

5 May 2006

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TO THE CREDITOR AS ADDRESSED

Dear Sir/Madam

**RE: PASMINCO LIMITED
(SUBJECT TO DEED OF COMPANY ARRANGEMENT)
ACN 004 368 674
AND ITS WHOLLY OWNED AUSTRALIAN SUBSIDIARIES ('PASMINCO')

CLAIMS BY AQUILA RESOURCES LTD**

I refer to my report dated 19 April 2006 and in particular point 4, which relates to Aquila's claims.

The foreshadowed mediation of Aquila's actions ordered by the Federal Court was held in Melbourne over two days on 26 and 27 April 2006. John Clarke QC, a retired New South Wales Supreme Court Judge, conducted the mediation.

The outcome of the mediation is that, subject to creditor approval, it is proposed that the litigation commenced by Aquila against Pasminco will be settled. The purpose of this report is to outline the background to the proposal, provide creditors with an understanding of the options available and provide the Deed Administrator's recommendation on the proposal to creditors.

The proceedings

At present, Aquila has two related proceedings on foot against companies in the Pasminco group.

Misleading and deceptive conduct proceedings

The first proceeding, W136 of 2003, is a Federal Court proceeding that relates to allegations of misleading and deceptive conduct and breach of contract against Pasminco companies arising out of events that occurred in March 2001 relating to the disposal by Pasminco of its 49% interest in the Ernest Henry Mine. The remaining 51% of the Ernest Henry Mine was at all material times held by MIM (now part of Xstrata Limited). MIM had a pre-emptive right which entitled it to acquire Pasminco's interest in the mine on the same terms as Pasminco was prepared to sell it to a third party. Pasminco gave notice to MIM of its intention to sell to Aquila as it was required to do. MIM had 35 days to exercise its pre-emptive right from receipt of that notice. In the first instance, MIM contested the validity of the notice given to it by Pasminco. Aquila's offer to buy Pasminco's interest was subject to its completion of a due diligence. Towards the end of the pre-emptive right period, MIM determined that it required further time to decide whether to acquire the 49% and approach Pasminco for an extension of time. Eventually that extension was granted by Pasminco with Aquila's consent.

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Aquila's claim arises out of the extension of the pre-emption period given to MIM. Aquila alleges that it was induced into agreeing to extend the pre-emption period by what it alleges were misleading implied representations which on Aquila's case could be drawn from statements made to it by a number of Pasmenco officers. Aquila also claims that Pasmenco, in breach of its obligations to Aquila, had failed to keep it properly informed about MIM's progress or otherwise toward pre-emption and that Pasmenco had entered into arrangements or understandings with MIM to facilitate the exercise of the option by MIM. These claims were all denied by Pasmenco.

The deed proceedings

Subsequent to the commencement of the first proceeding, Aquila also commenced proceedings in the Federal Court action W3007 of 2003 (**'Deed Proceedings'**) attempting to set aside a number of the Deeds of Company Arrangement that had been entered into by particular companies in the Pasmenco group, notably Savage Resources Limited (subject to Deed of Company Arrangement) and Savage EHM Finance Pty Ltd (subject to Deed of Company Arrangement) (**'Savage Group'**). The Deed Proceedings had not been actively prosecuted but remained on foot awaiting the outcome of the first proceeding.

Aquila's claim in the Deed Proceedings was in substance that the relevant companies were not insolvent at the date of the appointment of the Administrators in 2001 and that due to irregularities in a filing with ASIC of a deed of accession to a group cross-deed of guarantee signed by the relevant companies, it was not strictly proper for the Deed Administrators to treat those companies as part of the Pasmenco group. Accordingly Aquila alleged they should be separated from the Pasmenco group as a whole and dealt with on a stand alone basis. Aquila also alleged they were not liable on the cross-deed for the indebtedness of other companies in the Pasmenco group. If successful, this application had the potential to increase the dividend to the direct creditors of the Savage Group. It would lock out from proof in the Savage Group other Pasmenco companies and creditors of other companies in the Pasmenco Group who would otherwise be entitled to share in the Savage Group assets which, under the terms of the Pasmenco Group Deeds of Company Arrangement, form part of the pool of assets available to all creditors in the Pasmenco Group. The Savage Group Assets included an amount identified as relating to the US Assets incorporated into the float of Zinifex.

The Deed Administrators have denied Aquila's claim on the grounds of estoppel.

Background to recommendation

Aquila's claim was largely based on oral testimony to be given by officers of Aquila and former officers of MIM. In many respects, this testimony, details of which had been given in witness statements, conflicted with the evidence to be given by Pasmenco's witnesses, namely former executives and its lawyers involved in the Ernest Henry Mine transaction at the time. This polarisation of the evidence and the nature of the allegations raised by Aquila, resting as they did on inference and implication had led the Deed Administrators to a view that Aquila's claim had no merit. However, the polarisation of the evidence manifested a number of uncertainties, that gave rise to risks for Pasmenco were the matter to proceed to trial. Those risks and uncertainties largely related to the evidence to be given by one witness likely to be called by Aquila.

The witness Aquila was relying on had not filed a witness statement for Aquila and had also refused to speak to Pasmenco's lawyers, but the evidence may be potentially critical, as it may be in sharp contradiction to evidence to be given by the main witnesses Pasmenco is proposing to rely on in the case. With a lack of certainty regarding the evidence to be given by the witness concerned, the risk facing Pasmenco in dealing with



that uncertainty is that instead of the uncertainty being resolved in Pasminco's favour, it might be resolved in favour of Aquila, against Pasminco's interests and to the detriment of creditors generally.

In addition to the uncertainties in the evidence caused by the polarised versions of events, during the course of the mediation, Aquila pointed to a possible justification for Pasminco favouring MIM, and facilitating MIM's exercise of its pre-emptive rights to the disadvantage of Aquila. Until the mediation, it had also been considered that there was no possible justification for Pasminco to prefer MIM to Aquila, given that if Aquila was unsuccessful in its attempt to acquire the Ernest Henry Mine, Pasminco was required to pay it \$3,000,000. Accordingly, it was always seen as an unlikely scenario that Pasminco would have favoured MIM in the way alleged. It became apparent that the issue of an advantage to Pasminco if it undertook the transaction with MIM rather than with Aquila, had been considered at least by MIM and that dealing with MIM could deliver to Pasminco potentially a \$5,000,000 difference (in net terms). This advantage related to the capability of Pasminco to monetise the deferred consideration payable by the purchase which had been negotiated as part of the sale price. The sale of the receivable constituted by the deferred consideration could be done on better terms if MIM was the counterparty. After the transaction was completed we are not aware that Pasminco in fact took any steps to accelerate receipt of the deferred purchase consideration. None of the witness statements filed on behalf of Aquila referred to any financial advantage to Pasminco if MIM was the successful party. As a result there had been very little focus on this issue prior to mediation. It had not been raised in pleadings. Pasminco's witnesses had made no comment about the potential difference, but had only highlighted the fact that the \$3,000,000 fee was payable as justification for Pasminco wanting to deal with Aquila over MIM. Despite the fact that it appears Pasminco did not move to sell the debt after completion, there is a risk inherent in the argument that another piece of the legal argument raised by Aquila to justify its claim would fall into place and support its claim. If this is the case then it raises the risk that a court may accept Aquila's version of events.

Finally, there is the quantum of Aquila's claim which prior to the mediation had been quantified at AUD150 m in its proof of debt. Aquila puts its claim on the basis that if it had not been misled it would not have agreed to extend MIM's pre-emption period, but would have instead exercised its right to purchase. In its position paper for the mediation, Aquila substantially increased its claim to a figure of AUD424m based on the value it contends a 49% interest in the Ernest Henry Mine would now have, that is the position it would have been in if had not agreed to an extension of time, but had exercised its right to purchase. Aquila produced a spreadsheet to justify its claim. The increase in quantum was justified by reference to the likely value of the Ernest Henry Mine which has increased dramatically since the transaction was originally done as a result of the recent copper price boom. During the mediation we conducted a high level analysis of the base inputs and assumptions (commodity prices, exchange rates, discount rates and to the extent possible from publicly available information the production volumes and costs). Based on this analysis, it was clear that a significantly increased claim by Aquila if successful could be substantiated. In this regard, please note that prior to the creditors meeting on 19 May 2006, a further more detailed analysis will be carried out.



Assessment of risks

Every piece of litigation carries risk for both parties. Even the strongest case will have a 10-20% risk of loss. That range of risk reflects the prospect that in litigation witnesses do not give the evidence expected to be given by them, or contradict the evidence previously given by other witnesses, the prospect that a court believes one witness over another witness, or that a witness is simply found not to be credible. Additionally, a court may reach conclusions of fact that are unexpected. These risks of litigation suggest that a prudent person engaged in litigation will be realistic about the prospects and/or strength of the case they have to present.

Given the polarisation of evidence in this case, Pasminco's position has always been that it faced a risk of loss at a minimum of between 10-20% as a normal risk of litigation. While reports to creditors expressed the Deed Administrator's view that Aquila's claim had no merit, the Deed Administrators had always, in making dividend calculations, factored in an allowance for an amount to be paid to Aquila to settle its claim (except in the best case scenario). As mentioned above, the risks of litigation could possibly push Pasminco's risks higher depending on how the credit of particular witnesses was perceived by the court. For example, if all Aquila's witnesses were believed and Pasminco's were disbelieved, then the factual arguments to support the allegations made by Aquila would have been made out leading to a much higher risk of loss, possibly to around 40%. That is not to say there were still not good legal reasons why Aquila might still lose its case for reasons directed to such matters as its reliance on the representations that were allegedly made and so forth.

Recognising the prospect of a risk of loss in respect of a claim which was now substantially larger, the Deed Administrators' approach was to endeavour to factor in that risk and mitigate against the possibility of such a loss being realised on Pasminco's account.

Consequences for creditors of Aquila's claim

If Aquila was ultimately successful to the extent claimed, i.e. \$424 million, it would increase the creditor pool from \$2.61 billion to \$3.03 billion and reduce the dividend return to existing creditors.

Settlement proposal

In view of the quantum of the revised claim from Aquila and the natural uncertainty of outcome and the risks presented by Aquila's claim, it was appropriate that opportunities to explore settlement of the matters as between Aquila and Pasminco be pursued. At the end of two days of negotiation, the Deed Administrators agreed, subject to approval by Pasminco's creditors, with an express denial of liability, that Aquila will be admitted to claim for an amount upon which it will receive from the Pasminco Group administration a once only dividend of \$14,000,000 in full and final settlement of Aquila's claims and costs in Federal Court proceedings no W136/03 and W3007/03.

Further, subject to payment of the \$14,000,000 dividend there are to be:

- (a) mutual releases by the applicants and all related entities and Mr Poli of Aquila and the companies in the Pasminco Group and the Deed Administrators from all claims, causes of action, suits or demands which they or any of them have or might otherwise have had against each other or any of them including the claims in the Federal Court proceedings and the foreshadowed claim alleging sale of assets at an undervalue;



- (b) discontinuance of both of the Federal Court proceedings brought by Aquila with no orders as to costs.

Analysis of Settlement Proposal

An analysis of the dividend return to Aquila on the assumption that Aquila is successful in its claim(s), based on the various proof of debt quantum scenarios, is as follows:

Assumed Proof of Debt	\$m	\$m	\$m	\$m	\$m	\$m
	200	300	400	424	500	600
First Claim	40.4	58.5	75.5	79.4	91.3	106.3
First Claim + DOCA Claim	58.0	75.5	91.7	95.4	106.8	120.9

An analysis of the proposed settlement sum of \$14 million as a percentage of the estimated dividend return to Aquila, on the assumption that Aquila is successful in its claim(s), based on various proof of debt quantum scenarios, is as follows:

Assumed Proof of Debt	\$m	\$m	\$m	\$m	\$m	\$m
	200	300	400	424	500	600
First Claim	34.7%	23.9%	18.5%	17.6%	15.3%	13.1%
First Claim + DOCA Claim	24.1%	18.5%	15.2%	14.7%	13.1%	11.6%

In my view, given that the percentages set out above (assuming a proof of debt of \$424 million) are at the lower end of Pasminco's risk range as advised by our legal advisors i.e. substantially less than upper level of 40%, the settlement represents an acceptable commercial outcome for creditors.

Comparison of Dividend NPVs

The existing discounted dividend forecast, as at 31 December 2005, is compared to the revised estimate assuming that settlement is reached with Aquila and the revised estimate assuming settlement is not reached with Aquila, as follows:

- (i) Existing Forecast

Nominal Discount Rate	Estimated further dividends (cents in the dollar)		
	Worst Case	Mid Case	Best Case
8%	4.0	7.9	9.5
10%	3.6	7.3	8.9
12%	3.3	6.7	8.3



(ii) If Settlement Agreed to by Creditors

Nominal Discount Rate	Estimated further dividends (cents in the dollar)		
	Worst Case	Mid Case	Best Case
8%	6.1	8.1	9.2
10%	5.8	7.6	8.6
12%	5.5	7.2	8.1

(iii) If Settlement Not Agreed to by Creditors

Nominal Discount Rate	Estimated further dividends (cents in the dollar)		
	Worst Case	Mid Case	Best Case
8%	3.5	7.6	9.5
10%	3.2	7.0	8.9
12%	2.9	6.5	8.3

Please note that the dividend estimate as at 31 December 2005 has only been adjusted to reflect the updated Aquila position. All other issues affecting the administration have been ignored in this analysis.

Recommendation

Whilst the Deeds of Company Arrangement provide for the Deed Administrators to settle claims without reference to the creditors, in view of the quantum involved, and the fact that the Administrators are receiving releases of any personal liability, we consider it is appropriate that Pasmenco's creditors should vote on and either approve or otherwise.

In summary, the Deed Administrators recommend settling all claims as between Aquila, Pasmenco and the Deed Administrators on the basis proposed for the following reasons:

- (i) In view of the uncertainties of litigation, it is not possible to conclude that Pasmenco had no risk of loss;
- (ii) The risk of loss, meant there was the possibility of a significant potential impact on future dividends (refer above) if Aquila was successful having regard to the quantum of the claim. This risk is removed and a substantial variable that potentially could affect future dividend payments is removed;
- (iii) The settlement has been recommended to us by our solicitors and Senior Counsel;
- (iv) The costs of trial, which would be significant, are avoided;
- (v) The matter would be determined shortly, avoiding a further delay until the matter was finally resolved which could be some time next year before allowing for any appeals;
- (vi) It would enable a payment of a further dividend to creditors to be paid within a relatively short period of time.



At the meeting of creditors on 19 May 2006, a resolution will be proposed to approve the conditional settlement negotiated with Aquila. Further to the Deed Administrators report to creditors dated 19 April 2006, an updated proxy form is enclosed for the purpose of voting at the meeting of creditors to be held on 19 May 2006. This proxy form incorporates the additional resolution in relation to the proposed settlement between Aquila and Pasmenco.

Should you have any queries in respect of the enclosed please do not hesitate to contact me or Mr Greg Meredith.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Peter McCluskey', with a long horizontal flourish at the end.

PETER McCLUSKEY
DEED ADMINISTRATOR

Encl

MEETING OF CREDITORS PROXY FORM

Ref: C-

FORM 532

Regulation 5.6.29

**CORPORATIONS ACT 2001
APPOINTMENT OF PROXY**

Form 7a

**PASMINCO LIMITED
(SUBJECT TO DEED OF COMPANY ARRANGEMENT)
ACN 004 368 674
AND ITS WHOLLY OWNED AUSTRALIAN SUBSIDIARIES
(SUBJECT TO DEEDS OF COMPANY ARRANGEMENT) (“THE COMPANIES”)**

*I/*We(creditor name)
of(creditor address)
a primary creditor of.....(Pasminco company name)
appoint(proxy appointed)
or in their absence(proxy alternate)
as *my/our *(i) general OR *(ii) special proxy to vote at the meeting of creditors to be held on 19 May 2006 at 10:00am, or at any adjournment of that meeting, to vote
(i) on all matters arising at the meeting; OR
(ii) on each of the following kinds of resolution in the manner specified:

	For	Against	Abstain
1. A resolution that the further remuneration of the Deed Administrators of the Companies be calculated in accordance with Ferrier Hodgson’s scale of rates, as amended from time to time, up to the sum of AUD2,208,748.90 plus GST as applicable and that the Deed Administrators be authorised to draw their remuneration on a periodic basis.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	For	Against	Abstain
2. A resolution that the Deed Administrators settle all claims as between Aquila Resources Ltd, Pasminco and the Deed Administrators on the basis set out in the Deed Administrators letter to creditors dated 5 May 2006, such that Aquila will be admitted to claim for an amount upon which it will receive from the Pasminco Group administration a once only dividend of \$14,000,000 in full and final settlement of Aquila’s claims and costs in Federal Court proceedings no W136/03 and W3007/03.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

I am an unsecured creditor and the total amount owed to me is \$

OR

I am a secured creditor and the total amount owed to me is \$

DATED this day of 2006

.....
Signature² of individual or person³
authorised by corporate resolution to
represent the corporation

OR The Common Seal of¹
was hereunto affixed in the presence of

.....
Director

.....
Secretary

FOR OFFICE USE ONLY

Proxy Valid: Yes/No
Cross Deed Creditor: Yes/No
Amount admitted for voting:
\$.....

¹ The method of affixing the Common Seal should be prescribed by the creditor corporation's articles. See Note (2).
² The signature of the creditor is not to be attested by the person nominated as proxy.
³ Note that a corporation may by resolution of its directors provide standing authority for a person to represent it at members meeting and appoint proxies. Copy of authority to be annexed.