Form 1 Statement of Contentions

(rule 2.1)

IN THE SUPREME COURT OF NEW SOUTH WALES No. 237028 of 2015

DIVISION: EQUITY
REGISTRY: SYDNEY
CORPORATIONS LIST

IN THE MATTER OF BBY LIMITED (RECEIVERS & MANAGERS APPOINTED)(IN LIQUIDATION)

ACN: 006 707 777

FILED
- 3 AUG 2016
S.G.

SUPREME COURT OF NEW SOUTH WALES

STEPHEN ERNEST VAUGHAN AND IAN RICHARD HALL IN THEIR CAPACITY AS LIQUIDATORS OF BBY LIMITED (RECEIVERS AND MANAGERS APPOINTED)(IN LIQUIDATION) ACN 006 707 777

First Plaintiff

BBY LIMITED (RECEIVERS AND MANAGERS APPOINTED)(IN LIQUIDATION) ACN 006 707 777

Second Plaintiff

J MAZZETTI PTY LTD ACN 006 705 602 AS TRUSTEE FOR J MAZZETTI PTY LTD STAFF SUPERANNUATION FUND (AND OTHERS)
First Defendant

PETER BRIAN HAYWOOD AND BRONWEN MENAI HAYWOOD AS TRUSTEES FOR THE HAYWOOD SUPERANNUATION FUND ABN 19 554 378 088
Second Defendant

CLIVE RISEAM
Third Defendant

SECURITIES EXCHANGES GUARANTEE CORPORATION LIMITED ACN 008 626 793
Fourth Defendant

DAVID NADIN
Fifth Defendant

3458-4008-4226v1Filed
on behalf of Third Defendant
Prepared by Mark Anthony Wilks
Law firm Corrs Chambers Westgarth
Tel +61 2 9210 6159 Fax +61 2 9210 6610
Email mark.wilks@corrs.com.au
Address for service Level 9, 8-12 Chifley Square, Sydney NSW 2000

IN THE MATTER OF BBY LIMITED (RECEIVERS & MANAGERS APPOINTED) (IN LIQ)
SUPREME COURT OF NEW SOUTH WALES, PROCEEDING NO. 2015/00237028

THIRD DEFENDANT'S STATEMENT OF CONTENTIONS

Introduction

1. By an Originating Process dated 13 August 2015, the First Plaintiffs ("**the Liquidators**"), being the liquidators of the Second Plaintiff ("**BBY**"), seek various directions concerning the treatment of funds held by BBY in its so-called client segregated accounts – that is, accounts maintained for the purpose of facilitating the trading activities of BBY's clients. Those accounts were categorised by reference to the product lines offered by BBY.

2. The Third Defendant represents those clients who traded in Futures or foreign exchange ("**FX**") or availed themselves of the Saxo online trading platform. The Liquidators' investigations have revealed that the CSAs relating to those three product lines are in shortfall as against the claims of the relevant clients. Principally at issue in this proceeding is whether and to what extent the funds in the CSAs should be pooled for the purpose of making distributions to clients.

Pooling

3. The client segregated accounts ("**CSAs**") maintained for each of the various product lines offered by BBY are identified in sections 6.2.4 to 6.2.9 of the Liquidators' report dated 22 December 2015 ("**the CSA Report**"). There appears to be no dispute that the funds held in those accounts attract the application of Subdivision A (ss 981A to 981H) of Division 2 of Pt 7.8 of the *Corporations Act 2001* (Cth) ("**the Act**"), and that the accounts satisfied the requirements of s 981B of that statute. The funds were thus taken to be held on trust in favour of the clients by whom or on whose behalf they were paid to BBY (s 981H(1)).

4. Regulation 7.8.03 of the *Corporations Regulations 2001* ("**the Regulations**") addresses the manner in which money in an account maintained for the purposes of s 981B is to be dealt with if, amongst other things, the relevant financial services licensee becomes insolvent. It suffices presently to say that if the money in such an account is not sufficient to meet the claims of those whose money was paid into the account in error and those who are entitled to be paid money from the account, then that money "must be paid in proportion to the amount of each person's entitlement" (reg 7.803(6)(d)).

5. The regulation does not expressly confer upon the Court a power to pool accounts for distribution purposes, though the authorities recognise the availability of pooling where there has been a mixing of funds,[1] particularly if the accounts in question "can no longer practically or economically be the subject of a cash tracing exercise".[2] The term "mixing" in this context does not merely denote the physical mixing of funds in bank accounts; it also extends to situations where "funds in one trust have been applied to meet obligations of other trusts".[3]

6. In this case, mixing of both kinds has occurred, the extent of which suggests that those CSAs corresponding to the Equities/ETO, Futures, FX and Saxo product lines should be pooled. In particular:

---

[1] *Georges v Seaborn International* (2012) 288 ALR 240 ("***Sonray***") at 262-263 [82]-[86]; *Re MF Global Australia Ltd (in liq)* (2012) 267 FLR 27 at 45-48 [49]-[55].
[2] *Sonray* (2012) 288 ALR 240 at 264 [92].
[3] *Australian Securities and Investments Commission v Nelson* (2003) 44 ACSR 719 at 723 [21].

(a) on 2 December 2011, $12 million was transferred from an account holding Saxo client funds – namely, the eBridge Buffer account – to the Equities Trust account ending 8694 in order to meet a margin call of $9.5 million relating to ETO positions. This was in circumstances where those positions were being migrated from BBY's previous ASX clearing participant, Berndale Securities Limited, to BBY itself, following the approval of the latter's application to become an ASX Clear and ASX Settlement Participant. The plaintiffs' investigations indicate that the $12 million thus transferred "was not client money referable to the ETO clients whose positions were migrated from Berndale to [BBY] as clearing participant" (the Liquidators' Supplementary Report dated 15 June 2016 ("**the Supplementary Report**"), p 25), and there is nothing to suggest that that amount was ever repaid to the eBridge Buffer account. It is true that the obligation to provide margin was that of BBY, as distinct from its clients (ASX Clear Operating Rules, Rule 14.6.1). However, in the case of ETOs, BBY was obliged to call on the relevant client to provide sufficient cash or other collateral to meet its margin obligations (ASX Clear Operating Rules, Rule 14.7.1). This was also reflected in cl 13 of BBY's ASX, APX and International Trading Terms, which formed the basis of its client agreements. Thus, $12 million in Saxo client funds was used to meet an obligation that was ultimately to be borne by BBY's ETO clients;

(b) that $12 million transfer was but the first of a series of transfers, bearing the designation "BBY Corp" and occurring between December 2011 and December 2014, to and from various general trust accounts held by BBY, by which funding was provided to the Equities/ETO business and then, in most cases, repaid. This funding related to what the plaintiffs describe as "aged Equity debts". The ledgers maintained by BBY in relation to its Equities/ETO business, as adjusted for the purposes of the plaintiffs' investigations, suggest that transfers involving these particular trust accounts resulted in a net movement of approximately $2 million to the Equities/ETO CSAs (the Supplementary Report, 37).[4] And while the plaintiffs were not able to determine "whether client monies from non-Equity/ETO product lines were used for Equity/ETO Funding Transactions", they did observe that the most significant inflows into one of the relevant trust accounts during the period under investigation "were from Saxo product line sources" (the Supplementary Report, p 37);

(c) in June 2014, BBY contracted to purchase 51.4 million shares in Aquila Resources Limited ("**AQA**") for $192 million for its client, Mineral Resources Ltd ("**MR**"), which sale was to settle on 15 June 2014. When the AQA share price declined, the ASX required BBY to pay calls for cash market margin, an obligation that BBY (exclusively) owed ASX Clear (Vaughan Affidavit at [132]). BBY had insufficient funds to meet the calls and withdrew $1.8 million from a Saxo CSA and $6.8 million from a Futures CSA to do so. Following settlement, ASX Clear repaid the calls but the $1.8 million and $6.8 million were not restored to the relevant Saxo or Futures CSAs (the CSA Report, pp 92-94);

---

[4] There may be some debate as to whether the net movement of funds should be assessed by reference to four additional payments (two of which are included in the relevant adjusted ledger) made to meet BBY's margin obligations to the ASX. Three of these four payments appear to have been made from what is referred to as the Facilitation Account, which, as described in Section 6.2.2 of the December 2015 Report, was an overdraft facility provided by St George Bank which was used to settle the daily market obligations, and support business funding requirements, of the Equities/ETO business. The remaining payment appears to have been a transfer from another overdraft account held with St George into the Facilitation Account, which transfer then funded one of the payments referred to in the preceding sentence. These four payments thus do not appear to be in any way related to the provision of funding to the Equities/ETO business out of the so-called "BBY Corp" accounts.

(d) at this time BBY was attempting to comply with an amendment to its trading agreements with Saxo Capital Markets (Australia) Pty Ltd ("**SCMA**") which required BBY to transfer to SCMA by 1 April 2014 all client monies that BBY was obliged to hold for clients' trading using the Saxo online platform (the CSA Report, p 101). The difficulty for BBY was that even at this point, there was a shortfall between the funds that it actually held on behalf of Saxo clients and the amount that it was required to hold, a shortfall possibly explained, in part, by the transfers described in (a) and (b) above. In the period 1 April to 12 December 2014 BBY transferred $28.7 million to SCMA, including $7.1 million from the General Trust account into which the $6.8 million owing to Futures clients mentioned above was paid, along with $1 million initially withdrawn from the FX CSA (the CSA Report, 101). SCMA terminated its trading agreements with BBY on 1 December 2014 and repaid BBY $44.7 million. Of that amount, $0.5 million was restored to Futures and $1.1 million to FX (the December Report, p 102), with $33 million being paid to clients in relation to the closing out of their accounts on the Saxo platform, $8.8 million being transferred to other product line accounts held by Saxo clients and $4.3 million being transferred to BBY House accounts (the Supplementary Report, Appendix 10.2);

(e) on 16 December 2014, $1.37 million was transferred to BBY's General Trust account ending 002 from CSAs for the Saxo, Futures, FX, Carbon Trading and IB product lines. This then formed part of transfer of $4.1 million to the Equity/ETO Trust account ending 541 ("**the 541 Account**"), the principal daily working trust account for BBY's Equities and ETO business (the CSA Report, p 86). The plaintiffs' investigations suggest that this sum was ultimately, albeit indirectly, restored to the General Trust account, but there has been no return of the $1.37 million to the CSAs from which that amount was drawn (the Supplementary Report, p 43);

(f) on 17 December 2014, $300,000 was transferred from the FX Trust account ending 268 to the Equities Trust 2 account ending 415, apparently, according to the plaintiffs, so that the balance of the latter account was at least the amount that BBY regarded itself as obliged to hold for its ETO clients (the Supplementary Report, p 45). There was then a transfer, on 18 December 2014, of $575,053.60, presumably comprising the $300,000 drawn from the FX Trust account, from the Equities Trust 2 account to the 541 Account (the Supplementary Report, p 46); and

(g) on 13 and 16 March 2015, transfers were made in the amounts of $750,000 and $139,000 from the Saxo Buffer account ending 356 to BBY's General House Account. The first transfer appears to have been for the purpose of providing funding for the Equity/ETO trust account 541, as in the manner of the "BBY Corp" transfers described above, and the second for the purpose of funding an ETO margin call in circumstances where the overdraft account that BBY used to meet such calls lacked sufficient funds. Neither sum was restored to the Saxo Buffer account (the CSA Report, p 89-90).

7. Lest it be thought that the transfers described above are isolated and capable of being reversed, it should be borne in mind that the plaintiffs investigated funds transfers between BBY accounts on a sampled basis and, in their view, the reliable reversal of any intermingling of funds would require a full reconstruction and reconciliation of banks movements. They have indicated that this is not possible on the information available to them.[5]

8. Given that:

[5] Letter dated 11 March from Ashurst to Clayton Utz at [13].

(a) the balances of the accounts for the Futures, FX and Saxo product lines, combined with any cash, stock and options paid or held by counterparties, suggest shortfalls as against client claims of approximately $8.7 million, $1.4 million and $7.9 million respectively (the Supplementary Report, p 68); and

(b) the absence of any such shortfall in respect of the Equities and ETO product lines,

it is, in the Third Defendant's submission, entirely appropriate that the Court direct the pooling of the CSAs relating to those product lines as a step anterior to the application of reg 7.8.03 of the Regulations.

Recoveries and interest

9. The pooled fund contended for above should include the monies, referred to as Recoveries, described in paragraphs 178 to 196 of Mr Vaughan's affidavit affirmed 23 December 2015, particularly since they are not the subject of any claim by the Receivers. More importantly, those funds, when paid to the Plaintiffs, either did or would answer the description of money paid to BBY in its capacity as a person acting on behalf of clients, in connection with financial services that have been provided to those clients or financial products held by them. The funds would thus attract the application of Subdivision A of Division 2 of Part 7.8 of the Act and be subject to the trust imposed by s 981H(1).[6]

10. As for the interest earned on money held in the CSAs, even if BBY had made the disclosures required by reg 7.8.02(7) for the purpose of securing its entitlement to the retention of that interest, it is not now entitled to be paid anything on account of interest, having regard to the shortfall in the CSAs as against the claims of Equities/ETO, Futures, FX and Saxo clients. As Black J held in *MF Global* [7] by reference to reg 7.8.03(6)(e), a financial services licensee is only entitled to recover interest on the CSAs in question to the extent that monies remain after making prior-ranking payments, such as those owed to clients.

Calculation of client entitlements

11. It was determined in *Re MF Global*[8] that client entitlements should be assessed by reference to the gross liquidation value, as at the date of appointment of the administrators, of clients' positions, having regard to the terms of their various agreements with the financial services licensee, where in the case of open positions, this would be based on mark-to-market prices on the day before the appointment date.

12. This approach appears to have informed at least the manner in which the claims of Futures clients were calculated. Thus, the Plaintiffs relied on BBY's Futures Dealer Report for 15 May 2015, being the last trading day before the plaintiffs' appointment as administrators of BBY. That report effectively valued futures trades at their market value for the close of business on that date (the CSA Report, p 42). The Third Defendant takes no issue with this approach. Similarly, there appears to be no basis for criticising the plaintiffs' reliance on the FX Dealer Report and the "Outstanding Client Accounts" file in calculating the claims of FX and Saxo clients respectively (the CSA Report, pp 43 and 44).

13. One matter that the Plaintiffs should address in submissions is the exclusion of all debtor balances across every product line in the assessment of clients' claims on the apparent basis that "the collectability of these debt balances are uncertain" and their inclusion "would artificially reduce the total client claim" (the CSA Report, p 39). The extent to which the Plaintiffs have investigated the recoverability of debtor balances or the availability of any set-off in BBY's favour is not clear. In circumstances where the recovery of such balances

---

[6] *Re MF Global Australia Ltd (in liq)* (2012) 267 FLR 27 at 82-83 [189].
[7] *Re MF Global Australia Ltd (in liq)* (2012) 267 FLR 27 at 80 [180].
[8] (2012) 267 FLR 27 at 61 [108], 63 [114] and 67 [128].

might expand the pool of funds available for distribution, the Plaintiffs' position requires at least further justification.

14. Finally, for the reasons outlined in the Third Defendant's submissions on the separate questions earlier formulated by the Court, those clients represented by the First Defendant are not entitled to recover the so-called Returned Collateral and Erroneous Withdrawals in full and in priority to the claims of other clients. They must instead partake in the rateable distribution contemplated by reg 7.8.03(6) of the Regulations.

Set-off

15. In both *Sonray* and *MF Global*, orders were made permitting the liquidators to set off positive cash balances against negative cash balances in all accounts held by the same client. Unlike in those cases, however, BBY's client agreements did not provide for a simple entitlement in BBY to set off positive against negative balances in this manner. For example, in both the Futures Terms and Desk FX Terms (the CSA Report, Appendices 12 and 14), which respectively governed dealings between BBY and its Futures and FX clients, it was only upon a default by the client that BBY enjoyed any right of set-off. As for the Saxo clients, cl 4.7 of BBY's Online Account Terms permitted BBY to "combine all payments that are required to be made between the Client and BBY in the same day in the same currency so that only single payment in the amount of the net difference is payable by the relevant person to the other" (the CSA Report, Appendix 16). But this is quite different from a contractual right of set-off of the sort considered in *Sonray* and *MF Global*.

16. It is thus by no means obvious that there is a basis for permitting the setting off of positive against negative balances in accounts held by the one client, where this would represent something of a departure from the manner in which BBY chose to structure its dealings with its clients. That being so, the Third Defendant reserves his position on this question, pending the filing and service of submissions by the Plaintiffs.

Conversion of foreign currency and small client balances

17. The Plaintiffs' application for directions concerning:

    (a) the conversion into Australian dollars of foreign currency funds held in the CSAs; and

    (b) the treatment of client accounts with balances of $25 or less,

    is not opposed.

Date: 3 August 2016

	R. M. Smith		Gerald Ng
Phone	(02) 9233 1891	Phone	(02) 9233 4275
Fax	(02) 9221 5386	Fax	(02) 9221 5386
Email	rms@7thfloor.com.au	Email	gng@7thfloor.com.au