

To Torex Retail Shareholders

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UK Shareholders Association
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Torex Update – Number 6 – The Current Position

This note is to update those people who have supported our campaign on Torex Retail and advise you on the issues that we are likely to pursue going forward.

As you should be aware by now, Torex Retail Plc is now in Administration, having disposed of its main operating assets to Cerberus. Neither ordinary shareholders nor bondholders are likely to receive anything after bank debt has been repaid. The history of events and what UKSA has done to date is given on our web site at: www.uksa.org.uk/Torex.htm, although this note summarises the key points. The main questions that I will try and answer in this note are:

A – What went wrong?

B – What legal issues do the events raise and what actions might be pursued?

C – What are the general issues that are raised that should be borne in mind in possible legal or regulatory changes to avoid similar such events in future.

A – What went wrong

Clearly the company got into financial difficulties for two reasons. Firstly it became highly geared due to an aggressive acquisition strategy. The final step in that process was the issue of convertible bonds to finance the purchase of Retail-J. As a result the debts of the company became relatively high in relation to its equity and operational cash flow. That might have been OK if the company had not been impacted by other events that undermined the confidence of bankers, customers and suppliers. The second cause, and probably the issue that crystallised events, was the announcement of an investigation by the Serious Fraud Office into the affairs of the company and the doubts that this raised about the accounts of the company. The historic accounts were called into question, and future forecasts seemed very questionable.

Alongside these circumstances was the realisation that corporate governance at the company was very poor (Chairman Steve Marshall called it “breathhtaking” in his announcement of the disposal), with many allegations and rumours being bandied around about past events.

After the appointment of new directors (effectively replacing Chris Moore and his associates), it may have been possible to recover the situation if a sensible strategy had been followed so as to restore confidence. Some refinancing and restructuring was no doubt required, but the operating businesses still seemed to have sound prospects with good on-going customer relationships. Instead the company appeared to become dominated by its bankers with numerous sets of accountants and other consultants being employed at high cost and with the directors soon deciding that the easiest solution was to put the operating businesses up for sale. Note that UKSA has said repeatedly that for this type of business, in this market, such a decision was not likely to maximise the value obtainable, and was indeed likely to be prejudicial to the interests of ordinary shareholders.

B – What legal issues do the events raise and what actions might be pursued?

The following is a brief analysis of the possible legal issues, without going into detail, and not wanting to disclose exactly which issues we might pursue and how:

(i) Clearly if the accounts that were published in the past turn out to be false then claims might be lodged against former directors for breach of duty, and against the auditors if there were failings in their audit. Normally however, such claims have to be pursued by the company rather than by shareholders, which means in effect the Administrators would have to take up such claims. We do not yet know their attitude on this issue, but there is often a reluctance by Administrators or Receivers to pursue such actions on the grounds of cost, the risks of failure and the uncertainty of any substantial returns. But former Chief Executive Neil Mitchell has stated that there is copious evidence of false accounting or fraud and he expects a criminal prosecution to be brought against some former executives of the company in due course.

(ii) If the company issued any prospectuses that were false or misleading – for example for the bond issue made to finance the Retail-J acquisition – then whoever invested on the basis of that prospectus might have a claim against the company or the directors at the time.

(iii) If the company issued misleading trading statements then there might be claims under the Financial Services and Markets ACT (FSMA) for “market abuse” . This would be a matter for the FSA.

(iv) It appears to us that there was a breach of an AIM Listing Rule in that the major assets of the company were apparently disposed of without shareholder approval. This would be a matter for the AIM Listing Authority – the London Stock Exchange.

(v) There may also be claims possible against the more recent directors if it could be shown that they ignored the interests of all stakeholders or conspired in some way with the company bankers to protect their interests alone.

The above is a simple overview of the UK legal and regulatory issues. However, there may also be grounds for actions in the USA where shareholder lawsuits are generally easier to pursue. Torex had a substantial proportion of its assets in the USA and considerable numbers of shareholders were based there.

Bearing the above in mind, the UKSA Torex Group has instructed our lawyers to pursue some of the above issues. We have also openly stated that we would support other parties who might be pursuing their own claims.

Another issue outstanding is the question of the Requisition of an Extraordinary General Meeting which UKSA submitted to the company on the same day that it went into Administration. We feel that the directors should be accountable to shareholders at such a meeting for their past actions, but the Administrator has so far not called such a meeting on grounds which are not clear to us.

C – What are the general issues that are raised?

The following are the symptomatic problems revealed by the events at Torex which we believe need to be tackled by appropriate regulatory and legal changes:

(i) The difficulty in upholding shareholder democracy due to the degradation of share registers in recent years. Shareholders have a right to change the directors, and change the direction of the company, if they are unhappy with the policies pursued by directors. As you are probably aware, UKSA took the view that in this case the directors were not acting in the best interests of shareholders by pursuing a disposal of the assets. With the directors failing to respond to our comments, we decided to call an Extraordinary General Meeting (EGM) to remove certain directors and at the same time we arranged for discussions to take place on an alternative refinancing/restructuring proposal. But actually getting the required 10% of votes for the EGM requisition took a long time when events were rapidly unfolding. The main difficulty is that so few shareholders are nowadays in their own name on the share register – most are in nominee accounts and communicating with them is exceedingly difficult. Even when you have got in contact, getting them to arrange for the nominee operator to sign the requisition is not easy and takes time. Although we managed eventually to obtain the required numbers of votes, it was too late to block the disposal, and even if an EGM had been called in time, getting the required votes to win the polls would have been difficult. This problem is a major defect in UK financial markets which needs to be rectified if shareholders are really to regain power over directors who are acting contrary to their wishes. Note incidentally that although there was a major new Companies Act that recently became the prime legal corporate framework for limited companies in the UK, nothing in there would have helped in this case, particularly as this is an AIM company.

(ii) Is corporate governance in AIM companies of an adequate standard? Our answer would be no. Although the LSE has taken steps recently to improve this by strengthening the role of NOMADs (the “Nominated Advisors” to AIM companies) the general standard appears to be questionable. One particular issue at Torex was the dominance of the company and its board by one or two key executives. Strong and experienced non-executive director representation can usually help to avoid the worst excesses of corporate behaviour.

(iii) The inadequacy of the AIM Listing Rules in terms of enforcing the rights of shareholders to be consulted on major transactions, particularly when the company gets into difficulties. There have been other cases in recent years where assets have been disposed of, or companies delisted, without full shareholder consultation and consent, often on the pretext of “force-majeur”. In this case, Administration seems to have been “pre-arranged” as a way to avoid proper shareholder consent and shareholder democracy has thereby been thwarted.

(iv) The ability of bankers to still effectively take control of a company when it gets into financial difficulties when “Administration” was originally intended to provide a way for a company to have protection from its creditors to give it some chance to recover. Bankers are still calling the shots with the result that other stakeholders, including the owners of the business, can be left with nothing.

Join UKSA to help us campaign on these issues.

These are the kind of issues that the UK Shareholders Association needs to pursue and helps to explain why we feel that shareholders need to be properly represented. Although the UK has one of the better regulated markets in comparison with many, there are still many issues that need to be improved if shareholders are not be caught out and lose money as happened at Torex.

So we would urge you again to consider membership of UKSA so we can carry on fighting on these and similar issues. More information on membership is present on our web site at www.uksa.org.uk/Membership.htm or call 020-8467-2686 to order a printed information pack.

Torex campaign financial support.

We promised people who donated financially to our Torex campaign that we would give you regular statements of the financial position. At the time of writing we have raised £3,240 from our previous request for donations. Our costs are probably similar although it is difficult to be exact at this time as legal bills tend to take time to arrive. Thanks to all those who have donated but we clearly need more funds if we are to pursue some of the issues mentioned above. I have therefore attached another copy of our donation form to the end of this letter and would urge all those people who have not yet made a contribution to return the form to us. An enormous amount of effort has been put in by UKSA volunteers on this campaign, all unpaid of course, but we do need some minimal financial support to continue the fight.

If you have any questions on the above, please contact me via telephone or email.

Yours sincerely

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UKSA Torex Retail Action Group Donation Form

Name: _____

Address: _____

Postcode: _____

Email Address (please write clearly in capitals): _____

Telephone (optional): _____

Number of shares held _____

I enclose a cheque for £ _____ made payable to the UK Shareholders' Association as my contribution to this campaign, calculated as follows based on the number of shares I hold (the amount being asked for is based on a need to raise £10,000 initially and the likely number of respondents and contacts we already have). The suggested minimum contribution is 0.1p per share held, but additional contributions are welcomed of course. A table that gives some sample figures is below:

Shares held	Subscription Amount @ 0.1p per share
10,000	£ 10.00
25,000	£ 25.00
50,000	£ 50.00
100,000	£ 100.00
200,000	£ 200.00
1,000,000	£ 1000.00

Note that anyone who has already joined the UK Shareholders Association as a member can deduct the cost of their membership fee from the enclosed contribution, if you so wish.

Please return this form together with a cheque for the amount being contributed to the following address: UK Shareholders Association Ltd, PO Box 62, Chislehurst, BR7 5YB. Alternatively payment may be made by bank transfer to the following bank account: A/C UK Shareholders Association Ltd, HSBC, 11 North Street, Wetherby, LS22 6NT, Sort Code: 40-46-21 Account: 31342606 (quote reference "Torex donation")

Note that the UK Shareholders Association warrants that any contributions made in respect of this matter will be used solely to promote the interests of the shareholders of Torex Retail Plc. If the committee set up to organise this campaign subsequently determines at some point that no further action is necessary, then any funds remaining will either be returned by UKSA to contributors pro-rata to their total contributions, or may be used for any charitable purpose to promote the interests of UK shareholders in general by UKSA. Money paid to UKSA for this campaign will be accounted for separately, and any expenses incurred likewise, and a statement of income and expenses will be supplied to contributors at appropriate points in time, but no less than annually.

Note that the UK Shareholders Association (UKSA) is a "not for profit" company limited by guarantee – see www.uksa.org.uk/About.htm for more information. The Torex Retail Action Group is a group operating under the constitution of UKSA.