy measures;
- (d) further and in the alternative, having reviewed the impairment testing work performed by the first defendant and/or second defendant in his role as the Engagement Quality Review Partner for the 30 June 2012 Financial Statements Audit, was aware:
 - (i) of the contents of the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above;
 - (ii) of the age of the valuations relied on in preparing the Internal Memoranda prepared by the first defendant and/or second defendant for each loan of the Fund referred to in sub-paragraph (b) above;
- (e) reviewed the minutes of the credit committee of the plaintiff, which documented the plaintiff's consideration of all requests for variations or extensions of loans;
- (f) noted in the "Compliance Audit Testing / Findings 30 June 2012" that "the Schemes" (including the Feeder Funds) and LM Administration were "related parties";
- (g) was aware of the contents of the Financial Statements of the Currency Fund, Institutional Fund and Wholesale Fund for the year ended 30 June 2012, having reviewed the same in the course of a compliance plan audit conducted for those schemes, each of which stated that:
 - (i) "the manager suspended redemptions except for ... feeder fund payments for investor distributions and fund expenses."
 - (ii) "the directors of the responsible entity made the decision to suspend distributions from FMIF from 1 January 2011"
 - (iii) "[d]uring the period and to the date of this Report, the Scheme has received all distributions receivable and redemptions requested from the LM First Mortgage Income Fund";
- (h) reviewed the minutes of the meetings of the plaintiff's Compliance Committee, which did not document any consideration by the Committee of the propriety of the allowing redemptions for feeder fund expenses and distributions while redemptions were otherwise suspended;
- (i) reviewed the results of the redemption testing carried out by the first defendant and/or second defendant in connection with the 30 June 2012 Financial Statements Audit on a sample of 10 redemptions across the

Feeder Funds, as recorded in audit workpaper 12 YE T200.4, which included notes to the effect that redemptions were, variously, "B. for expenses paid by FMIF on behalf of CPAIF" and "C. Same as B but between ICAIF and FMIF".

~~123-133.~~ In breach of the Auditors' Duty of Care and the Auditors' Contractual Duty, the first defendant and/or the third defendant, in undertaking the Compliance Plan Audits:

- (a) did not undertake any or any proper consideration of:
 - (i) whether the valuation of Fund assets (including the measuring of impairment) was done in accordance with paragraphs 58, 59, 63 and AG84 of Australian Accounting Standard AASB139, the Australian Accounting Standards as required by the Act;
 - (ii) whether the Fund property was properly valued at regular intervals as required by the Act and the Compliance Plans;
 - (iii) whether the valuations used in the valuation of Fund assets were valued as required by the Compliance Plans and/or were appropriate for the proper application of the Australian Accounting Standards in accordance with the Act;
 - (iv) whether the employees of the company providing management services to the plaintiff were adequately trained and/or skilled in measuring impairment on loans and receivables in accordance with Australian Accounting Standard AASB 139;
 - (v) whether the employees of the company providing management services to the plaintiff were adequately qualified to value real properties held as security for the Fund assets;
 - (vi) whether the internal audit function was adequate where the financial position of the Fund and the pressures of the global financial crisis had increased the risks of potential non-compliance with the Act, the Compliance Plan and the Constitution;
 - (vii) whether the payment of management fees in advance fees and expenses paid to the RE and/or LM Administration was were paid in accordance with the Act, the Constitutions, the Fund's product disclosure statements and/or the Compliance Plans;
 - ~~(vi)~~(viii) whether the payment of Loan Management Fees to the RE and/or LM Administration was in accordance with the Act, the Constitutions, the Fund's product disclosure statements and/or the Compliance Plans;
 - (ix) whether the distributions and/or redemptions paid to Class B unitholders of the Fund after 11 May 2009 were properly paid in accordance with the Act and/or the Compliance Plans;

~~(vii)~~(x) whether the income distributions recognised for the benefit of Class B unitholders of the Fund after 1 January 2011 were properly recognised in accordance with the Act, the Constitutions and/or the Compliance Plans;

~~(viii)~~(xi) whether the plaintiff, its directors and employees and/or agents were acting in the best interests of the Members in accordance with the Act and/or the Compliance Plans;

- (b) did not apply any or any adequate professional scepticism in assessing the adequacy of the Compliance Plans, or to the information and documents provided to them in the course of the audit;

Particulars

- (i) The first and/or third defendants in many cases accepted the values for underlying security properties identified by the plaintiff without appropriate professional scepticism;
- (ii) The first and/or third defendants in many cases accepted the plaintiff's identification and measurement of impairment of loans and receivables without appropriate professional scepticism and, in particular, failed in many cases to adequately question:
 - (A) the plaintiff's objective evidence of impairment, including fair value of collateral;
 - (B) whether the plaintiff had properly, or at all, discounted the estimated future cash flows to present value;
 - (C) whether the plaintiff had properly, or at all, estimated the amount/timing of estimated future cashflows;
 - (D) whether the plaintiff had properly, or at all, accounted for the cost of holding and/or realising real property securities underlying those loans; and
 - (E) whether the plaintiff had properly applied paragraphs 58, 59, 63 and AG84 of Australian Accounting Standard AASB 139;
- (iii) The first and/or third defendants failed to question or properly consider whether the RE had complied with its obligations under section 601FC(1) of the Act, in particular, they failed to question, or properly consider, whether:
 - (A) the plaintiff as RE was acting in the best interests of the Members and, if there was a conflict between the Members' interests and its own interests, that it was giving priority to the Members' interests;

- (B) the plaintiff as RE was ensuring that all payments out of the Fund's property were made in accordance with the Constitutions and the Act;
- (C) the plaintiff as RE was treating the members who held interests of the same class equally and members who held interests of different classes fairly;
- (iv) The first and or third defendant accepted the RE's implied assertion that the measures in the Compliance Plans that gave a discretion to the RE not to obtain an updated valuation where the RE considered that an updated valuation would serve no useful purpose were adequate without question or proper consideration of whether in fact such measures were adequate to ensure compliance with the Act and/or the Constitutions;
- (v) The first and/or third defendant accepted the RE's implied assertion that it had exercised that discretion not to obtain an updated valuation appropriately without question or proper consideration of whether in fact it had;
- (vi) Further particulars will be provided on completion of interlocutory steps.
- (c) did not take reasonable care to determine whether the Financial Statements and the financial records of the Fund were made and maintained in accordance with paragraphs 58, 59, 63 and AG84 of Australian Accounting Standard AASB139; the Act, the Australian Accounting Standards or other mandatory professional accounting and reporting requirements;

Particulars

- ~~(i)~~ — ~~The first and/or third defendants did not properly identify and report the deficiencies in the measures contained in the Compliance Plans, including in respect of identification and measurement of impairment of loans, to the plaintiff, ASIC and/or the Members;~~
- ~~(ii)~~(i) The first and/or third defendants did not obtain sufficient appropriate evidence on which to base a conclusion as to compliance with the financial records and financial reporting requirements of the Act, including in regard to the identification and measurement of impairment of loans in accordance with paragraphs 58, 59, 63 and AG84 of Australian Accounting Standard AASB139;
- ~~(iii)~~ — ~~Further particulars will be provided on completion of interlocutory steps.~~

- (d) did not use staff who were sufficiently familiar and experienced with:
 - (i) the application of AASB139 to loans and receivables of the type held by the plaintiff; and/or
 - (ii) the proper management of managed investment schemes of the type operated by the plaintiff.

134. Further, in the premises of the matters referred to in paragraphs 123 to 132 hereof, it is to be inferred that the third defendant became aware in the course of the conduct of the Compliance Plan Audits of the matters referred to in paragraphs 119(a), (b), (c), (d), (f) and (h) and 120(a), (b) and (c) hereof.

135. In the premises of the matters referred to in paragraphs 123 to 132 and 134 hereof, the first and/or third defendants became aware of circumstances that there were reasonable grounds to suspect amounted to the contraventions of the Constitutions and/or the Act pleaded in paragraphs 121(a) to (c) and (e) hereof, as well as 121(g) hereof insofar as it concerns the breaches alleged in paragraphs 119(a), (b), (c), (d), (f) and (h) hereof.

136. In the premises of the matters set out in paragraphs 123 to 132, 134 and 135 above, the first defendant and/or the third defendant:

~~(e)(a) in the premises of the matters set out in paragraphs 121 and 121A above, and in contravention of the obligation imposed by section 601HG(3)(c), properly construed as pleaded in paragraph 41 41A above, did not provide to the plaintiff a report that was reasonable based on the circumstances of which they had become aware in the course of their examination and audit carried out in accordance with sections 601HG(3)(a) and (b) of the Act, namely an opinion that included statements to the effect that in their opinion:~~

- (i) the plaintiff had not complied with the Compliance Plans during the financial year; and
- (ii) the Compliance Plans did not meet the requirements of Part 5C.4 of the Act,

(a Non-Compliance Report).

~~(f)(b) in the premises of the matters set out in paragraphs 121 and 121A above, and in contravention of section 601HG(4B) and/or section 601HG(4) of the Act, did not notify ASIC that they were aware of circumstances that they had reasonable grounds to suspect amounted to significant contraventions of the Act.~~

~~124.137. In the premises of the matters set out in paragraphs 122(e) and 122(f) above, the plaintiff breached the Auditors' Statutory Duties.~~

Consequence of the lack of reasonable care in the Compliance Plan Audits

~~125.138.~~ In relation to each of the Compliance Plan Audit Engagements, if the first defendant and/or the third defendant had not breached the Auditors' Duty of Care and the Auditors' Contractual Duty:

- (a) the first defendant and/or the third defendant would have detected the matters referred to in paragraphs ~~119+18~~ to ~~121+20~~ above as they existed at that time;
- (b) the first defendant and/or the third defendant would have reported the matters referred to in paragraphs ~~119+18~~ to ~~121+20~~ above to those charged with governance of the plaintiff, by delivery of a Non-Compliance Report or otherwise;
- (c) if necessary, the first defendant and/or the third defendant would have notified ASIC of some or all of the matters referred to in paragraphs ~~120+19~~ and ~~121+20~~ above;
- (d) further and in the alternative, the first defendant and/or the third defendant would have promptly:
 - (i) reported to the plaintiff, by providing a Non-Compliance Report or otherwise, the matters of which it was aware referred to in paragraph 121 above; and
 - (ii) given notice of those matters to ASIC or, in the alternative if any of those matters was not a significant breach of the Act, if and insofar they were not then adequately dealt with by the plaintiff;
- (e) the plaintiff would have promptly provided to ASIC any Non-Compliance Report under section 601HG(7) of the Act.
- (f) the plaintiff would voluntarily or have been required to take steps to:
 - (i) improve its internal audit function and/or procedures, in particular in relation to compliance with AASB139;
 - (ii) retain or consult suitable qualified agents or employees to enable them to comply with AASB139, and to assess the validity of fees, redemptions and distributions proposed to be paid or recognised by the Fund;
 - (iii) obtain up to date and relevant independent valuations of the real property assets securing the Mortgage Investments;
- (g) as a direct result of (f) above, the plaintiff would have been caused to:
 - (i) properly recognise and calculate impairment of the Mortgage Investments of the Fund;

- (ii) realise Mortgage Investments (in a fashion and at times substantially the same as that as upon a winding up as set out in paragraphs ~~76(h)~~~~75(h)~~ and ~~148~~~~134~~ hereof);
- (iii) stop the pre-payment of management fees and other expenses to itself and LM Administration;
- (iv) stop the payment of loan management fees to itself and/or LM Administration;
- (v) stop the payment of redemptions to Class B unitholders after 11 May 2009;
- (vi) stop the recognition of distributions to Class B unitholders after 1 January 2011.

~~126-139.~~ Further, in relation to each of the Compliance Plan Audit Engagements, if the first defendant and/or the third defendant had not breached the Auditors' Statutory Duties, the matters set out in paragraphs ~~138(d)~~~~124(d)~~ to ~~138(g)~~~~124(g)~~ would have occurred.

Misleading and Deceptive Conduct with respect to the Compliance Plan

~~127-140.~~ The third defendant is a:

- (a) person for the purposes of section 18 of the ACL (Qld) as in force from 1 January 2011;
- (b) person for the purposes of section 1041H and 1041I of the Act;
- (c) person for the purposes of section 12DA of the ASIC Act;
- (d) person within the meaning of section 6(2)(h) and section 6(3) of the TPA, as in force until 1 January 2011, which sections give the TPA extended application to the conduct of persons in certain circumstances for the purposes of section 52 of the TPA; and
- (e) person within the meaning of section 6(2)(h) and section 6(3) of the CCA, as in force on and from 1 January 2011, which sections give the CCA extended application to the conduct of persons in certain circumstances for the purposes of section 131 of the CCA, which gives force including to section 18 of the ACL.

~~128-141.~~ The first defendant, by itself and/or through the third defendant, by conducting the Compliance Plan Audits and preparing and completing the Compliance Plan Audit Reports pursuant to the Compliance Plan Audit Engagements:

- (a) provided services in trade or commerce to the plaintiff within the meaning of section 52 of the TPA as in force until 1 January 2011, and of section 18 of the ACL (Qld) and section 18 of the ACL as in force thereon and after;

- (b) provided services to the plaintiff in trade or commerce among the States, within the meaning of section 6(2)(a) of the TPA and section 6(2)(a) of the CCA;
- (c) in the alternative, provided services using postal, telegraphic and telephonic services within the meaning of section 6(3) of the TPA and section 6(3) of the CCA; and

Particulars

- (i) Further particulars will be provided upon completion of interlocutory steps.
- (d) provided auditing services in relation to a financial product (being the units in the Fund) within the meaning of Part 7.10 Division 2 of the Act and Part 2, Division 2, Subdivision D of the ASIC Act.

The Compliance Plan Representations

~~129.142.~~ The first defendant and/or the third defendant represented to the plaintiff to the effect that as at the time of each of the Compliance Plan Audit Reports:

- (a) the first defendant and/or the third defendant had done sufficient audit work for them to form conclusions as to issues arising from the Compliance Plan Audits;
- (b) the first defendant and/or the third defendant had exercised reasonable care, diligence and skill to the standard of a reasonably competent auditor in carrying out the Compliance Plan Audits;
- (c) there existed a reasonable basis for an auditor exercising care, diligence and skill to the standard of a reasonably competent auditor to form the Compliance Plan Audit Opinions contained in the Compliance Plan Audit Reports.

(The above representations are referred to as the **Compliance Plan Representations**).

The falsity of the Compliance Plan Representations

~~130.143.~~ In the premises of the matters set out in paragraphs ~~121, 133, 122, 136~~ and ~~140, 126~~ to ~~142, 128~~ above, the Compliance Plan Audit Representations were false in that at the time of making each of the Compliance Plan Audit Reports:

- (a) the first defendant and/or the third defendant had not done sufficient audit work for them to form conclusions as to issues arising from the Compliance Plan Audits;

- (b) the first defendant and/or the third defendant had not exercised reasonable care, diligence and skill to the standard of a reasonably competent auditor in carrying out the Compliance Plan Audits;

Particulars

- (i) The manner in which the first and/or third defendants failed to exercise reasonable care included those matters referred to in paragraph ~~133~~¹⁴² hereof.
- (c) in the premises of paragraphs ~~136~~¹⁴² and sub-paragraphs (a) and (b) above, the first defendant and/or the third defendant did not have a reasonable basis for the Compliance Plans Audit Opinions contained in each of the Compliance Plan Audit Reports;

~~131, 144.~~ In making the Compliance Plan Representations, the first defendant and/or the third defendant engaged in misleading and deceptive conduct or conduct which was likely to mislead or deceive, contrary to:

- (a) in relation to the Compliance Plan Representations made in the course of the 30 June 2011 Compliance Plan Audit Engagement and the 30 June 2012 Compliance Plan Audit Engagement, section 18 of the ACL (Qld);
- (b) section 1041H and 1041I of the Act;
- (c) section 12DA of the ASIC Act;
- (d) in relation to the Compliance Plan Representations made in the course of the 30 June 2008 Compliance Plan Audit Engagement, the 30 June 2009 Compliance Plan Audit Engagement and the 30 June 2010 Compliance Plan Audit Engagement, section 52 of the TPA; and
- (e) in relation to the Compliance Plan Representations made in the course of the 30 June 2011 Compliance Plan Audit Engagement and the 30 June 2012 Compliance Plan Audit Engagement, section 18 of the ACL,

(the Compliance Plan Auditors' Misleading Conduct).

Consequences of the Compliance Plan Auditors' Misleading or Deceptive Conduct

~~132, 145.~~ If the first defendant and/or the third defendant had not engaged in the Compliance Plan Auditors' Misleading Conduct, then:

- (a) the first defendant and/or the third defendant would not have provided the Compliance Plan Audit Reports;
- (b) the first defendant and/or the third defendant would promptly have completed the Compliance Plan Audits exercising reasonable care, diligence and skill to the standard of a reasonably competent auditor;

- (c) the matters set out in paragraphs ~~138(a)~~~~124(a)~~ to ~~138(g)~~~~124(g)~~ would have occurred.

Reliance

~~133,146.~~ At all material times until the Fund was wound up, the plaintiff relied on each of the following in continuing to operate and to not either wind up or otherwise make significant changes to its management of the Fund:

- (a) the conduct by the first defendant and/or the third defendant of the Compliance Plan Audits;
- (b) the absence of any Non-Compliance Report; and
- (c) the Compliance Plan Audit Representations.

Causation – compliance plan breaches and misleading conduct

~~134,147.~~ Further to each of paragraphs ~~138~~~~124~~, ~~139~~~~125~~ and ~~145~~~~131~~ above:

- ~~(a) — upon notification to ASIC of some if not all of the matters referred to in paragraphs 118 to 120 above, ASIC would have been aware of, or by carrying out its own further investigations become aware of, all of these matters;~~
- ~~(b)(a) further and in the premises of the matters set out in paragraphs 138~~~~124~~, ~~139~~~~125~~ and ~~145~~~~131~~ and sub-paragraph (a) above:

 - (i) the circumstances set out in paragraph ~~64~~~~63~~ above would not have continued;
 - (ii) the plaintiff would have been required to identify substantial impairment losses across a wide range of the Fund's assets;
 - (iii) the plaintiff and/or LM Administration would not have been able to keep receiving fees in advance of providing services to the Fund;
 - (iv) the plaintiff and/or LM Administration would not have been able to continue to receive the further loan management fees;
 - (v) the plaintiff would not have been able to receive RE Management Fees based on an overvaluation of the Fund; and
 - (vi) the plaintiff would not have kept paying redemptions to Class B unitholders after 11 May 2009;

~~(e)~~(b) in the premises, the management of the plaintiff and/or ASIC would promptly have caused the Fund to be wound up;

Particulars

- (i) ASIC would have so caused the Fund to be wound up by applying to the Court under section 601ND(2)(d) of the Act for the necessary relief, on the just and equitable ground.
- (ii) The management of the plaintiff would have so caused the Fund to be wound up by causing the plaintiff to take the necessary steps to do so under section 601NC(1), on the basis that the purpose of the Fund cannot be accomplished.
- (iii) Alternatively, the management of the plaintiff would have caused the Fund to be wound up by causing the plaintiff to apply to the Court under section 601ND(2)(a) of the Act, or by one of the directors of the plaintiff applying to the Court under section 601ND(2)(b) of the Act, for the necessary relief on the just and equitable ground.
- (iv) ASIC and/or the plaintiff would thereby have caused the winding up of the Fund to be commenced within around three months of becoming so aware of the matters pleaded.

~~(d)~~(c) in the alternative, the creditors of the Feeder Funds would have caused the Fund to be wound up;

Particulars

- (i) Upon the plaintiff ceasing to pay redemptions to the Class B Unitholders, the Feeder Funds would have been unable to indemnify LMIM for its liabilities including to pay fees to LM Administration and (in the case of the Currency Fund and the Institutional Fund) under foreign exchange derivative contracts.
- (ii) The external creditors of the Currency Fund and the Institutional Fund would have taken steps to cause the assets of those Feeder Funds to be realised so as to recover their debts, and either:
 - (A) appointed a receiver over their assets, who would in turn have caused the RE to take steps as a Member to cause the Fund to be wound up; or
 - (B) applied to the Court as a creditor of the Feeder Fund for orders that it be wound up on the just and equitable ground, following which the person or persons responsible for the winding up would have caused the plaintiff as RE of the Feeder Fund to take steps as a Member to cause the Fund to be wound up.

Loss and damage with respect to the Compliance Plan Audits

~~135-148.~~ Following the commencement of any winding up of the Fund, as referred to in paragraphs ~~147(b)~~~~133(e)~~ and ~~147(c)~~~~133(d)~~ above, the matters referred to in ~~76(a)~~~~75(a)~~ to ~~76(o)~~~~75(o)~~ would have occurred.

~~136-149.~~ In the premises, the breaches of the Auditors' Statutory Duties, the Auditors' Duty of Care and the Auditors' Contractual Duty and the Compliance Plan Auditors' Misleading Conduct has caused the plaintiff loss and damage.

Particulars

- (a) The loss or damage caused is that particularised to paragraph ~~77~~~~76~~ above

~~137-150.~~ Further and in the alternative:

- (a) the third defendant personally carried out the Compliance Plan Audits, gave the Compliance Plan Audit Reports and expressed the Compliance Plan Audit Opinions and/or the Compliance Plan Representations;
- (b) the third defendant was at all material times acting:
- (i) in the ordinary course of business of the first defendant; or, alternatively
- (ii) with the authority of his co-partners of the first defendant,
- (c) in the premises, by reason of the matters pleaded in paragraphs 4 and 6 above the first defendant is liable to the plaintiff for its loss and damage to the same extent as the third defendant in committing those acts and omissions, pursuant to section 13 of the *Partnership Act 1891* (Qld) or the general law.

Fraudulent concealment of the plaintiff's rights of actions

The Financial Statements Audits and Reviews

~~138-151.~~ The first defendant and/or the second defendant was aware at all material times:

- (a) that the Compliance Plan of the Fund obliged the plaintiff to generally obtain updated valuations for the Fund's commercial loans at 24 month intervals and for the Fund's construction loans at 12 month intervals, which requirement could be waived by the plaintiff as the responsible entity of the Fund where the plaintiff considered that an updated valuation would serve no useful purpose;
- (b) that paragraph 58 of AASB139 required the plaintiff to assess at the end of each reporting period whether there was any objective evidence that any of the Fund's loans and receivables or any group of its loans and

receivables was impaired, by considering objective evidence of impairment, which would include:

- (i) the fair value of the real estate assets securing the Fund's loans and receivables;
 - (ii) levels of and trends in delinquencies for similar financial assets; and
 - (iii) national and local economic trends and conditions;
- (c) that paragraphs 63 and AG84 of AASB139 required an impairment loss on a loan to be measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the loan's original effective interest rate, except that cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial;
- (d) that AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors (**AASB 108**) required the plaintiff, on the identification of a material prior period error, to correct that error in the first set of financial statements authorised for issue after its discovery, in accordance with AASB108 paragraphs 41 to 48;
- (e) that paragraph 49 of AASB108 required the plaintiff also to disclose in the first set of financial statements authorised for issue after the discovery of any material prior period error:
- (i) the nature of the prior period error;
 - (ii) to the extent practicable, the amount of the correction for each financial statement line item affected;
 - (iii) the amount of the correction at the beginning of the earliest prior period presented; and
 - (iv) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected;
- (f) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by ASA315 and ASA330:
- (i) to identify and assess the risks of material misstatement in the Financial Statements, whether due to fraud or error (including due to possible management bias); and
 - (ii) to design and perform additional audit procedures to adequately address any such identified risks;

- (g) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraphs 9 and A39 to A44 of ASA540 to review the outcome of accounting estimates included in the prior period financial report, or, where applicable their subsequent re-estimation for the purpose of the current period:
 - (i) to identify and assess any risk of material misstatement of accounting estimates made in the current period financial report;
 - (ii) thereby also to obtain audit evidence which may be pertinent to the re-estimation of prior period accounting estimates in the current period financial report, or to matters that may be required to be disclosed in the current period financial report;
- (h) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraph 32(b)(ii) of ASA240 to perform a retrospective review of management judgements and assumptions related to significant accounting estimates reflected in the financial report of the prior year;
- (i) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraph 5 of ASA200 to obtain a high level of assurance that there were no material prior period errors which had not been properly recognised and disclosed in the Financial Statements;
- (j) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraph 5 of ASA200 to obtain a high level of assurance that the level of impairment of all impaired loans and receivables had been properly assessed in accordance with AASB139;
- (k) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraph 11 of ASA450 to determine whether uncorrected misstatements are material, individually or in aggregate, and in doing so to consider the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial report as a whole;
- (l) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 31 December Financial Statements was required by paragraph 22 of ASRE2410 to evaluate, individually and in the aggregate, whether uncorrected misstatements that have come to the auditor's attention are material to the financial report;
- (m) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraph 16 of ASA260 to communicate with those charged with governance of the plaintiff the auditor's views about significant qualitative aspects of the entity's accounting practices, including

accounting policies, accounting estimates and financial report disclosures, and other matters arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process;

- (n) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 30 June Financial Statements was required by paragraphs 12 and 13 of ASA450 to communicate to those charged with governance of the plaintiff:
 - (i) uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation; and
 - (ii) the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial report as a whole; and
- (o) (for financial reporting periods commencing on or after 1 January 2010) that the auditor of the 31 December Financial Statements was required by paragraph 31 of ASRE2410 to communicate relevant matters of governance interest arising from the review of the financial report to those charged with governance.

~~139,152.~~ At all material times from about October 2008, the first defendant and/or the second defendant was aware:

- (a) that the Fund was exposed to uncertainty in and the weakening of property markets in Australia caused by the occurrence of the global financial crisis;
- (b) that the management of the plaintiff, in the event of any of the Fund's loans and receivables falling into default, or the borrower otherwise facing a difficult financial position, had adopted as its general strategy in relation to the real property assets securing those loans and receivables to "lock it up and sit on it until the property market rebounds".

Particulars.

- (i) Closing Meeting held on 8 October 2008 at 11am, attended including by the second defendant and Rebecca Burrows of the first defendant.
- (ii) Further particulars will be provided upon completion of interlocutory steps.

~~140.~~153. In the premises of the matters set out in paragraph ~~152~~138 above, the first defendant and/or the second defendant was aware at all material times from about October 2008 of an increased risk, including an increased risk of management bias, in:

- (a) management's estimation of the value of the real property assets securing the Fund's loans and receivables;
- (b) management's assessment of objective evidence of impairment, and its estimation of the level of impairment, of the Fund's loans and receivables.

~~141.~~154. The plaintiff's management did not between about early to mid-2008 and the completion of the 30 June 2012 Financial Statements Audit obtain updated external valuations of a significant number of significant real property assets securing the Fund's loans and receivables.

Particulars

- (a) Further particulars will be provided upon completion of interlocutory steps and by way of an expert's report.

~~142.~~155. The plaintiff's management first identified substantial impairment of the Fund's loans and receivables in the 31 December 2010 Financial Statements, amongst other things the most significant contribution to which was management's adjusted valuations of underlying real property securities based on sales of securities for materially less than:

- (a) had been previously estimated by the plaintiff's management; and
- (b) the estimates of value contained in the external valuations obtained by the plaintiff before about 1 October 2008.

~~143.~~156. As at the material date of the 31 December 2010 Financial Statements, the first defendant and/or the second defendant was not aware of any events which had occurred or circumstances which had arisen since the material date of the 30 June 2010 Financial Statements affecting the property markets which were sufficient to explain the change in the plaintiff's estimate of the fair value of those of the Fund's underlying real property securities carrying the impairment losses first identified in the 31 December 2010 Financial Statements.

~~144.~~157. Following identification by the plaintiff's management of substantial impairment losses in the 31 December 2010 Financial Statements, and as part of the 31 December 2010 Financial Statements Review, the first defendant and/or the second defendant reviewed the Fund's loans and receivables for the existence of indicators of impairment, and the level of impairment.

Particulars

- (a) Internal Memorandum dated 1 March 2011 documenting the first defendant and/or the second defendant's approach to determining the

existence of impairment on the Fund's loans and receivables as at 31 December 2010.

- (b) Internal Memoranda dated in around February and March 2011 documenting the first defendant and/or second defendant's review of the Fund's loans and receivables for impairment, as at 31 December 2010.

~~145-158.~~ The Directors' Report in the 31 December 2010 Financial Statements contained the following statement, of which the first defendant and/or second defendant was aware:

"The Australian property market has performed well in comparison to other developed countries during the course of the GFC (in particular the affordable residential sectors), however some sectors of the market remain affected by the continued lack of credit in the marketplace, hence seeing a slowness continue in the rate of sales and some discounting apply in order for property sellers to realise cash.

During the course of the accelerated sales and marketing campaign, the manager accepted sales prices which have resulted in the fluctuation of the unit price. After assessment of this market evidence, the directors are of the opinion that some additional provisions were required in the accounts in order to reflect these values.

... The assets which have been retained by the Scheme may provide outperformance over the medium to longer term (particularly those in the retirement sector) and in fact see the reversal of some of these provisions."

~~146-159.~~ In the premises of the matters set out in paragraphs ~~151-137~~ to ~~158-144~~ above, and following the review referred to in paragraph ~~157-143~~ above, and subsequently during each subsequent Review and Audit, the first defendant and/or the second defendant was aware:

- (a) of the matters set out in paragraph ~~154-140~~ above;
- (b) of the matters set out in paragraph ~~155-141~~ above;
- (c) of the matters set out in paragraph ~~156-142~~ above;
- (d) that the external valuations obtained prior to or in early to mid-2008 of real property assets securing the Fund's loans and receivables no longer accurately identified the fair value of the real property assets which they addressed;
- (e) of the matters set out in paragraphs ~~64(d)-63(d)~~ and ~~64(f)-63(f)~~ above in relation to the Financial Statements for previous periods;
- (f) that an opinion on the fair value of the real property assets in question, specifically an updated external valuation, could reasonably have been expected to have been obtained and taken into account in the preparation of Financial Statements for previous periods;

- (g) in the premises of sub-paragraphs (a) to (f) above, that there were material prior period errors within the meaning of AASB108, which were not corrected and disclosed in the Financial Statements for the current period;
- (h) that, despite being aware of the increased risk referred to in paragraph ~~153~~¹³⁹ above, the first defendant and/or the second defendant had not properly designed and performed additional audit procedures to adequately address that risk in previous Reviews and Audits;
- (i) that if the first defendant and/or the second defendant had properly designed and performed such additional audit procedures in the course of previous Reviews and Audits, the first defendant and/or the second defendant:
 - (i) would have discovered the matters referred to in paragraphs ~~64(d)~~^{63(d)} and ~~64(f)~~^{63(f)} above in those previous Reviews and Audits;
 - (ii) could have taken steps to seek to cause those matters to be corrected and disclosed in the Financial Statements then under examination;
 - (iii) if appropriate corrections and disclosures had not then been made, could have provided a qualified opinion or conclusion that the Financial Statements then under examination did not give a true and fair view of the Fund's financial position as at their material date, and did not comply with the Act, including the requirement to comply with the Australian Accounting Standards.

~~147-160.~~ ____ In assessing the level of impairment of the Fund's loans and receivables from time to time, the plaintiff's management:

- (a) generally did not discount expected future cash flows for the Fund's loans and receivables until its preparation of the 30 June 2010 Financial Statements;
- (b) continued thereafter not to discount expected future cash flows:
 - (i) for some of the Fund's development loans, being those of the Fund's loans and receivables which were secured by uncompleted development projects, at least until the 31 December 2011 Financial Statements;
 - (ii) for most or all of the Fund's other loans and receivables;
- (c) in relation to those of the Fund's development loans which were thereafter discounted, in many or if not most cases, did not properly discount expected future cash flows at the loan's original effective interest rate through to and including the 30 June 2012 Financial Statements.

~~148-161.~~ The first defendant and/or the second defendant reviewed or considered the projected cash flows for development projects securing the Fund's loans and receivables and valued on an 'as complete' basis in each of the 30 June 2010 Financial Statements Audit, the 31 December 2010 Financial Statements Review, the 30 June 2011 Financial Statements Audit, the 31 December 2011 Financial Statements Review and the 30 June 2012 Financial Statements Audit.

~~149-162.~~ In the premises of the matters set out in paragraphs ~~153-139~~, ~~158-144~~, ~~159-145~~, ~~160-146~~ and ~~161-147~~ above, at all material times from at least the completion of the 30 June 2010 Financial Statements Audit the first defendant and/or the second defendant was aware of a further increased risk, including of management bias, in management's assessment of objective evidence of impairment, and its estimation of the level of impairment, of the Fund's loans and receivables.

~~150-163.~~ In the 30 June 2011 Financial Statements, the plaintiff disclosed its significant accounting judgements, estimates and assumptions regarding the allowance for impairment loss on loans and receivables as follows:

"The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of future cash flows through a "on completion" valuation or the property based on an "as is" valuation."

~~151-164.~~ In the 30 June 2012 Financial Statements, the disclosure of significant accounting judgements, estimates and assumptions regarding the allowance for impairment loss on loans and receivables was changed, in a passage drafted by the first defendant and/or the second defendant, to the following:

"The Scheme determines whether loans are impaired on an ongoing basis. Individually assessed provisions are raised where there is objective evidence of impairment that is where the Scheme does not expect to receive all of the cash flows contractually due. Individually assessed provisions are made against individual facilities. The provisions are established based primarily on estimates of the realisable (fair) value of collateral taken and are measured as the difference between a financial asset's carrying amount and the present value of the expected future cash flow (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. Short term balances have not been discounted."

~~152-165.~~ On about 25 October 2012, and as part of the 30 June 2012 Financial Statements Audit, the plaintiff sent an email to the first defendant and/or the second defendant stating:

"We have been looking into what is the appropriate discount rate to be used in our loan feasibilities and have received some verbal advice.

We would like to do the following:

- Use the original loan rate for the discount rate (based on Para 63 of AASB 139, extract below), and

- Include the 15% p.a. cost in the feasibility for the specific amount of the Duetsche Bank facility that will be used for each asset.

[Paragraph 63 of AASB 139 is then set out in full]

Can you please let me know your thoughts on this and we will update our feasibilities accordingly?"

Particulars

- (a) Email from Eryn Vannucci, Financial Controller of the plaintiff to the second defendant, copied including to Nathan Quinlin of the first defendant, dated 25 October 2012.

~~153-166.~~ Subsequently on or about 7 November 2012, and as part of the 30 June 2012 Financial Statements Audit, the first defendant and/or the second defendant sought technical advice on the appropriate basis for measurement of loans and receivables, and was advised that impairment ought to be calculated as the difference between the loan's carrying amount and the present value of the estimated cash flows, discounted at the loan's original effective interest rate.

Particulars

- (a) Internal Memorandum from Nathan Quinlin of the first defendant to Lynda Tomkins of the first defendant, copied to the second defendant, and others.

~~154-167.~~ The management of the plaintiff did not correct or disclose any material prior period error in any of the Financial Statements as required by AASB108.

~~155-168.~~ In the premises of the matters set out in paragraphs ~~151-137~~, ~~152-138~~, ~~157-143~~ and ~~160-146~~ to ~~167-153~~ above, the first defendant and/or the second defendant at the latest by the date of its completion of the 30 June 2012 Financial Statements Audit was aware:

- (a) of the matters set out in paragraph ~~160(a)-146(a)~~ above;
- (b) of the matters set out in paragraph ~~160(b)-146(b)~~ above;
- (c) of the matters set out in paragraph ~~160(c)-146(c)~~ above;
- (d) of the matters set out in each of paragraph ~~64-63~~ above in relation to the Financial Statements for previous periods;
- (e) in the premises of sub-paragraphs (a) to (d) above, that there were material prior period errors within the meaning of AASB108, which were not corrected and disclosed in the Financial Statements for the current period;
- (f) that, despite being aware of the increased risk referred to in paragraphs ~~153-139~~ and ~~162-148~~ above, the first defendant and/or the second defendant had not properly designed and performed additional

audit procedures to adequately address that risk in previous Reviews and Audits;

- (g) that if the first defendant and/or the second defendant had properly designed and performed such additional audit procedures in the course of previous Reviews and Audits, the first defendant and/or the second defendant:
 - (i) would have discovered the matters referred to in paragraphs ~~6463~~ and ~~160146~~ above in those previous Reviews and Audits;
 - (ii) could have taken steps to seek to cause those matters to be corrected and disclosed in the Financial Statements then under examination;
 - (iii) if appropriate corrections and disclosures had not then been made, could have provided a qualified opinion or conclusion that the Financial Statements then under examination did not give a true and fair view of the Fund's financial position as at their material date, and did not comply with the Act, including the requirement to comply with the Australian Accounting Standards.

~~156.169.~~ The first defendant and/or the second defendant, being aware of the matters set out in paragraphs ~~151137~~, ~~159145~~ and ~~168154~~ above, and in relation to each of the Financial Statements from and including the 31 December 2010 Financial Statements:

- (a) did not in the course of the Review or Audit in question communicate any of the matters set out in paragraphs ~~159(d)145(d)~~ to ~~159(g)145(g)~~ and ~~168(a)154(a)~~ to ~~168(e)154(e)~~ above to those in charge of the governance of the plaintiff, despite knowing that it was required to do so according to ASA260, ASA450 or ASRE2410 (as applicable), or alternatively being wilfully blind or recklessly indifferent to that fact;
- (b) did not provide a qualified opinion or conclusion that the Financial Statements did not give a true and fair view of the Fund's financial position as at each material date, and did not comply with the Act, including the requirement to comply with the Australian Accounting Standards, despite knowing that its opinion should have been a qualified opinion, or alternatively being wilfully blind or recklessly indifferent to that fact.

~~157.170.~~ In the premises of the matters set out in paragraphs ~~159(g)145(g)~~ to ~~159(i)145(i)~~, ~~168(e)154(e)~~ to ~~168(g)154(g)~~ and ~~169155~~ above, the first defendant and/or the second defendant in relation to each of the Audits and Reviews from and including the 31 December 2010 Financial Statements Review:

- (a) was not capable of exercising objective and impartial judgment in relation to the conduct of the audit or review of the Financial

Statements, such that a conflict of interest situation existed within the meaning of section 324CD of the Act; and

- (b) gave a written declaration pursuant to section 307C(1) and/or (3) of the Act that to the best of the first defendant and/or the second defendant's knowledge and belief there had been no contraventions of the auditor independence requirements of the Act, despite knowing that not to be true, or alternatively being wilfully blind or recklessly indifferent to that fact.

~~158-171.~~ In the premises of the matters set out in paragraphs ~~152-138~~ to ~~170-156~~ above, the plaintiff's rights of action set out in this Statement of Claim with respect to the Audits and Reviews in negligence and for breach of contract were concealed from those authorised to commence legal proceedings on behalf of the plaintiff by the fraud of the first defendant and/or the second defendant, within the meaning of section 38(1)(b) of the *Limitation of Actions Act 1974* (Qld).

~~159-172.~~ Those authorised to commence legal proceedings on behalf of the plaintiff did not become aware of the matters set out in paragraphs ~~159(a)-145(a)~~ to ~~159(i)-145(i)~~ and ~~168(a)-154(a)~~ to ~~168(g)-154(g)~~ until around June 2015.

Particulars

- (a) Pursuant to summonses issued under section 596A of the Act and served on the second and third defendants on about 12 February 2015 (the Summonses), and between about 19 March 2015 and 30 April 2015, the second and third defendants provided various hard copy files to the Receivers, which were not organised in any reasonably understandable way, and also omitted numerous relevant documents, such that they were not reasonably capable of analysis by the Receiver.
- (b) Pursuant to the Summonses, and on about 20 May 2015, the second and third defendants provided to the Receiver a laptop loaded with some of the defendants' working papers relating to the Audits, the Reviews and the Compliance Plan Audits, but which was missing some of them which prevented the Receiver from conducting a proper analysis.
- (c) Pursuant to the Summonses, and on about 4 June 2015, the second and third defendants provided to the Receiver a replacement laptop loaded with defendants' working papers, including many which had previously been missing.

The Compliance Plan Audits

~~160.~~173. _____ The first defendant and/or the third defendant, being aware of the matters set out in paragraphs 119(a), (b), (c), (d), (f) and (h), 120(a), (b) and (c) and 121(g) (insofar as it concerns the breaches alleged in paragraphs 119(a), (b), (c), (d), (f) and (h))~~118 and 119~~ above, as pleaded in paragraphs 134 and 135 ~~121~~ above, and in relation to each of the Compliance Plan Audit Engagements:

- (a) did not in the course of the Compliance Plan Audit Engagement in question adequately communicate those the matters set out in paragraphs 118 and 119 above to the plaintiff;
- (b) did not provide a qualified opinion that the plaintiff as responsible entity of the Fund had not complied with the Compliance Plans during the financial year in question, and/or that the Compliance Plans did not continue to meet the requirements of Part 5C.4 of the Act, despite knowing that the opinion should have been a qualified opinion, or alternatively being wilfully blind or recklessly indifferent to that fact.

~~161.~~174. _____ In the premises of the matters set out in paragraph 173~~159~~ above, and in relation to each Compliance Plan Audit Engagement from and including the 2009 Compliance Plan Audit Engagement, the first defendant and/or the third defendant:

- (a) either:
 - (i) was aware of the matters set out in paragraphs 119(a), (b), (c), (d), (f) and (h), 120(a), (b) and (c) and 121(g) (insofar as it concerns the breaches alleged in paragraphs 119(a), (b), (c), (d), (f) and (h))~~159~~ above in relation to previous Compliance Plan Audit Engagement or Engagements; or
 - (ii) in becoming aware of the matters set out in paragraphs 119(a), (b), (c), (d), (f) and (h), 120(a), (b) and (c) and 121(g) (insofar as it concerns the breaches alleged in paragraphs 119(a), (b), (c), (d), (f) and (h))~~118 and 119~~ above in the course of a Compliance Plan Audit, would also have become aware that, if the first defendant and/or the third defendant had conducted the previous Compliance Plan Audit Engagement or Engagements with due care, diligence and skill to the standard of a reasonably competent auditor, they would have discovered those contraventions in the course of an earlier Compliance Plan Audit Engagement;
- (b) was therefore not capable of exercising objective and impartial judgment in relation to the conduct of the Compliance Plan Audit, such that a conflict of interest situation existed within the meaning of section 324CD of the Act; and
- (c) gave a written declaration that the first defendant and/or the third defendant had met the independence requirements of the Act, despite

knowing that not to be true, or alternatively being wilfully blind or recklessly indifferent to that fact.

~~162-175.~~ In the premises of the matters set out in paragraphs ~~173-159~~ and ~~174-160~~ above, the plaintiff's rights of action set out in this Statement of Claim with respect to the Compliance Plan Audits in negligence and for breach of contract were concealed from those authorised to commence legal proceedings on behalf of the plaintiff by the fraud of the first defendant and/or the third defendant, within the meaning of section 38(1)(b) of the *Limitation of Actions Act 1974* (Qld).

~~163-176.~~ Those authorised to commence legal proceedings on behalf of the plaintiff did not become aware of the matters set out in paragraphs ~~119-118~~ to ~~121-120~~ above until around June 2015.

Particulars

- (a) Pursuant to the Summonses, and between about 19 March 2015 and 30 April 2015, the second and third defendants provided various hard copy files to the Receivers, which were not organised in any reasonably understandable way, and also omitted numerous relevant documents, such that they were not reasonably capable of analysis by the Receiver.
- (b) Pursuant to the Summonses, and on about 20 May 2015, the second and third defendants provided to the Receiver a laptop loaded with some of the defendants' working papers relating to the Audits, the Reviews and the Compliance Plan Audits, but which was missing some of them which prevented the Receiver from conducting a proper analysis.
- (c) Pursuant to the Summonses, and on about 4 June 2015, the second and third defendants provided to the Receiver a replacement laptop loaded with defendants' working papers, including many which had previously been missing.

The Plaintiff claims the following relief:

- 1. Damages for negligence and/or breach of contract.
- 2. Damages for misleading or deceptive conduct pursuant to (each further and in the alternative):
 - (a) sections 52 and 82 of the *Trade Practices Act 1974* (Cth) (as in force prior to 1 January 2011);
 - (b) sections 18 and 236 of Schedule 1 to the *Competition and Consumer Act 2010* (Cth) by force of section 131 of the *Competition and Consumer Act 2010* (Cth) (as in force from 1 January 2011), or alternatively section 16 of the *Fair Trading Act 1989* (Qld) (as in force from 1 January 2011);
 - (c) sections 1041H and 1041I of the *Corporations Act 2001* (Cth);

(d) sections 12DA and 12GF of the *Australian Securities and Investments Commission Act 2001* (Cth).

3. Further and in the alternative, orders under sections 1325(2) and 1325(5)(e) of the *Corporations Act 2001* (Cth) directing the First and Third Defendants to pay to the Plaintiff the amount of its loss and damage suffered because of their conduct in contravention of section 601HG in Chapter 5C of the *Corporations Act 2001* (Cth).
4. Interest pursuant to section 58 of the *Civil Proceedings Act 2011* (Qld).
5. Costs.

The further amendments to this pleading were settled by Mr Ananian-Cooper of Counsel.

Signed:



Description: Solicitors for the plaintiff

Dated: 30 November 2018

NOTICE AS TO DEFENCE

Your defence must be attached to your notice of intention to defend.

SUPREME COURT OF QUEENSLAND

REGISTRY: BRISBANE
NUMBER: 2166/15

Amended with the leave of the Court pursuant to the Orders of Justice Jackson dated 8 October 2018.
Signed: *Gadens*
Gadens, Solicitors for the Plaintiff
Dated: 9 November 2018

Plaintiff: **LM INVESTMENT MANAGEMENT LIMITED (IN LIQUIDATION)
IN ITS CAPACITY AS RESPONSIBLE ENTITY FOR THE LM
FIRST MORTGAGE INCOME FUND (RECEIVERS AND
MANAGERS APPOINTED) (RECEIVER APPOINTED) ARSN 089
343 288**

AND

First Defendant: **EY (FORMERLY KNOWN AS ERNST & YOUNG) (A FIRM)**

AND

Second Defendant: **PAULA MCLUSKIE**

AND

Third Defendant: **MICHAEL JAMES REID**

AMENDED CLAIM

The plaintiff claims:

1. Damages for negligence and/or breach of contract, ~~and/or~~
2. Damages for breach-misleading or deceptive conduct pursuant to (each further and in the alternative):
 - (a) sections 52 and 82 of the Trade Practices Act 1974 (Cth) (as in force prior to 1 January 2011);
 - (b) sections 18 and 236 of Schedule 1 to the Competition and Consumer Act 2010 (Cth) by force of section 131 of the Competition and Consumer Act 2010 (Cth) (as in force from 1 January 2011), or alternatively section 16 of the Fair Trading Act 1989 (Qld) (as in force from 1 January 2011);
 - (c) sections 1041H and 1041I of the Corporations Act 2001 (Cth); ~~and or~~
 - (d) sections 12DA and 12GF of the Australian Securities and Investments Commission Act 2001 (Cth).
3. Further and in the alternative, orders under sections 1325(2) and 1325(5)(e) of the Corporations Act 2001 (Cth) directing the First and Third Defendants to pay to the Plaintiff the amount of its loss and damage suffered because of their conduct in contravention of section 601HG in Chapter 5C of the Corporations Act 2001 (Cth).
4. Interest pursuant to section 58 of the Civil Proceedings Act 2011 (Qld).
5. Costs.

The plaintiff makes this claim in reliance on the facts alleged in the attached Statement of Claim.

ISSUED WITH THE AUTHORITY OF THE SUPREME COURT OF QUEENSLAND

Amended Claim
Filed on behalf of the Plaintiff
Form 2 R. 22

GADENS LAWYERS
Level 11, 111 Eagle Street
BRISBANE QLD 4000
Tel No.: 07 3231 1666
Fax No: 07 3229 5850
SCZ:AXS:201413563

And filed in the Brisbane Registry on ~~2 March 2015~~ 9 November 2018

Registrar:

To the defendants:

TAKE NOTICE that you are being sued by the plaintiff in the Court. If you intend to dispute this claim or wish to raise any counterclaim against the plaintiff, you must within 28 days of the service upon you of this claim file a Notice of Intention to Defend in this Registry. If you do not comply with this requirement judgment may be given against you for the relief claimed and costs without further notice to you. The Notice should be in Form 6 to the Uniform Civil Procedure Rules. You must serve a sealed copy of it at the plaintiff's address for service shown in this claim as soon as possible.

Address of Registry: 415 George Street, Brisbane Qld 4000

If you assert that this Court does not have jurisdiction in this matter or assert any irregularity you must file a Conditional Notice of Intention to Defend in Form 7 under Rule 144, and apply for an order under Rule 16 within 14 days of filing that Notice.

If you object that these proceedings have not been commenced in the correct district of the Court, that objection must be included in your Notice of Intention to Defend.

PARTICULARS OF THE PLAINTIFF:

Name: LM INVESTMENT MANAGEMENT LIMITED (IN LIQUIDATION) IN ITS CAPACITY AS RESPONSIBLE ENTITY FOR THE LM FIRST MORTGAGE INCOME FUND (RECEIVERS AND MANAGERS APPOINTED) (RECEIVER APPOINTED) ARSN 089 343 288

Plaintiff's residential or business address: C/- David Whyte, BDO
Level 10
12 Creek Street
BRISBANE QLD 4000

Plaintiff's solicitors name: Scott Couper
and firm name: Gadens Lawyers

Solicitor's business address: Level 11
111 Eagle Street
BRISBANE QLD 4000

Address for service: Level 11
111 Eagle Street
BRISBANE QLD 4000

Telephone: 07 3231 1666
Fax: 07 3229 5850

Signed:



Description:

Solicitor for the plaintiff

Dated:

~~2 March 2015~~ 9 November 2018

Claim is to be served on:

The First Defendant, Second Defendant and Third Defendant
C/- EY
One One One
Level 51
111 Eagle Street
BRISBANE QLD 4000

Statement pursuant to s.96 of the *Trusts Act 1973* (Qld)

1. The applicants are:

- (a) Trilogy Funds Management Limited ACN 080 383 679 (**Trilogy**) in its capacity as responsible entity of the LM Wholesale First Mortgage Income Fund ARSN 099 857 511 (**WFMIF**); and
- (b) The Trust Company Limited ACN 004 027 749 (**Trust Company**) in its capacity as Custodian of the property of the WFMIF.

The WFMIF

- 2. On 22 March 2002 LM Investment Management Limited ACN 077 208 461 (**LMIM**) established the WFMIF, and the WFMIF was registered as a managed investment scheme on that date.¹
- 3. The current constitution of the WFMIF is its Constitution created by a deed dated 10 April 2008, as amended by a Supplemental Deed dated 26 October 2012.²
- 4. From 22 March 2002 until 16 November 2012 LMIM was the responsible entity of the WFMIF.³
- 5. Since 16 November 2012, Trilogy has been, and remains, the responsible entity of the WFMIF.⁴
- 6. Pursuant to s.601FC(2) of the *Corporations Act 2001* (Cth) (**the Act**) and clause 2.2 of the WFMIF's Constitution, as responsible entity Trilogy holds the scheme property of the WFMIF on trust for the members of the scheme.

¹ Recital B to the Constitution of the WFMIF dated 10 April 2008 (p.470 of the exhibits to the affidavit of David Whyte filed 1 February 2019 in proceeding 3383/13 ("**the first Whyte affidavit**"); an ASIC search of the WFMIF is exhibited commencing at p.458 of the exhibits to the first Whyte affidavit.

² The Constitution dated 10 April 2008 appears at pp.469-498 of the exhibits to the first Whyte affidavit; the Supplemental Deed appears at pp.499-510.

³ Page 459 of the exhibits to the first Whyte affidavit.

⁴ Page 459 of the exhibits to the first Whyte affidavit.

7. LMIM engaged Permanent Trustee Australia Ltd ACN 008 412 913 (**PTAL**) to act as the custodian trustee of the WFMIF from its establishment on 22 March 2002 until 9 April 2008.⁵
8. LMIM re-appointed PTAL custodian trustee of the WFMIF on or about 30 November 2011.⁶
9. In or about November 2012 Trilogy appointed Trust Company custodian trustee of the WFMIF.⁷
10. Pursuant to clauses 2.3 and 21.1 of the WFMIF's Constitution, as custodian trustee Trust Company holds the Scheme Property of the WFMIF as agent for Trilogy as the RE of the WFMIF.
11. The WFMIF's only asset is its unitholding in the LM First Mortgage Income Fund (**FMIF**).⁸

The FMIF

12. On 28 September 1999 LMIM established the FMIF.⁹ LMIM was, and remains, the responsible entity of the FMIF.¹⁰
13. The current constitution of the FMIF is its Constitution created by a deed dated 10 April 2008.¹¹
14. Pursuant to s.601FC(2) of the Act and clause 2.2 of the FMIF's Constitution, as responsible entity LMIM holds the scheme property of the FMIF on trust for the members of the scheme.

⁵ Paragraphs 50 to 53 of the first Whyte affidavit.

⁶ Paragraph 54 of the first Whyte affidavit.

⁷ Paragraph 58 of the first Whyte affidavit.

⁸ Paragraph 11 of the affidavit of Philip Ryan filed 1 February 2019 in proceeding 13534/16

⁹ Recital B to the Constitution of the FMIF dated 10 April 2008 and clauses 2.1 and 2.2 (p.45 and p.53 of the exhibits to the first Whyte affidavit).

¹⁰ Definition of "LMIM" at page 3 of the FMIF Constitution (page 46 of the exhibits to the first Whyte affidavit).

¹¹ The Constitution dated 10 April 2008 appears at pp.44-83 of the exhibits to the first Whyte affidavit.

15. The beneficial interest in Scheme Property of the FMIF is divided into Units (clause 3.1 of the FMIF's Constitution). The RE of the FMIF was authorised to create and issue different classes of units at its complete discretion (clause 3.2).
16. Three different classes of units were issued in the FMIF: A, B and C-class units.¹²

The WFMIF's unit holding in the FMIF

17. The B-class units in the FMIF are held for three managed investment schemes, commonly referred to as the **Feeder Funds**.¹³
 - (a) the WFMIF, via its RE Trilogy and its present custodian trustee Trust Company;
 - (b) by LMIM as RE of the LM Currency Protected Australian Income Fund ARSN 110 247 875 (**CPAIF**); and
 - (c) by LMIM as RE of the LM Institutional Currency Protected Australian Income Fund (**ICPAIF**).
18. As at 30 June 2008, the FMIF had 481,418,849 units on issue, at a unit price of \$1.00.¹⁴
19. As at 21 July 2008:
 - (a) the three Feeder Funds held a total of 218.3 million units in the FMIF, at a \$1.00 unit price, which constituted approximately 45% of the units issued in the scheme;¹⁵ and
 - (b) LMIM as the then RE of the WFMIF held 91.5 million of these units.¹⁶
20. As at 21 July 2018, the FMIF's unit register records that the fifth defendant holds 99,488,928.68 units as custodian for the WFMIF, valued at \$14,326,405.78 (based on a unit price of \$0.1440).

¹² Paragraph 25 of the first Whyte affidavit.

¹³ Paragraph 25 of the first Whyte affidavit.

¹⁴ Pages 17 and 18 of the affidavit of Philip Ryan (stated in the FMIF's Annual Financial Report dated 30 June 2008, which commences at p.13 of the exhibits to that affidavit).

¹⁵ Transaction statements for each of the Feeder Funds' unit holdings appear at pp.990-998 (CPAIF), 999-1008 (WFMIF) and 1009-1017 (ICPAIF) of the exhibits to the first affidavit of Whyte.

¹⁶ Page 999 of the exhibits to the first affidavit of Whyte.

External administration of LMIM, and appointment of Mr Whyte (inter alia) as receiver of the property of the FMIF

21. On 19 March 2013 Mr John Park and Ms Ginette Muller were appointed voluntary administrators of LMIM.¹⁷ On 1 August 2013 the voluntary administrators were appointed liquidators of LMIM.¹⁸ Since 17 May 2017 Mr Park has been the sole liquidator of LMIM.¹⁹
22. By orders of the Supreme Court of Queensland dated 21 August 2013 and 17 December 2015 Mr David Whyte was appointed:
 - (a) as receiver of the property of the FMIF; and
 - (b) as the person responsible for ensuring that the FMIF is wound up in accordance with its constitution.²⁰
23. Pursuant to paragraph 7(b) of the orders dated 21 August 2013, Mr Whyte was (inter alia) authorised to bring, defend or maintain any proceedings on behalf of the FMIF in the name of LMIM as is necessary for the winding up of the FMIF in accordance with clause 16 of its constitution.²¹

The Feeder Fund Proceeding

24. By a Claim and Statement of Claim filed 23 December 2016, Mr Whyte caused LMIM as RE of the FMIF to commence proceeding 13534/16 (**the Feeder Fund Proceeding**).²²
25. The original defendants to the Feeder Fund Proceeding were:
 - (a) LMIM as RE of the CPAIF as the first defendant;
 - (b) Trilogy as RE of the WFMIF as the second defendant;

¹⁷ Page 129 of the exhibits to the first Whyte affidavit (ASIC company search for LMIM).

¹⁸ Page 128 of the exhibits to the first Whyte affidavit (ASIC company search for LMIM).

¹⁹ Page 128 of the exhibits to the first Whyte affidavit (ASIC company search for LMIM).

²⁰ Paragraph 8 of the affidavit of Philip Ryan; the orders are exhibited at pp.1-12 of the exhibits to that affidavit.

²¹ Page 3 of the exhibits to the affidavit of Ryan.

²² Paragraph 13 to the affidavit of Ryan. The original Claim and Statement of Claim are court document 1 in proceeding 13534/16.

- (c) LMIM as RE of the ICPAIF as the third defendant; and
 - (d) LMIM as the fourth defendant.
26. The plaintiff has amended its Claim and Statement of Claim on various occasions during the course of the Feeder Fund Proceeding. The plaintiff's present pleadings are its Further Amended Claim and Second Further Amended Statement of Claim filed 21 June 2018.²³ By the Further Amended Claim the plaintiff sought to join Trust Company in its capacity as custodian trustee of the WFMIF to the Feeder Fund Proceeding as the Fifth Defendant.
27. By its pleadings in the Feeder Fund Proceeding, the plaintiff seeks declarations to the effect that:

Redemptions Claim

- (a) LMIM as RE of the FMIF permitted units held on behalf of the Feeder Funds in the FMIF to be redeemed, in circumstances where it had no power to do so, or alternatively where such an action was in breach of trust;
- (b) it is entitled to withhold from distributions or payments in relation to the WFMIF units the sum of \$55,059,318.12 plus interest, or alternatively \$9,432,090.76 plus interest;
- (c) the cancellation of Class B units which occurred via redemptions of these units is void ab initio or, alternatively, voidable;

Income Distributions and Reinvestments

- (d) the issuing of 8,190,101.02 Class B units to the WFMIF via certain income distributions and reinvestments was void or, alternatively, voidable;

Underpayment via Capital Distributions

- (e) if the plaintiff's other contentions are successful, the WFMIF should be given a credit for an underpayment made in capital distributions made in February and June

²³ Paragraph 15 to the affidavit of Ryan; the Second Further Amended Statement of Claim is exhibited at pp.63-95 of the exhibits to that affidavit. The Further Amended Claim and Second Further Amended Statement of Claim are exhibited at pp.84-121 of the first affidavit of Whyte.

2013.

28. On 13 June 2018 Jackson J ordered, inter alia, that:²⁴

- (a) the Feeder Fund Proceeding be placed on the Commercial List;
- (b) Trust Company in its capacity as custodian trustee of the WFMIF be joined to the Feeder Fund Proceeding as the fifth defendant, and granted the plaintiff leave to file its Further Amended Claim;
- (c) pursuant to s.59 of the *Trusts Act* 1973 (Qld), the interests of LMIM in its capacity as RE of the CPAIF and RE of the ICPAIF be represented by Mr Said Jahani of Grant Thornton, in his capacity as receiver and manager of LMIM in its capacity as RE of the CPAIF and LMIM in its capacity as RE of the ICPAIF;
- (d) the parties (except for the fourth and fifth defendants) participate in a mediation. By orders dated 4 September 2018 his Honour varied his earlier orders, to require the specified parties to attend a mediation on 5 and 6 November 2018.

29. Accordingly the mediation was required to take place before the defendants to the Feeder Fund Proceeding were required to deliver any Defences.

30. The fifth defendant elected to participate in the mediation. The plaintiff, the first to third defendants and the fifth defendant are hereafter referred to as the **Mediating Parties**.

Mediation of the Feeder Fund Proceeding and proposed Deed of Release and Settlement

31. Position papers were delivered before the mediation on behalf of:

- (a) the plaintiff (position paper dated 17 October 2018, and position paper in reply dated 2 November 2018);²⁵

²⁴ The orders dated 13 June 2018 are exhibited at pp.96-101 of the affidavit of Ryan; his Honour's subsequent orders dated 4 September 2018 are exhibited at pp.102-103.

²⁵ The plaintiff's position paper dated 17 October 2018 is exhibited at pp.1161-1178 to the first affidavit of Whyte; its position paper in reply is exhibited at pp.1238-1259.

- (b) the first and third defendants (position paper dated 30 October 2018, and rejoinder paper dated 4 November 2018);²⁶
 - (c) the second defendant (position paper dated 1 November 2018);²⁷ and
 - (d) the defendants to proceeding 2166 of 2015 (**the EY Proceeding**).²⁸
32. The Mediating Parties participated in the mediation on 5 and 6 November 2018. The following persons also attended the first day of the mediation on 5 November 2018:
- (a) Mr John Peden QC instructed by Russells Law, representing the liquidator appointed to the fourth defendant;
 - (b) Mr Philip Pan of King & Wood Mallesons, representing the defendants to the EY Proceeding; and
 - (c) solicitors representing certain investors in the ICPAIF.
33. The Mediating Parties agreed to continue the mediation on 20 November 2018. At the mediation the Mediating Parties agreed in principle to a resolution of the Feeder Fund Proceeding.
34. After the mediation the Mediating Parties, together with:
- (a) Mr Whyte as Court-appointed receiver of the assets of the FMIF; and
 - (b) Mr Jahani as receiver and manager of the assets of LMIM as RE of the CPAIF and LMIM as RE of the ICPAIF;
- entered into:
- (c) a Deed of Settlement and Release;²⁹ and
 - (d) a Variation to the Deed of Settlement and Release.³⁰

²⁶ The first and third defendants' position paper dated 30 October 2018 is exhibited at pp.1179-1217 to the first affidavit of Whyte; its rejoinder paper is exhibited at pp.1260-1268.

²⁷ Exhibited at pp.1218-1233 to the first affidavit of Whyte.

²⁸ Exhibited at pp.1234-1237 to the first affidavit of Whyte.

²⁹ Exhibited at pp.105-136 of the confidential affidavit of Philip Ryan sworn 1 February 2019.

³⁰ Exhibited at pp.137-143 of the confidential affidavit of Philip Ryan sworn 1 February 2019.

The EY Proceeding

35. By a Claim and Statement of Claim filed 2 March 2015 Mr Whyte caused LMIM as RE for the FMIF to commence the EY Proceeding against the firm EY (formerly known as Ernst & Young) and two other defendants, who were the former auditors of the FMIF **(the EY Defendants)**.
36. The current pleading in the EY Proceeding is the plaintiff's Amended Claim and Sixth Further Amended Statement of Claim.
37. By orders of Jackson J in the EY Proceeding dated 13 November 2018 the EY Defendants were granted leave to file any third party notices and statements of claim on or before 1 March 2019.

EY Proof of Debt

38. By paragraphs 3 to 10 of the orders of the Supreme Court of Queensland dated 17 December 2015 referred to above,³¹ Jackson J set out a procedure by which Mr Whyte was empowered to determine whether LMIM was entitled to be indemnified from the property of the FMIF in respect of any expense or liability of, or claim against, LMIM in acting as RE of the FMIF. As part of this procedure, the liquidators appointed to LMIM were directed (inter alia) to adjudicate the debts payable by, and the claims against, LMIM, and identify whether LMIM had a claim for indemnity from the property of the FMIF in respect of any, or part of any, debt admitted by the liquidators.
39. On or about 25 January 2019 Trilogy's solicitors received a letter from the remaining liquidator of LMIM, enclosing a proof of debt dated 20 December 2018 from EY in the amount of \$9,432,090.76 plus interest and legal costs.

Third party claim by EY

40. On 7 March 2019 Trilogy's solicitors received a letter from the EY Defendants' solicitors, enclosing:

³¹ Exhibited at pp.6-8 of the affidavit of Ryan.

- (a) the plaintiff's Amended Claim and Sixth Further Amended Statement of Claim; and
 - (b) a Third Party Notice and Third Party Statement of Claim filed 1 March 2019 in the EY Proceeding from the EY Defendants. By the Third Party Notice the EY Defendants joined Trilogy to the EY Proceeding as the Fourth Third Party.
41. By the Third Party Notice the EY Defendants seek (inter alia):
- (a) declarations that LMIM is liable to the FMIF for various loss and damage, and that the defendants are entitled to exercise or be subrogated to LMIM's rights to an indemnity from the assets of the WFMIF in satisfaction of such liabilities;
 - (b) a declaration that the plaintiff is entitled to withhold from distributions or payments otherwise payable in relation to the Class B units in the FMIF held for the WFMIF in respect of the amount of the loss or damage referred to in paragraphs 79 and 80 of the third party statement of claim.
42. The EY Proceeding is also listed on the Commercial List before Jackson J. His Honour's most recent orders are dated 18 March 2019. Relevantly:
- (a) the EY Defendants are required to file their Defence to the plaintiff's Sixth Further Amended Statement of Claim by 31 May 2019;
 - (b) the EY Proceeding is listed for further review to be fixed in the week commencing 10 June 2019 (or otherwise as convenient to the Court). At this further review Jackson J will consider directions as to when the third parties are to file their defences.

The second and fifth defendants' costs of the Feeder Fund Proceeding

43. Trilogy and Trust Company's legal costs incurred to date in relation to the Feeder Fund Proceeding are in excess of \$370,000.00.³²

³² Paragraph 21 of the affidavit of Philip Ryan.

44. Trilogy and Trust Company's solicitors have estimated that Trilogy and Trust Company will incur legal costs of approximately \$1,399,600.40 (excluding GST) if the Feeder Fund Proceeding proceeds to trial.³³
45. By the plaintiff's Claim in the Feeder Fund Proceeding the plaintiff seeks orders for costs (paragraph 10 of the Further Amended Claim). Mr Whyte has estimated that if the Feeder Fund Proceeding does not settle, the legal costs and remuneration that the plaintiff will incur up to and including trial will be \$1.5 million.³⁴

³³ Paragraph 23 of the affidavit of Ryan. The budget prepared by Trilogy and Trust Company's solicitors is exhibited at pp.104-109 to the affidavit of Ryan.

³⁴ Paragraph 137 of the second affidavit of Whyte, filed 23 April 2019 in proceeding 3383/13.