

# Commentary on Black Tree Proposal

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# Schedule

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## Black Tree Proposal – Issues Outline

### 1. *Each Notice of meeting, and Meeting Material, is defective and invalid.*

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

#### 1.1 **Members cannot call a meeting to consider ordinary resolutions**

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 to divert attention from the true business of the meetings; and
- Invalidate the Notices, and in turn invalidate the meetings.

The defects are material in that they:

- By proposing resolution 1 as an ordinary resolution, fail to clearly inform Growers that in order to approve the Black Tree Proposal, they must pass an extraordinary and a special resolution (not just resolution 1 and resolution 3);
- Misstate the nature of the business being voted upon, and those misstatements in the Meeting Material means there is a significant risk that the meetings were not properly notified.

#### 1.2 **The ordinary resolutions serve no purpose and are misleading**

In addition to paragraph 1.1, for the Black Tree Proposal to take effect both an extraordinary resolution and a special resolution must be passed. Any ordinary resolution relating to that proposal therefore has no effect and therefore serves no purpose.

Accordingly, it is also misleading to propose the ordinary resolutions because:

- 1.2.1 The Notices necessarily imply that the resolutions serve some purpose, when they do not;
- 1.2.2 They obscure the true purpose of the meeting which is the due consideration of:
  - (a) whether the Constitutions should be amended to give effect to the proposal – which requires a special resolution; and
  - (b) whether FEAP should be replaced as RE – which requires an extraordinary resolution;
- 1.2.3 They obscure the different voting thresholds;

1.2.4 They dissuade Growers from critically analysing each of the other resolutions which have a higher voting threshold.

### 1.3 Notices are in many instances ineffectively served

The Black Tree website states that:

Unfortunately a large number of addresses (both email and street) contained in the Growers Registry provided by the Administrator have turned out to be out of date

Where Black Tree had an email address supplied by the Administrators, Black Tree served the Notices electronically. Yet:

- Email service is not permitted in respect of the 1999, 2000, 2001 and 2002 Schemes; and
- Email service is ineffective if the sender is notified of non-receipt in respect of the 2007 and 2008 Schemes.

The apparent scale of non-service as indicated on the Black Tree website, and the use of email as a means of service where it is not permitted, raises a significant risk that the Notices and the meetings held pursuant to them, are invalid and ineffective.

### 1.4 It is not clear which Growers have called the meeting and whether they hold the required 5% of interests in each Scheme

This information has not been supplied or made public by any of those parties connected to the Black Tree Proposal, namely:

- 1.4.1 The three attorneys who signed the Notices;
- 1.4.2 Black Tree;
- 1.4.3 Professional Investment Services Pty Ltd; or
- 1.4.4 FEAGG.

It remains to be seen whether the ownership thresholds were met in respect of each Scheme. In the absence of this information, the Meeting Material is not clear, concise and effective, and is not open and frank.

## 2. *The Meeting Material is misleading and deceptive, and not clear, concise and effective*

The Meeting Material is misleading and deceptive in a variety of ways.

- It relates to a proposal which is constantly changing prior to the meetings;
- It misrepresents the nature and conditionality of the Information contained in the Explanatory Memoranda;
- Risks are clearly understated in, and omitted from, the Explanatory Memoranda;
- Information contained in the Explanatory Memoranda is different from that presented in the proposed new Constitutions;
- Information about expected returns is provided without the disclosure of material assumptions and without reasonable grounds, via unlicensed financial product advice; and

- It is misleading in other ways.

On this basis alone, the Notices, and the meetings held pursuant to them, are invalid and ineffective.

## **2.1 The Black Tree Proposal continues to change**

Each of the following sets of documents have been released at different times:

- The Cover letter to Growers from FEAGG, and the Notices; then
- The Explanatory Memoranda; then
- The proposed new Constitutions; then
- The Operations Agreement; then
- Amendments to the arrangements set out in these documents.

Despite not all information having been made available to Growers, Black Tree has facilitated a process by which Growers have registered their proxies and given their voting directions before all information was made available.

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. For instance:
  - The form of the Notice mentions only the interdependence of resolutions 4 & 5;
  - Until all Meeting Material was published, a Grower could not have known the implications of their vote on any of the resolutions. Registration of voting directions should not have been possible until all Meeting Material was released and, arguably, voting directions given before all Meeting Material was released are invalid;
  - The substance of a resolution proposed in a Notice must be the same as that which is subsequently passed at a meeting. However, the substance of each of the 5 resolutions has changed materially over time since the Notices were issued, as more Meeting Material has been published. It is therefore impossible for Black Tree to demonstrate that the substance of the resolutions set out in the Notice are the same as those which may be passed in any meeting, thereby invalidating those resolutions.

Further, the Meeting Material represents that the Black Tree Proposal will continue to change after the meetings are held. For instance:

- Resolution 4 purports to enable the Attorneys to simply nominate a separate RE, other than Primary RE, to become the replacement RE; and

- Black Tree undertakes in the Explanatory Memoranda to procure a replacement company if Primary RE does not become replacement RE.

In short, neither means of identifying an alternative RE is permissible. Any such nomination by the Attorneys would mean the substance of the resolutions of which Growers were notified, and those which were subsequently passed, would be entirely different and the resolutions would be invalid. Any subsequent replacement of the RE would, in fact, have to be effected by the Growers not by Black Tree.

## 2.2 The Black Tree Proposal is presented as bringing in a new RE, but the Meeting Material suggests that the appointment of a new RE is not necessary

The Black Tree Proposal contains 5 resolutions. The Meeting Material presents resolutions 1, 2 and 3 as interdependent, and 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.

This is despite the fact that, in various places in the Explanatory Memoranda, representations are clearly made to the effect that the Black Tree Proposal will deliver to Growers a new RE. For instance:

- The Explanatory Memoranda present the Black Tree Proposal as a single proposal: not as two separate proposals, the first being to make the FEA Schemes fully contributing and to install a new manager, the second being to replace the insolvent RE;
- For example, from the 1999 Explanatory Memorandum:

p. 2 under 'Conditionality'

The implementation of the Black Tree proposal presented in this Explanatory Memorandum is subject to the satisfaction of a number of conditions. Growers should carefully read Section 2.4 of Part A to understand this conditionality.

*This suggests that all Resolutions are dependent upon the conditions set out in the Explanatory Memorandum, including the three conditions applying to the appointment of Primary RE as RE.*

p. 2 under 'About this Explanatory Memorandum'

It provides information in relation to a proposal (Proposal) by Black Tree Pty Ltd (Black Tree) for the Project and being put forward for consideration by Growers at the Meeting.

*This refers to the Black Tree Proposal as a single proposal..*

p. 8 under 'Black Tree as Manager'

If the first 3 Resolutions are passed and the various conditions attached to the Black Tree Proposal are satisfied (see section 2.4 below), the Responsible Entity must appoint Black Tree as Manager of the Project.

*This links the first 3 resolutions to the entire Black Tree Proposal.*

p. 10 under 'Change of Responsible Entity to Primary RE'

**As part of the Black Tree proposal, the Responsible Entity will change from FEAP to Primary RE. [emphasis added]**

The Resolutions to remove FEAP as the Responsible Entity and replace FEAP with Primary RE will only be passed once the conditions precedent listed above have been achieved.

If these conditions precedent are not met then Growers may pass the first three resolutions at the meeting and agree to adjourn the consideration of Resolutions 4 and 5 until a later meeting.

*These representations are contradictory and obscure the fact that delivering a solvent RE to Growers is not a necessary condition of the Black Tree Proposal.*

p. 4 under 'Why vote?'

If any Resolution is rejected, the Project **will remain in its** current uncertain state with a Responsible Entity that is in Administration. The Responsible Entity is insolvent. BRI Ferriers as administrators of the Responsible Entity are not likely to remain permanently in that position.

*Again, this representation contradicts other material in the Explanatory Memorandum, suggesting that all resolutions must be passed for the Black Tree Proposal to succeed.*

Accordingly:

- The Meeting Material is misleading in that it contains conflicting information about whether there is a single 'Black Tree Proposal';
- It is evident that all the resolutions are so intimately connected that none of the resolutions can be passed and take effect on its own, regardless of how Black Tree purports to put them to Growers;
- It seems, however, that Black Tree is asserting that the amendments to the Constitutions necessary to install Black Tree as manager of the FEA Schemes are not dependent on a change in RE;
- It seems that on this interpretation 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, and 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 the restructured FEA Scheme would be subject to the charges held by ANZ and CBA..

### **2.3 The Black Tree Proposal sets no 'sunset date' for the appointment of Primary RE to take effect**

The Explanatory Memoranda provide that the appointment of Primary RE as the new RE of each relevant FEA Scheme is conditional on ASIC approval and on 'Primary RE [being] satisfied that the replacement of FEAP by Primary RE is in the best interests of Growers'.

Yet no date is set by which these conditions must be met.

Conceivably, Growers could pass resolutions 4 & 5, but either ASIC could take a considerable time to make a decision, or Primary RE could withhold its decision about Growers' best interests for as long as it thought fit.

Further, for so long as Primary RE is approved by Growers as the replacement RE, but the conditions have not been met and it has not been appointed as RE, Primary RE would not yet be required to prefer Growers' interests to its own interests when making its decision (in contrast, this is an obligation on all REs).

#### **2.4 The Black Tree Proposal is misleading – representations about the Administrators' lien**

The Meeting Material misrepresents the impact on the Schemes of the Administrators' lien. For example, 1999 EM states:

The Administrators, BRI Ferriers, would be entitled to a lien in respect of funding for their reasonable expenditure and reasonable remuneration in relation to the care, preservation and protection of the assets of the Project. The Administrators have estimated the value of their lien at 31 December 2010 over the assets of the Project to be approximately \$6,625.

The wording suggests that, if and when the lien is asserted, then its value would be approximately \$6,000. The future tense is used – '...would be entitled...' – in combination with an 'estimate' made by the Administrators to the period 31 December 2010, to suggest that the lien has not yet been asserted, and when it is asserted it will result in a claim of only \$6,000.

Yet, simply by reference to the Administrators' Report to Creditors dated 9 September 2010, the representation in respect of the Administrators' lien is clearly misleading. For example:

- (p. 3 Remuneration Report) That report discloses remuneration paid to the Administrators in respect of the 'Managed Investment Schemes' in the period 1 September 2010 to 7 September 2010, to be \$159,000; and
- (p. 3, Remuneration Report) The Administrators' estimated remuneration for the period 8 September 2010 to 20 September 2010 is \$406,000.; and
- (p. 62) Lists the value of the 'Voluntary administrators' lien' as \$205,687.

#### **2.5 The Black Tree Proposal is misleading - Black Tree retains discretion on account of 'interconditionality'**

In the Explanatory Memoranda for the FEA Schemes other than the 1999 Scheme, Black Tree assert that:

- The implementation of all Resolutions is conditional on similar resolutions being passed at meetings of Growers in other forestry projects listed in the Schedule to the Notice;
- There was no schedule to any of the Notices, and to further confuse matters the only comments on interdependence are that resolutions 4 & 5 are interdependent (no mention is made of resolutions 1,2 or 3, or interdependency with other Schemes);
- Even if not all Resolutions are passed in the other Schemes, 'Black Tree and the Responsible Entity may choose to implement the Black Tree Proposal for some Forestry Projects even if similar resolutions are not passed for other Forestry Projects';



- Thus even if resolutions are passed in respect of one Scheme, but not in respect of some other, Growers have no certainty as to whether any of Resolutions 1 to 5 in respect of their Scheme will be implemented. Further, there is no date by which the RE and Black Tree must exercise their discretion to accept the appointment;

The failure to specify the 'interconditionality' in the Notices, or to list the Schemes in the Notices, the retention of a discretion by Black Tree and the RE concerning whether or not any of the Resolutions passed will, in fact, take effect and the failure to disclose this as a risk in relation to the relevant Schemes (eg, part 2.7 of the EMs) means the Meeting Material is uncertain, Growers do not in fact have any certainty about whether the Black Tree Proposal will proceed even if they vote in favour of it, and thus the Meeting Material is also misleading and likely invalid.

## **2.6 The Black Tree Proposal is misleading – there are insufficiently disclosed conditions subsequent in addition to the purported conditions precedent**

Even if Growers approve the Black Tree Proposal and pass all 5 resolutions, implementation of the Proposal is still conditional on these subsequent conditions, in respect of which Growers have little or no control:

- ASIC varying Primary RE's AFS Licence to include an authorisation enabling Primary RE to operate each of the relevant FEA Schemes;
- Primary RE forming the view that it is 'satisfied that the replacement of FEAP by Primary RE is in the best interests of Growers';
- The RE applying to the court for directions that it is justified in implementing the Black Tree Proposal;
- Either:
  - The Black Tree Proposal being approved by Growers in other (as yet unspecified) Schemes; or
  - If it is not approved in that way in respect of those other Schemes, the RE and Black Tree choosing to implement the Black Tree Proposal in respect of the Scheme.

## **2.7 The Black Tree Proposal is misleading – comments on disenfranchised Growers**

P. 5 of the EM reads as follows:

The key feature of the Black Tree Proposal is that no Grower will be disenfranchised by virtue of having had the bad luck to be allocated a woodlot with a sub-lease in a poorly performing area. If Leases are terminated, the Growers holding the relevant sub-leases will not be removed from the Scheme or otherwise treated adversely.

However, note that (by reference to the 1999 Meeting Materials):

- The only change to the proposed new Constitution in this regard seems to have occurred in clause 21 where, if the insurance proceeds are paid in respect of a woodlot, these are simply paid to the Proceeds Fund - no payment is made to the affected Growers, and, instead, all Growers are meant to share in the final balance of the proceeds fund.
- Clause 5 of the existing 1999 Management Agreement provides that the agreement terminates 'in the event that the trees to be planted on the Land are

destroyed by any cause whatsoever, in which case the Manager shall not be required to refund any part of the Management Fee already paid or then due.'

- However, that does not result in the Grower ceasing as a Grower under the existing 1999 Constitution. By reference to the existing Constitution, the Grower's position is only affected to the extent that, if there are insurance moneys paid to the Grower in respect of a destroyed or partially destroyed woodlot, then the final proceeds distribution to that Grower is reduced accordingly (but their interest in the Scheme is not extinguished altogether as the EM asserts).

## **2.8 Examples of differences between the Explanatory Memoranda, and the proposed new Constitutions and Operations Agreements**

### ***Representations about limits on Annual Fee***

As referred to above, there is no limit on the Annual Fee.

However Black Tree clearly attempts to create the impression that the Annual Fee will be similar to that which Growers currently pay. By way of example from the 1999 Explanatory Memorandum:

Where Growers are already obligated to make contributions under the original terms of their investment the annual fee is anticipated to be unchanged.

Yet there is no such limitation contained in the proposed new Constitutions.

### ***Representations about insurance of plantation***

In the 1999 EM (p. 6) the letter from the Black Tree Chairman says:

Under the Black Tree Proposal, Black Tree and the Responsible Entity will (unless the cost is deemed to be prohibitive) insure the plantation estate as a whole, in a similar manner to the current arrangements, with costs to be passed on to Growers as part of the Annual Fee.

Yet clause 22(a) of the proposed 1999 Constitution provides that:

The Responsible Entity may, but is under no obligation to do so, arrange insurance cover for the Plantation at the Grower's own cost and expense.

Accordingly there is no obligation on the RE to take out the insurance as the Explanatory Memorandum suggests.

## **3. The Black Tree Proposal requires Growers to assume all risk**

### **3.1 The Black Tree Proposal requires Growers to write a blank cheque to Black Tree, and to the RE**

The Explanatory Memoranda provide figures which the Upfront Fee and Annual Fee are 'not expected to exceed'.

However, the full implications of the mechanisms for calculating and charging Growers for the Upfront Fee, and Annual Fee, can be summarised as follows:

- The RE can strike the Upfront Fee and invoice Growers for the amount which it requires to reimburse parties such as Black Tree and FEAGG, and meeting the costs of running the Scheme up to 30 June 2011;
- The RE can then strike a Rent Levy and invoice Growers for that amount if FEAP loses its right of set-off against FEA;

- The RE can then strike a budgeted Annual Fee to meet a broad range of operational costs and expenses (including those of Black Tree as manager which on collection it must remit to Black Tree) and invoice Growers for that amount;
- The RE can then strike a final Annual Fee (the 'Supplementary Annual Fee') and invoice Growers for that amount to recover budget over-runs;
- There is no limit on the quantum of amounts which the RE may expend and then recover from Growers when operating each Scheme; and
- Accordingly Growers, by giving effect to the Black Tree Proposal are effectively writing a blank cheque to the RE and Black Tree.

This highlights the implications of the extraordinary range of costs which the RE may recover as a 'valid' expense of the Scheme, and also the year by year calculation of the Annual Fee by which all those expenses are on-charged to Growers.

Yet despite this importance, the significant risk is no more than alluded to in the Explanatory Memoranda.

### **3.2 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',<sup>1</sup> and the Court may terminate the Black Tree Proposal;
- That Growers lose the benefit of rent set-offs 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 – and 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 operates only in relation to the circumstances described in the application – a matter not ever 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;

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<sup>1</sup> Eg. p. 13 1999 EM

- 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; and
- 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.

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. Its suggested Operations Agreements are drafted on the basis that Black Tree receives its remuneration, but is also reimbursed for all costs associated with providing the services. This is an uncommercial arrangement, whereby the manager seeks to be remunerated with fees, but also to be reimbursed for what are, in effect, its own overheads. The issue is clear from clause 13.1 of the proposed Operations Agreements:

The Responsible Entity agrees that the Manager is entitled to be paid from the Grower Contribution Fund or from the Proceeds Fund the Manager's reasonable fees, costs and expenses in relation to such of the Manager's Services as may be carried out by the Manager or on its behalf for the Responsible Entity as are payable to the Responsible Entity under the Constitution or otherwise.

and the fact that Black Tree can recover amounts such as (definition of 'Manager Services'):

...in connection with the Manager providing the Manager's Services including, but not limited to, leasing office premises, accounting, audit [etc]

### **3.3 Growers are being asked to meet an inappropriate range of costs which are personal to FEAGG, Black Tree and Primary RE**

#### ***Cost of meetings***

Meetings for the Schemes have been called under Section 252D of the Act. This section provides that 'The Members calling the meeting must pay the expenses of calling and holding the meeting.'

However, the Upfront Fee which Growers must pay on commencement of the Black Tree proposal, includes a payment to FEAGG and Black Tree concerning the preparation and the

holding of those meetings. This is captured by the definition of 'Upfront costs' on page 49 of the proposed Constitution which includes in the costs to be recovered 'costs, expenses and disbursements of \$607,454 incurred by FEAGG and Black Tree associated with the Project including preparing for, convening and holding the Growers' Meeting'.

This is borne out in each Explanatory Memorandum which provides that the Upfront Fee will be used in part (p. 8, Part 2.2):

- "to pay for the costs incurred by FEAGG in protecting and fighting for the rights of Growers to date"; and
- "to pay for the costs incurred by FEAGG and Black Tree in the 10 months since FEA went into administration, and in preparing for, convening and holding the Meeting".

### ***Personal costs of the RE***

As an example, clause 19.2 of the proposed 1999 Constitution enables the RE to recover 'expenses reasonably and properly incurred by the Responsible Entity in connection with the Project or in performing its duties or obligations under this Constitution.' However, query the basis on which the following categories of costs should be included and why Growers should be liable for them:

- The costs of the RE applying for and obtaining an Australian financial services licence variation – despite holding itself out as an experienced and qualified scheme operator;
- Undertaking due diligence on Project to identify potential problems and solutions or in relation to issues RE considered necessary to protect interests of RE officers;
- Communicating with Growers concerning a change in RE;
- Dealing with Growers' representatives;
- Travel for meetings with the Scheme's manager;
- Preparing statements of advice and financial services guides – these are documents which an AFS licensee must prepare in the course of its business, not for the specific purpose of a Scheme;
- Dealing with any breaches of the Constitution (without any limitation concerning when the RE may be responsible for the breach);
- Costs of preparation and lodgement of returns by the RE – again this extends to compliance obligations the RE which are personal to it;
- Costs and liabilities, including but not limited to legal fees, whether incurred by the RE or third parties, associated with the development of the proposal set out in the Explanatory Memorandum, Total Costs, Upfront Costs and costs associated with accounting, audit, ASIC fees and professional indemnity insurance.

These are items one would normally associate with the RE's own overheads but here they are treated as Project costs

### **3.4 Scheme solvency depends on Growers continuing to pay**

The solvency of each Scheme depends on Growers paying the Upfront Fee, Rent Levy and Annual Fees. Yet as set out above, Growers:

- May form a view that the range of costs, expenses and remuneration they are required to pay is inappropriate;
- May form a view that they would be better off ceasing payments and allowing the default procedures to take effect;

This set of circumstances would:

- Pose a significant risk to a Scheme's ongoing viability;
- Lead to a situation where, after a Grower is removed from the register, the costs of operating the Scheme remain the same but the pool of Growers is reduced. Hence the calculation of the Annual Fee would have to take into account the reduced number of continuing Growers, and those continuing Growers would be forced to pay even more in order to maintain the Schemes.

### **3.5 The Black Tree Proposal imposes contractual penalties on Growers for a failure to pay**

A failure to pay the Upfront Fees can result in the RE removing the Grower from the Scheme (2003-2008).

Similarly, failing to pay the Annual Fees can then result in the RE removing the Grower from the Scheme. For instance, in relation to the 2003 Scheme, if the Grower misses payment of the Annual Fee, clause 6.11 of the proposed new Constitution provides that the Grower will then become liable for a Deferred Fee equal to:

- For the first payment missed, 50% of Net Proceeds of Sale;
- For the second payment missed, 30% of Net Proceeds of Sale; and
- For the third payment missed, 20% of Net Proceeds of Sale,

whereupon they are removed as a Grower from the register but will continue to be liable to the RE.

This mechanism raises the following issues:

- The definition of 'Net Proceeds of Sale' is a gross amount, and is not a per woodlot figure. Thus each defaulting Grower is liable for an amount equal to the whole Net Proceeds of Sale, not just the Net Proceeds of Sale in respect of their woodlot. Obviously this mechanism is flawed and is unenforceable;
- If we assume it is on a per-woodlot basis, then the RE may become entitled to an amount equal to 100% of the Net Proceeds of Sale from that Grower's woodlot;
- This would amount to a contractual penalty given it cannot be a realistic estimate of loss as the proceeds of harvest are unclear, and given the potential quantum of the Deferred Fee which is linked to the level of harvest proceeds received.

A similar issue arises in respect of the Upfront Fee and a failure to pay that amount. There is no cap on the Upfront Fee, yet if the amount is not paid the Grower is simply be removed from the Grower register.

### 3.6 **The Black Tree Proposal confers powers on the RE to act as attorney, all costs in relation to which are borne by Growers**

The Black Tree Proposal confers powers and discretions on the RE as attorney of the Growers which are much broader than can be justified, in circumstances where the Grower ultimately bears the costs arising out of the exercise of those powers and discretions.

Take for instance the relevant provisions of the proposed 1999 Constitution:

- Clause 16.4(b) states that the Grower irrevocably appoints the RE and its directors and secretary 'to be the agent and attorney of the Grower, in the Grower's name, on the Grower's behalf and as the Grower's act and deed, to exercise the powers and do anything and take any action set out in clause 16.4(a) of this Constitution';
- Clause 16.4(a) then states the RE's powers which include:
  - 'take any action (including Court action) necessary or desirable to protect and preserve the Grower's right to use, occupy or access the Land to grow their Trees, should that right be threatened, challenged or compromised, or otherwise if thought fit by the Responsible Entity';
  - 'commence any other legal or arbitration proceedings to protect the interest of the Grower';
  - 'apply to the Australian Taxation Office for a new Product Ruling or for a private ruling in relation to the Project';
  - 'execute any deed, agreement, certificate or other document and do all other things necessary or desirable in furtherance of the powers granted to the Responsible Entity by this clause';
- Clause 16.4(c) then states that the RE can then recover all costs properly incurred in exercising its powers under the Power of Attorney from the Growers' Contribution Fund and from the Proceeds Fund;

The powers set out above are but a sample. Accordingly there is a very broad range of actions, including commencing litigation, which the RE can do in the Grower's name. Although the RE can then recover **its** costs from the Scheme funds, this says nothing of the liabilities which the Grower incurs to third parties by virtue of the acts of its attorney. The Grower will be primarily liable to those third parties where, for instance, the RE as attorney commences litigation in the Grower's name and a costs or damages award is subsequently made against the Grower.

Again, Growers are left to bear the risks and the costs in this scenario – including risks arising directly out of the RE's actions.

### 4. ***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 purports to contemplate 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)* does not have the financial capacity, 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 (on terms which are, as yet, unseen); 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 the financial resources and 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.

**5. *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 (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, 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 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 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.

**6. Statements that the Black Tree Proposal presents the best outcome for Growers are unjustified**

**6.1 Black Tree has made representations in the material as to the likely return to Growers, which is incomplete, which is based on questionable assumptions 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 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 (across all Schemes) between the figures given to BRI Ferrier by its expert forestry analysis and the expert analysis obtained by the receivers of FEAP; and

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

Particularly by making the calculator available, Black Tree are 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.

- Without a full description of the assumptions, or justifying the reasonableness of the 'expected returns'. For instance:
  - As to assumptions, do the expected returns assume that there will be a solvent RE?
  - There is no statement of why the expected returns are reasonable, and no statements in respect of each of the following issues:
    - why the timber volumes are reasonable;
    - why the timber prices are reasonable;
    - assumptions why have been made as to the proportion of sawn log timber to woodchip which will be sold on harvest;
    - assumptions which have been made (as contained in the BRI information) about two new mills being operational in NSW by the time of harvest, or the implications of those mills not commencing operations;
    - why an inspection of the standing timber was not deemed as necessary in order for the expected returns to be calculated.

**6.2 Black Tree and FEAGG state that the Black Tree Proposal offers the best solution for Growers, but does not compare it to other available courses of action**

FEAGG has issued statements clearly supporting the Black Tree Proposal as enabling the Growers to move into the future with certainty, and as the best available course of action. Black Tree advises in the Explanatory Memoranda that 'we believe [the proposal] will offer Growers the best solution to the circumstances which have arisen from the insolvency of the FEA Group. However:

- The Meeting Material does not mention, let alone compare, the likely outcome for Growers as a result of any other process such as the RFM restructure proposal;
- In spite of many matters only being detailed by Black Tree many weeks after the initial Notices of Meeting were issued, FEAGG has made its statements of support a long time prior to the release of, the proposed final form of:
  - the Explanatory Memoranda;
  - the proposed new Constitutions;
  - the Operations Agreement.

Accordingly, it is difficult to see how the executive of FEAGG can be seen to have met its obligations to its members by making these statements in support of the Black Tree Proposal.

**7. *The Black Tree Proposal impacts on Growers of different classes unfairly***

The RE of a registered scheme must 'treat the members who hold interests of the same class equally and members who hold interests of different classes fairly' (s601FC(1)(d) of the Act).

The amendment to the Constitutions in some cases requires the RE to treat members of different classes unfairly. Take, for instance, the 1999 Scheme which enabled Growers to pay maintenance fees either entirely upfront, or on an annual basis:

- Clause 13A of the existing Management Agreement was entitled 'Once Only Payment';
- That clause enabled a Grower to make a once only payment in payment of all management fees until the conclusion of the Scheme;
- If there were some Growers which took this option, and some Growers who paid on an annual basis, then there are likely two classes of interest in the Scheme;
- By then requiring all Growers to contribute equally to the Scheme, regardless of which class they are in and whether or not a Grower paid all their management fees up front, those Growers who paid upfront are being treated unfairly.

Another example is the 2008 Scheme, where all of Option 1, Option 2, Option 3 and Option 4 Growers are to be levied with the same fees. Currently, Option 3 Growers are subject to a lower level of fees, presumably in view of the significantly longer period to harvest. Option 3 Growers obviously form a different class, but are now to be held liable to the same quantum of fees as other classes despite the significantly longer harvest period. Again, it is likely that the Black Tree Proposal requires the RE to treat Option 3 Growers unfairly.

To the extent that the Black Tree Proposal requires the RE to act in contravention of the Act, the proposal will be invalid and ineffective.

**8. *The Black Tree Proposal requires each of Black Tree, the Growers and FEAP to interfere with property which is the subject of charges in favour of each of ANZ and CBA over FEAP***

As referred to above, the Black Tree Proposal involves each and all of Black Tree, the Growers and FEAP:

- interfering with property or rights of FEAP which are the subject of the Banks' charge;
- putting in place arrangements for the payment of moneys to FEAP, in respect of which FEAP has an existing duty to account to the Banks.

On the first point, take the proposed treatment of voluntary payments which Growers may have made to the Administrators to date. On p.9 of the 1999 EM, Black Tree asserts that 'Those Growers who have paid voluntary invoices will have those amounts credited against Upfront Fees'. This is reflected in the clause 6.3(f) of the Proposed 1999 Constitution where a credit is given to the Grower for any voluntary fees paid.

Similarly, on p. 10 of the 2003 EM, Black Tree asserts that 'Those Growers who have paid voluntary invoices will have those amounts credited against the Upfront Fees and clause 6.3(f) of the Proposed 2003 Constitution confers the same credit on Growers as in the 1999 Scheme.

However, as we have previously communicated to Primary RE:

- Both the amounts received or receivable by FEAP in respect of rent and management fees (or 'Upfront Fees' and 'Annual Fees'), are subject to the charges of the Financiers and are therefore not available to FEAP (or any replacement RE); and
- Accordingly, any dealing with those funds, other than accounting for them to the Receivers or the Banks, will result in a party disposing of them being liable to the Receivers or the Banks for an equivalent amount.

A contractual undertaking by the RE to credit voluntary payments made by Growers, against fees due by Growers on harvest, amounts to such a dealing rendering the parties liable to account to the Banks.

Further, the existing sub-leases from FEA and FEAP to Growers, and management agreements with Growers, are not property of the FEA Schemes and are also subject to the Banks charges. Thus:

- Any termination or amendment to those documents, as contemplated by the Meeting Material, would be inconsistent with the Banks' rights; and
- This includes any arrangement such as depositing sub-lease rental payments or management payments into a Scheme bank account.

**9. *The Black Tree Proposal punishes the RE for the insolvency of Black Tree***

The proposed new Constitutions purport to strip the RE of its right to the Harvest Fee and the Performance Fee if an insolvency event occurs in relation to Black Tree.

The grounds for penalising the RE in these circumstances is entirely unclear. If Black Tree becomes insolvent and unable to perform its obligations under the Operations Agreement, then the RE could decide to conduct maintenance and harvest operations itself or engage a third party to do so. Either way, its entitlement to its own fees should be unaffected.

**10. *The RE as attorney of each Grower, will not be able to terminate or vary Grower Agreements pursuant to that power of attorney***

In view of the numerous issues involved with the Black Tree Proposal, and the substantial risks which it poses to Growers, it would be inherently problematic for the RE to take any action to purport to vary Grower Agreements relying on its power of attorney under the proposed Constitutions.

Attorneys are fiduciaries. Accordingly, attorneys owe duties to their principals and must act honestly and in the interests of the principal (the Grower). It is difficult to see how, given the significant disadvantages to Growers presented by the Black Tree Proposal, the attorney could vary or terminate Grower Agreements in compliance with its fiduciary duties.

Also, where the RE, or an officer of the RE, is to exercise the power to execute under power of attorney on behalf of the Grower, sections 601FC and 601FD of the Act may be triggered, which provide that where the interests of the RE and those of the member conflict, the RE/officer must give priority to the member's interests.