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6 November 2015

## **BBY Limited (Receivers and Managers Appointed) (In Liquidation)**

**ACN 006 707 777**

### **Liquidators' Notice to Creditors – Court Directions Regarding Client Monies**

#### **1. Background**

- 1.1 As you may be aware, Ian Hall and I were appointed as liquidators of BBY Limited (Receivers and Managers Appointed) (In Liquidation) ACN 006 707 777 (**BBYL**).
- 1.2 In BBYL's business, client funds deposited with BBYL were held by BBYL in client segregated accounts (**CSAs**). Funds in the CSAs are held on trust by BBYL for its clients.
- 1.3 We have conducted preliminary investigations into the CSAs, which are continuing. There are a total of 47 CSAs, holding approximately \$17 million, including \$3.4 million received from ASX in relation to clients (and this has been placed in a separate trust account). These amounts do not include any monies held by financial services counterparties on behalf of BBYL's clients, which we may recover in due course.

#### **2. Preliminary investigations identify a shortfall**

- 2.1 Our preliminary investigations indicate that:
  - there is likely to be a significant overall shortfall between client claims in relation to CSAs, and the funds held in the CSAs. Based on figures available as at 15 May 2015, client claims are in the order of \$29.8 million, and the shortfall is in the order of approximately \$19.2 million (excluding the \$3.4 million received from the ASX and any other recoveries from counterparties).
  - BBYL did not maintain comprehensive records that show the client or clients who are entitled to the balance of any particular CSA. For example, to date we have not identified any document in the nature of a trust ledger account, or a statement of trust account, for each client recording the contributions and withdrawals by that client into or from particular CSAs. BBYL does not appear to have recorded any individual cash balances of each client in each account.
  - there appear to be transactions between CSAs within and across different product lines.

### 3. Court Application

- 3.1 Copies of the Liquidators' application and the material in support which has been filed is available on the website at <http://www.kpmg.com/AU/bby>.
- 3.2 On 13 August 2015, we commenced proceedings in the Supreme Court of New South Wales seeking a number of directions and declarations in relation to the distribution of client funds. The Liquidators are seeking the Court's guidance as to how the amounts in the CSAs and other recoveries should be dealt with. The aim of the Court process is to resolve these issues in one set of proceedings and avoid unnecessary time and cost of dealing with various separate legal challenges by clients, creditors or other interested parties.
- 3.3 On 19 October 2015, the Court made a number of procedural orders, the important ones of which are referred to below, and adjourned the proceedings to 15 February 2016 for directions and 22 March 2016 (provisionally) for hearing.

#### *The issues for determination*

- 3.4 The main questions raised are:
- Whether or not CSAs should be grouped or pooled, and if so, how (see paragraphs 3.6 to 3.14 below)?
  - Whether foreign currency held in the CSAs should be converted into Australian Dollars to facilitate distribution?
  - Whether amounts recovered by BBYL since 17 May 2015, when the company went into administration, and amounts that may be recovered by the Liquidators in the future, are beneficially owned by BBYL, or are held on trust for clients?
  - Whether positive client positions should be set-off against negative client positions, including across different product lines in respect of the same client (see paragraph 3.15 below)?
  - Whether small client entitlements (less than \$25) can be disregarded (see paragraph 3.16 below)?
  - Whether amounts deposited by clients after 17 May 2015, when the company went into administration, should be returned to clients, or treated as a deposit to the relevant CSA?
  - Whether interest earned on the CSAs is owned beneficially by BBYL or is held on trust for clients?
  - Whether the liquidators' remuneration, costs and expenses should be paid out of trust property?

***How could the court application affect clients?***

3.5 How much each client will be paid from the CSAs and other recoveries will depend on the Court's answers to the questions in the court application. There are three issues in particular, in respect of which clients' interests may differ:

- the grouping or pooling of CSAs, discussed at paragraphs 3.6 to 3.14 below;
- setting off positive client positions against negative client positions, discussed at paragraph 3.15 below; and
- the treatment of small client entitlements, discussed at paragraph 3.16 below.

***Pooling***

3.6 BBYL's financial products may be classified broadly into the following product lines:

- Exchange-traded financial products:
  - (i) cash equities (e.g. listed shares and units) and exchange traded options (**Equities** and **ETOs**); and
  - (ii) futures contracts and futures options (**Futures**).
- "Over the counter" financial products:
  - (i) foreign exchange contracts (**FX**);
  - (ii) a variety of products, including FX contracts of difference and international products offered by Saxo Capital Markets (**Saxo**); and
  - (iii) other miscellaneous financial products, such as those traded on the Interactive Brokers platform and carbon trading (**Other Products**).

3.7 Depending on whether or not CSAs are grouped or pooled, and if so, how, some clients with claims in a particular product line may be paid their claims in full, while other clients with claims in another product line face a shortfall. As explained below, pooling could mean that:

- Clients with claims in product lines that currently indicate a low return (eg Futures and Saxo) could receive a greater return if CSAs are pooled (depending on how they are pooled);
- Clients with claims in product lines that currently indicate a relatively high return (eg Equities and ETOs) could receive less in respect of their claims if CSAs are pooled (depending on how they are pooled); and
- Clients with claims in the FX product line, although they currently show a deficiency, may not see a significant change in the return on their claims based on whether or not CSAs are pooled (depending on how they are pooled).

***Scenario 1 (no pooling and excluding post-appointment deposits, withdrawals, recoveries and costs)***

3.8 If CSAs are not grouped or pooled, the result could be that Equities clients and ETOs clients will receive better returns from CSAs than Futures, FX and Saxo. These are not the only potential outcomes. Based on our preliminary investigations, if the balances of the CSAs as at the date of appointment of administrators (being 17 May 2015) are dealt with along separate product lines, then only clients with claims against the Equities and ETOs product line are likely to be paid in full, and clients with claims on the other product lines will face a shortfall. If the balances of the CSAs are dealt with along product lines, then the current estimated return using the balances of the CSAs as at the date of our appointment, and ignoring post-appointment deposits, withdrawals, recoveries and costs, is as follows:

- \$1.00 for every dollar claimed (i.e. 100 cents in the dollar) for Equities;
- \$1.00 for every dollar claimed (i.e. 100 cents in the dollar) for ETOs;
- \$0.04 for every dollar claimed (i.e. 4 cents in the dollar) for Futures;
- \$0.55 for every dollar claimed (i.e. 55 cents in the dollar) for FX;
- \$0.02 for every dollar claimed (i.e. 2 cents in the dollar) for Saxo; and
- \$0.00 for every dollar claimed (i.e. 0 cents in the dollar) for Other Products (excluding Interactive Brokers).

***Scenario 2 (with pooling and excluding post-appointment deposits, withdrawals, recoveries and costs)***

3.9 However, if CSAs are pooled across all product lines, then the return to all clients could be up to \$0.36 for every dollar claimed (i.e. 36 cents in the dollar) (again ignoring post-appointment deposits, withdrawals, recoveries and costs). This would mean that:

- Equities clients would receive up to 36 cents, rather than \$1, for every dollar claimed;
- ETOs clients would receive up to 36 cents, rather than \$1, for every dollar claimed;
- Futures clients would receive up to 36 cents, rather than 4 cents, in the dollar for every dollar claimed;
- FX clients would receive up to 36 cents, rather than 55 cents, in the dollar for every dollar claimed;
- Saxo clients would receive up to 36 cents, rather than 2 cents, in the dollar for every dollar claimed; and
- Other Products (excluding Interactive Brokers) clients would receive up to 36 cents, rather than 0 cents, in the dollar for every dollar claimed.

***Scenario 3 (no pooling and including post-appointment deposits, withdrawals, recoveries and costs)***

3.10 The results differ if post-appointment deposits and withdrawals in respect of the CSAs and other recoveries are taken into account. If they are taken into account, then treating CSAs along separate product lines, without pooling (and ignoring costs), the current estimated return is as follows:

- \$1.00 for every dollar claimed (i.e. 100 cents in the dollar) for Equities;
- \$0.88 for every dollar claimed (i.e. 88 cents in the dollar) for ETOs;
- \$0.36 for every dollar claimed (i.e. 36 cents in the dollar) for Futures;
- \$0.60 for every dollar claimed (i.e. 60 cents in the dollar) for FX;
- \$0.05 for every dollar claimed (i.e. 5 cents in the dollar) for Saxo; and
- \$0.00 for every dollar claimed (i.e. 0 cents in dollar) for Other Products (excluding Interactive Brokers).

***Scenario 4 (with pooling and including post-appointment deposits, withdrawals, recoveries and costs)***

3.11 If CSAs are pooled across all product lines, and post-appointment deposits and withdrawals in respect of the CSAs and other recoveries are taken into account (but ignoring costs), then the return to all clients could be up to \$0.58 for every dollar claimed (i.e. 58 cents in the dollar). This would mean that:

- Equities clients would receive up to 58 cents, rather than \$1, for every dollar claimed;
- ETOs clients would receive up to 58 cents, rather than 88 cents, in the dollar for every dollar claimed;
- Futures clients would receive up to 58 cents, rather than 36 cents, in the dollar for every dollar claimed;
- FX clients would receive up to 58 cents, rather than 60 cents, in the dollar for every dollar claimed;
- Saxo clients would receive up to 58 cents, rather than 5 cents, in the dollar for every dollar claimed; and
- Other Products (excluding Interactive Brokers) clients would receive up to 58 cents, rather than 0 cents, in the dollar for every dollar claimed.

3.12 The above scenarios do not model client positions in respect of clients who traded through the Interactive Brokers platform. However, clients who traded through Interactive Brokers could receive high returns of close to \$1 for every dollar claimed if potential recoveries from Interactive Brokers are taken into account (but ignoring costs) and not pooled across all product lines.

- 3.13 There is also a sum of approximately \$135,000 held in trust accounts operated by BBYL not directly referable to any particular Product Line, and this amount has also been excluded from the above scenarios.
- 3.14 Whether pooling is appropriate is likely to be influenced by how the CSAs were operated by BBYL and, in particular, whether there was a mixing of funds.

*Set off*

- 3.15 Some clients may have a positive position on one product and a negative position on another. The question is whether to set off a client's positive position against that client's negative position, including across different product lines. If set off is allowed, then only the net amount will be left owing either by the client to BBYL, or by BBYL to the client, depending upon the result of the set off. For example, if BBYL owes a client \$100 on an Equities or ETO account, and the same client owes BBYL \$50 on an FX account, then if set off is permitted that client would have a single net claim against BBYL of \$50, and would avoid a two-step process. Applying set off would also mean that affected clients would receive the benefit of 100 cents in the dollar for amounts owed to them by BBYL up to the amount of the set-off.

*Small entitlements*

- 3.16 Our preliminary investigations indicate that there are approximately 1,118 accounts across the Equities, ETOs, Futures, FX and Saxo product lines with a value of less than \$25. Given the disproportionate costs of administering such small claims, there is a question whether they should be disregarded, such that they will have no entitlement to make a claim against BBYL. If the court determines that small entitlements of \$25 or less may be disregarded, then all clients who have a claim of \$25 or less will be disadvantaged because they will not be able to make a claim against BBYL and will be treated as though they have no entitlement to any distributions or recoveries.

**4. Participation in the proceedings**

*Can clients participate in proceedings or oppose the proceedings?*

- 4.1 Yes, however you do not need to participate in the Court proceedings if you do not wish to.
- 4.2 Non-participation in the proceedings will not affect your status as a client of BBYL. However, if you do not participate, orders may be made in your absence which determine any of the above issues adversely to your interests.

However, as discussed in paragraphs 4.3 to 4.5 below, representative defendants have been appointed to represent members of the affected classes of clients so as to ensure that all client interests are represented before the Court.

*What are representative defendants?*

- 4.3 There are thousands of clients of BBYL who potentially have an interest in the CSAs and recoveries. The rules of Court allow for a representative to be appointed to represent members of a class where it is expedient for the purpose of saving expense (having regard to all of the circumstances, including the amount at stake and the degree of difficulty of the issue or issues to be determined).

- 4.4 The Liquidators proposed that representative defendants be appointed to represent the respective interests of the different classes of BBYL clients. This will ensure that arguments are presented for and against each position.
- 4.5 On 19 October 2015, the Court appointed three representative defendants for certain categories of clients as per the table below. If it later appears that further or different representative defendants are required, for example because a conflict of interest arises or because new or updated information becomes available, the appointment of representative defendants can be revisited. The Liquidators intend to revisit the issue of representative defendants once they have finalised their investigations and reported their findings to ensure that all clients are adequately represented.

No.	Representative defendant	Class	Interest	Solicitor
1	J Mazzetti Pty Ltd ACN 006 705 602 as Trustee for J Mazzetti Pty Ltd Staff Superannuation Fund	ETOs clients with open positions as at 15 May 2015	Client of BBYL who holds an ETO account with a claim to be entitled to a margin return of \$2,001,962.70	Peter Gandolfo, Partners Legal pgandolfo@partnerswealthgroup .com.au
2	Peter Brian Haywood and Bronwen Menai Haywood in Trust for the Haywood Superannuation Fund ABN 19 554 375 088	Equities clients and ETO clients without open positions as at 15 May 2015	Client of BBYL who holds an Equities account with a claim to be entitled to \$144,594.02	Ariel Borland, Mills Oakley aborland@millsoakley.com.au
3	Clive Riseam	Futures, FX, Saxo and Other Products clients ( <b>Shortfall clients</b> )	Client of BBYL who holds a Futures account with a claim to be entitled to \$706,320.79	Mark Wilks, Corrs Chambers Westgarth mark.wilks@corrs.com.au

- 4.6 Also, on 19 October 2015, the Court made orders in relation to the payment of costs and expenses to the effect that:
- the Liquidators' reasonably incurred remuneration, costs and expenses, and the second and third representative defendants' reasonably incurred legal costs will be paid out of certain recovered amounts and the CSAs of BBYL (other than an amount of \$5.8 million, made up of \$2.4 million in withdrawals by BBYL relating to margin calls and the \$3.4 million returned from the ASX, referable to the ETO product line); the reasonably incurred legal costs of the first representative defendant will be paid out of the sum of \$5.8 million (made up of \$2.4 million in withdrawals by BBYL relating to margin calls and the \$3.4 million returned from the ASX, referable to the ETO product line); and
  - the legal costs of the representative defendants, and the legal costs, expenses and remuneration of the Liquidators will be examined and approved by a Registrar of the Court before they are paid.

***What do clients need to do if they wish to participate or oppose the proceedings?***

- 4.7 If you wish to be heard or become a party to the proceedings, including to object to the representative defendants appointed or the costs orders made, you should:
- file a Notice of Appearance in accordance with rule 2.9 of the *Supreme Court (Corporations) Rules 1999 (Rules)* and serve it on the Liquidators' solicitors c/- Ashurst Australia, Level 11, 5 Martin Place, Sydney NSW 2000 (Ref: EP RYZA 02-3003-4959) and otherwise comply, if appropriate, with rule 2.9 of the Rules. Any such notice of appearance must be filed by 1 February 2016.
  - appear before the Court at the directions hearing on 15 February 2016 at law Courts Building, Queens Square, Sydney.
- 4.8 We recommend that you obtain legal advice if you are considering taking these steps. The time and court details of the proceedings will be specified in the Court List which should be available the day before at the following link:


[http://www.lawlink.nsw.gov.au/courtlists/nswsc\\_lists.nsf/Web+Version+Courtlist](http://www.lawlink.nsw.gov.au/courtlists/nswsc_lists.nsf/Web+Version+Courtlist)



5. **Ongoing communications**

- 5.1 We intend to communicate regularly with clients via email and our dedicated website at <http://www.kpmg.com/AU/bby> on the Court process. **If you are not a client but are otherwise a creditor of BBYL, please provide an email address to which you would like future communications to be sent by sending an email to [BBY@kpmg.com.au](mailto:BBY@kpmg.com.au).**
- 5.2 Should you have any questions in the meantime, please send your question by e-mail to [BBY@kpmg.com.au](mailto:BBY@kpmg.com.au). It would be helpful if the subject line of your e-mail is titled "BBYL Court Process".

Yours faithfully



**Stephen Vaughan**

In his capacity as one of the joint and several liquidators of  
BBY Limited (Receivers and Managers Appointed)(In Liquidation) ACN 006 707 777