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Email Letter

From Julian Smith	Date 1/04/2011	
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To Robert Burns	Organisation FEA Growers Group Inc	Email robb@bcpgroupservices.com.au
Mark Bland	Clarendons Lawyers	mark.bland@clarendonlawyers.com.au

Our Ref JMS:5674591

Dear Mr Burns

**Forest Enterprises Australia Group
Managed Investment Schemes 1999 to 2008 (FEA Schemes)
FEA Limited (subject to deed of company arrangement)(receivers and managers appointed)
(FEA)
FEA Plantations Limited (subject to deed of company arrangement)(receivers appointed)
(FEAP)
Proposed adjourned Grower meetings on 4 April 2011**

As you are aware, we act for the Receivers and Managers of FEA, Tim Norman and Sal Algeri. As you will also be aware, FEA is a Grower in certain of the FEA Schemes in relation to which the above Grower meetings have been called.

We have now reviewed the material published by FEAGG and Black Tree in respect of the above Grower meetings, comprised of (**Meeting Material**):

- Material posted on the FEAGG website (www.feagg.com.au, which website we note is published by Professional Investment Services Pty Ltd (**PIS**));
- Material posted on the Black Tree website (www.blacktreeltd.com.au);
- Notices of meeting in respect of each of the FEA Schemes;
- Explanatory Memorandum in respect of each of the FEA Schemes;
- Proposed new Constitutions in respect of each of the FEA Schemes.

Having reviewed that material, our clients' view is that the Grower meetings should not proceed and that the current Black Tree Proposal cannot be put to Growers. This is on account of material faults with the Meeting Material, and because the Black Tree Proposal itself is flawed. Thus we are writing to you:

- In your capacity as the incumbent Chair of those meetings; and
- In your capacity as President of the FEA Growers Group Inc (**FEAGG**);

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This highlights the importance of:

- the extraordinary range of costs which the RE may recover as a 'valid' expense of each Scheme; and
- the Annual Fee mechanism, whereby there is a year by year calculation of the Annual Fee based on Scheme costs and expenses, with the RE then recovering all those costs and expenses from Growers.

Despite the importance of these aspects of the Proposal, the significant risk to Growers is no more than alluded to in the Explanatory Memoranda.

2. The Black Tree Proposal will not necessarily deliver Growers a solvent RE.

The Black Tree Proposal contains 5 resolutions. The Meeting Material presents resolutions 1, 2 and 3 as interdependent, and then resolutions 4 and 5 as interdependent. However the Meeting Material asserts that resolutions 1, 2 and 3 are not dependent on resolutions 4 and 5 being passed.

Accordingly:

- the amendments to the constitutions necessary to install Black Tree as manager of the FEA Schemes are not dependent on a change in RE;
- Growers could be left with fully contributing schemes in a situation where the RE continues to be an insolvent company;
- Growers would continue to be left exposed to the uncertainty and the instability that entails, and be responsible for paying the increased layer of the Administrators' remuneration and expenses.

The quantum of costs incurred by the Administrators in relation to each of the Schemes has run into the many hundreds of thousands of dollars, with Growers for the most part being responsible for paying these costs. To support a proposal which allows or requires Growers to vote in circumstances where this fundamental point is not addressed, where Growers continue to bear the burden of these costs, and to assume all risks, seems to us untenable for a group such as FEAGG which professes to act in Growers' best interests.

Further, even if there is a change of RE, it will continue to be the case that all payments made to the RE under each restructured FEA Scheme would be subject to the charges held by ANZ and CBA.

3. The Black Tree Proposal will effectively appoint Black Tree as RE.

Black Tree states that it has proposed a permanent solution for Growers in the FEA Schemes, and has worked closely with the FEAGG to develop that solution.

Yet in circumstances where the proposal expressly contemplates that the existing insolvent RE may remain in place, but with Black Tree as the new manager of each FEA Scheme, it is clear that Black Tree will be primarily responsible for the operation of each FEA Scheme. Black Tree is not licensed to operate managed investment schemes under the *Corporations Act 2001 (Act)* and may not have the organisational competence or capital adequacy to obtain such a licence.

These circumstances are reflected in the terms of the proposed Operations Agreements. Take, for instance, clause 13 which provides that effectively the benefit of all amounts paid to the RE under the proposed new Constitutions flow to Black Tree, with the exception of the

RE Fee, amounts payable to Growers, amounts payable to lessors, and amounts a Court determines are payable to third parties.

Two significant consequences flow from this:

- It would leave the FEA Schemes in circumstance where an unlicensed entity is effectively operating them; and
- There would be a real risk that ASIC would take action to address those circumstances as it could not permit an insolvent RE, consistently in breach of its AFS Licence and itself lacking financial resources, organisational competence, and various other licence requirements to operate the FEA Schemes. If no replacement RE could be found, the obvious outcome would be a winding-up of the FEA Schemes – clearly undermining the basic premise of the Black Tree Proposal.

4. All ongoing Scheme documents have been drafted by Black Tree without adequate negotiation or review

The Black Tree Proposal:

- Involves Growers being asked to vote on detailed and lengthy amendments to the FEA Scheme Constitutions which have been prepared by Black Tree in anticipation of its appointment as manager; and
- If approved, directs the RE to enter into an Operations Agreement with Black Tree, the form of which was released one month after the Explanatory Memoranda, was prepared by Black Tree, and has been developed without the benefit of bona fide commercial negotiation.

Growers who may be in favour of the Black Tree Proposal generally, must either take or leave these suggested forms of agreement. How else would one explain the Operations Agreement:

- Requiring the payment to the incoming manager of an Upfront Fee (eg., for the 1999 Scheme of \$498,000) on account of the manager's 'costs, expenses and disbursements...associated with the Project including preparing for, convening and holding' the proposed meetings; and
- Requiring the payment to the incoming manager of a Break Fee (eg., for the 1999 Scheme of \$550,000) on account of:
 - the manager's 'costs of engaging in the Proposal or in not engaging in other alternative strategic initiatives';
 - 'costs of management and directors' time in planning and implementing the Proposal' and out of pocket expenses incurred including, but not limited to, airfares, hotel accommodation, meals...[incurred by Black Tree staff]...in planning and implementing the Proposal'; and
 - damage to Black Tree's reputation 'associated with a failed transaction',

Despite clearly contemplating a form of double-recovery by Black Tree (in respect of its costs in developing the Black Tree Proposal), why should Growers bear the costs of:

- The incoming Manager's process of considering and establishing the Proposal in circumstances where such due diligence inquiries would, in commercial circumstances, be borne by the incoming manager if it sought the engagement;

- Damage to Black Tree's reputation where the EM clearly states that the Black Tree Proposal does not preclude Growers considering other alternative future opportunities.

We also note that the Break Fee would be payable if FEAP remained as RE following Black Tree's appointment, but FEAP was then subsequently replaced within 6 months (by, say, Primary RE or some other third party becoming RE), as this is an event of default under the Operations Agreement giving rise to a termination right on the part of Black Tree.

5. Black Tree has made representations in the Meeting Material as to the likely return to Growers, which is incomplete, which is based on questionable assumptions and which result in findings which have been directly challenged by other independent experts.

In the Meeting Material, Black Tree make various assertions concerning the likely successful outcome which its proposal will deliver. It has also made available a 'Grower Calculator' by which Growers can look up their 'expected returns'.

These assertions, and the calculator, have been based on:

- Estimated Scheme costs taken from FEA Group records;
- Black Tree's 'considerable experience managing forestry plantations';
- Estimates of timber productivity and pricing supplied by BRI Ferrier.

However, these assertions are made, and the calculator is made available:

- Without having undertaken an inspection of the timber plantations.
- Without having undertaken any comparison with other alternatives available to Growers.
- Other than in compliance with ASIC policy in respect of prospective financial information.

The forecasts are given in respect of a period of up to 15 years, but without any statements from the Black Tree directors as to why they believe the prospective financial information is objectively reasonable, and despite the anticipated substantial change in the operations of the FEA Schemes.

- Where there is a discrepancy in excess of \$300 million.

Black Tree have been made aware of the significantly optimistic timber and pricing estimates of BRI Ferrier – there being a discrepancy in excess of \$300 million as to Scheme returns (across all Schemes) between the findings of BRI Ferrier's expert forestry analysis, and the expert analysis obtained by the receivers of FEAP.

- By a person who is not licensed to provide financial product advice.

Particularly by making the calculator available, Black Tree is providing Growers with financial product advice, despite it not holding an Australian financial services licence. Further, by operation of the Upfront Fee and Break Fee, Black Tree is effectively asking to be remunerated for having prepared and given that financial product advice.

6. Growers bear the full risk of the financial performance of the FEA Schemes should the Black Tree Proposal be carried into effect: Black Tree carries no commercial risk.

If the Black Tree proposal was carried into effect, there remain voluminous and significant financial risks to Growers. These risks include:

- That Black Tree may cause the RE to apply to the Court 'for directions that it is justified in implementing the proposals',¹ meaning the Court may terminate the Black Tree Proposal shortly after the meetings are held but by which time Black Tree has been remunerated and has become entitled to its Break Fee;
- That Growers lose the benefit of rent set-offs of approximately \$11m in the pending Judgment of the Full Federal Court of Appeal;
- That, even if the Growers do not lose the benefit of rent set-offs, the impact of the attendant \$11m liability which FEAP and the administrators personally have to FEA as a result of having borrowed that amount pursuant to the letter of comfort provided by FEA (which risk we note has not been disclosed in any way in the Meeting Material);
- That Growers may lose past tax benefits and deductions, on the basis that the structure of the FEA Schemes will be dramatically different from that set out in any relevant tax ruling, which rulings operate only in relation to the circumstances described in the application – a matter not even referred to in the Meeting Material;
- That Growers lose existing tax benefits, and do not enjoy continuing tax benefits, as a result of the Black Tree Proposal;
- The continuing additional layer of costs by virtue of the continuation of an insolvent RE;
- ASIC action in respect of the continued involvement of an insolvent RE;
- The implications of the Black Tree Proposal seeking to deal with property and rights which are currently charged to the Banks;
- The Black Tree Proposal being carried into effect, but significant numbers of Growers ceasing to pay, or being unable to pay, leaving the Schemes insolvent;
- Returns from the FEA Schemes which do not match those which Black Tree have advised Growers they can expect.

This list is not exhaustive. Yet the financial burden of each of these risks rests on the shoulders of the Growers. At every turn, in the Meeting Material and the proposed new Constitutions, it is clear that Black Tree has protected itself first and foremost from the implications of underperformance or increased costs. Black Tree, through the RE and the Operations Agreement:

- Recovers all its costs to date via the Upfront Fee;
- Recovers any lost set-off entitlements by invoicing Growers for the 'Rent Levy';
- Covers all its ongoing internal costs, as well as Scheme costs, by invoicing Growers for the Annual Fee;
- Covers its cash flow requirements by invoicing Growers for the Annual Fee on an estimated basis;
- Covers any subsequent unexpected costs by way of a Supplementary Annual Fee;

¹ Eg. p. 13 1999 EM

- Has the option to back out of these arrangements, and take a significant Break Fee, if FEAP is replaced not at the Grower meetings but within 6 months after those meetings.

Accordingly, it is glaringly obvious that though Black Tree is prepared to become involved with the FEA Schemes, it is unwilling to assume any risk in doing so.

7. The Notices of meeting are defective and invalid.

The Meeting Material itself is defective in material respects, and is therefore invalid.

The Meeting Material is misleading and deceptive in the extent to which:

- Information contained in the Explanatory Memoranda is different from that presented in the proposed new Constitutions;
- Risks are not referred to or clearly understated in the Explanatory Memoranda;
- Information about expected returns is provided without the disclosure of material assumptions and without reasonable grounds, via unlicensed financial product advice.

On this basis alone, there is a significant risk that the Notices, and the meetings held pursuant to them, are invalid and ineffective.

Further the Notices propose two ordinary resolutions which, by operation of section 252D of the Act:

- Cannot be put to the Growers, as section 252D reads as follows and can only be used to propose special or extraordinary resolutions:

Members of a registered scheme...may call and arrange to hold a meeting of the Scheme's members to consider and vote on a proposed special resolution or a proposed extraordinary resolution.

- Serve only as a diversion from the subject matter of the meetings; and
- Invalidate the Notices.

As Chair of the meetings, and assuming the meetings proceed, you would be obliged to ensure the ordinary resolutions were not put to the Growers.

8. FEAGG and Black Tree have accepted voting directions prior to the full Black Tree Proposal being disclosed

FEAGG and Black Tree have facilitated a process by which:

- Growers have made decisions, and registered voting directions, in respect of which there has not been full and fair disclosure;
- Growers have registered voting directions on the basis of documents such as the Notice and Explanatory Memoranda, in circumstances where subsequent material such as the proposed new Constitutions and the Operations Agreements have not been released and are subsequently shown to be inconsistent with the Notice and Explanatory Memoranda.

