CHAPTER 12

AUDITORS' COMMUNICATIONS WITH TRICONTINENTAL'S MANAGEMENT AND BOARD ON MATTERS AFFECTING CREDIT RISK

A. Background

12.1 KPMG Peat Marwick Hungerford ('KPMG') and their predecessor firms have been the external auditors of the Tricontinental group of companies since its incorporation.

12.2 In May 1986 KMG Hungerford ('KMG') were appointed the internal auditors for the Tricontinental group of companies. The scope of the internal audit, its methodology and procedures were discussed at a meeting between Mr Johns and Mr Ziebell, representing Tricontinental, and Mr Weir and Mr Bray representing KMG. Mr Weir and Mr Bray were, respectively, the partner in charge, and the manager, of the internal audit. Mr Weir was also the audit engagement partner for the external audit.

12.3 The internal auditors were responsible to Mr Johns for the conduct of the internal audit function. The internal audit team was to interview staff, review minor findings with the relevant general manager and forward reports to Johns. Johns informed the managers that the internal audit reporting function would be conducted along the same responsibility lines as the management structure. Although the internal audit was primarily to review administrative and accounting systems existing within Tricontinental, documenting them where necessary, it was also to ensure guidelines and procedures were adhered to, and draw attention to systems or procedures which could be made more effective. It was not to be concerned with the adequacy or appropriateness of board policies.

12.4 An internal audit strategy paper was sent to Johns by the auditors in June 1986. He passed it on to the then members of the audit committee. The strategy paper summarised the objectives of the external and internal audit
functions and noted the distinction between them, the external auditor's report being to the shareholders and independent of the organisation, whereas the internal audit report was to the group managing director and represented another means of management control. It was "to review systems and related internal controls; and to...report to management on the economy, effectiveness and efficiency of management's controls". After consultation with Johns, the strategy paper noted:

"The group managing director has expressed a view that liability management is relatively more important than asset security in the context of Tricontinental. Our audit approach, as evidenced in the attached timetable, reflects this priority".

12.5 At the May 1986 board meeting it was agreed to establish an audit committee. The audit committee initially comprised Ryan, Moyle and Morton with Smith joining in 1987. The committee was to receive copies of the internal audit programs. The same members would also form Tricontinental's accounting committee.

12.6 The audit committee met five times before integration in May 1989. The dates of the meetings were 4 August 1986, 1 September 1987, 24 February 1988, 24 June 1988 and 23 August 1988.

12.7 In between May 1986 and May 1989, the auditors produced numerous internal audit reports, either in draft or final form (refer Attachment 12A). Some areas of Tricontinental's operations received more attention than others. For example, the following reports were issued to the main areas of the operation:

12 reports (draft and final) on Capital Markets;
24 reports (draft and final) on Corporate Funding;
23 reports (draft and final) on Foreign Exchange;
6 reports (draft and final) on Lending and Lending Procedures;
1 report (draft) on Investment Banking.
Matters arising out of the internal and external audits were to be reviewed by the audit committee before finalising and reporting on Tricontinental's year-end accounts. This committee was to form the main avenue of communication between the auditors and directors.

B. Terms of Engagement for Internal Audit

Before 1986, Tricontinental had not sought an outside audit firm to act as its internal auditor. It appears there was some dissatisfaction with the existing in-house arrangements, and KMG's predecessor firm had, in 1982, put forward a proposal that the firm could be appointed to perform internal as well as external audits. In March or April 1986 Johns approached Weir, requesting KMG to make a submission about the internal audit function for Tricontinental. Johns later appointed KMG as internal auditors. Johns and Ziebell were the only directors involved in this decision. On 15 May 1986 Johns notified management of this appointment. Mr Ryan believed the appointment of the internal auditor was a decision endorsed completely by the board.

The Commission did not examine whether it was prudent for Tricontinental to have the same firm conducting both internal and external audits. There are obvious reasons of convenience and potential efficiency in favour of such an arrangement; but any element of double-checking is likely to be lost. There was certainly some evidence of concern about the need to distinguish the different roles of each audit, for the benefit both of the directors of Tricontinental and of management. Examples of this concern were expressed at two audit committee meetings:

(i) On 1 September 1987 Mr Smith queried whether it was a good idea for KMG to continue with the internal audit whilst also acting as the external auditors. Weir reassured Smith, saying it was an excellent idea as it put KMG into very close contact with each Tricontinental department and general manager.

(ii) Following an audit committee meeting on 24 June 1988, Weir observed there still seemed to be some confusion in the minds of the
directors as to how the auditors carried out both the internal and external audit functions. Weir noted in a memo to Bray that they must remember the distinction in future negotiations and dealings with the directors.

12.11 Mr Bray acknowledged it was sometimes difficult to distinguish matters arising from the separate audits, however the general knowledge obtained assisted them in understanding the company. Following an attack by Johns, who alleged the credit risk audit of 1988 went outside the scope of the internal audit brief (see below), Bray noted that this highlighted one of the potential conflicts in one firm conducting both internal and external audits.

12.12 No detailed letter of engagement setting out the terms of the internal audit was issued to or by KMG at the time of their appointment. Apart from the internal audit strategy paper, the terms of their engagement and the scope of the audit programs were defined by Johns' directions. In a letter dated 24 April 1986, Weir referred to the description in the 1982 proposal of "the main thrust" of the internal audit. He did so for the purpose of stating what KMG's fee of $40,000 would cover. This in no way alters the fact that Johns at all times decided the scope of the audit.

12.13 One issue which arose at the outset was whether prudential guidelines were to be examined by the internal auditors and, if so, to what extent. At a meeting held on 13 May 1986, Johns emphasised to Weir that the internal audit was primarily to check compliance with guidelines and procedures. The internal auditors were not to be concerned with the adequacy or appropriateness of such policies. Johns also made clear that he was more concerned with liability risk management than asset management and security. As he explained in evidence, this was due to his familiarity with the lending side of Tricontinental's business and concern over the liability side, where he was inexperienced and felt more exposed.
12.14 Mr Weir gave evidence that he considered this to be an important limitation. However, he could not recall having informed the audit committee or the board of this limitation. Mr Weir said he believed the internal auditors examined compliance with prudential guidelines when conducting the asset management and security side of the internal audit. Mr Bray similarly gave evidence that from this meeting he understood the internal audit was to look at compliance with policies and procedures but not the wisdom behind such prudential policies. At a later meeting, held on 30 June 1988 concerning the internal audit, Bray believed that Johns amended his directions when requesting special emphasis on lending risks to include examination of prudential policies. Mr Bray gave evidence that he saw this as a variation, in this particular instance, from Johns' original direction that the internal auditors were not to tell management how Tricontinental's business should be run. However Johns soon made it very clear that he had implied no such variation.

12.15 Mr Weir gave evidence that, in the course of the external audits, the adequacy and appropriateness of policies set down by the Tricontinental board would not be examined; the audit would merely examine the outcome of the policies set down by the board. Therefore the adequacy or appropriateness of Tricontinental policies were not examined to any significant extent by either the internal or external auditors.

C. Chronology

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td></td>
</tr>
<tr>
<td>24 April</td>
<td>Letter from Weir to Johns containing KMG's proposal to conduct the internal audit function.</td>
</tr>
<tr>
<td>13 May</td>
<td>Meeting between Johns, Ziebell, Weir and Bray. Johns confirms the appointment of KMG to conduct the internal audit of Tricontinental.</td>
</tr>
<tr>
<td>28 May</td>
<td>Tricontinental board establishes audit and accounting committees.</td>
</tr>
</tbody>
</table>
13 June Weir sends to Johns the proposed internal audit strategy paper.

25 June Johns sends the internal audit strategy paper to members of the audit and accounting committees.

4 August Accounting/audit committees meeting with Weir.

1987
4 March Meeting between Johns, Ziebell, Weir and Bray discussing the internal and external audits.

11 August Meeting between Johns, Ziebell, Weir and Bray discussing the audit for year end 30 June 1987.

26 August Draft accounts for 30 June 1987 tabled and discussed at board meeting.

1 September Meeting of Tricontinental audit committee with Weir, Johns and Ziebell.

10 September Letter from Weir to Ziebell enclosing proposed timetable for the 1987/88 internal audit.

19 October Letter from Johns to Weir confirming internal audit timetable for 1987/88 internal audit.

23 December Letter from Weir to the board enclosing management letter re 1987 audit.

1988
29 January Tricontinental board refers management letter to audit committee.

24 February Tricontinental audit committee meeting with Johns, Ziebell and Weir.

26 February Johns meets Weir.

8 March Johns meets Weir.

31 March Draft audit paper on provision for contingencies for 30 June 1988 external audit.

24 June Meeting of accounting and audit committees with Johns, Ziebell and Weir.

30 June Johns meets Weir and Bray.

3 August Letter from Weir to Johns enclosing proposed internal
23 August Audit committee meeting with Johns, Ziebell and Weir.

24 August Draft accounts for 30 June 1988 tabled and discussed at board meeting.

9 November Johns meets Weir.

1 December Johns meets Bray, Duff and Mrs Wilson on credit risk internal audit.

12 December Johns meets Weir.

1989 Johns meets Weir.

17 May Johns meets Weir.

D. 1986/87 Audit

(a) Strategy

12.16 In a letter to Johns in June 1986, Mr Weir said the internal auditors planned to audit each division of Tricontinental on a quarterly basis. This strategy was subject to modifications. In determining the allocations, Weir took into consideration the financial budget and discussions with Johns as to where the emphasis should lie.

12.17 The total fee for the internal audit was estimated at $40,000. As requested by Johns, only senior audit staff with varying degrees of association with Tricontinental were to be used. Mr Weir was the partner in charge of the internal audit, Mr Bray was the manager. All reports would ultimately be directed to Johns. All weaknesses or "potential efficiencies" noted were to be accumulated and "written in the normal KMGH management letter format".

12.18 The internal audit strategy paper provided that periodic meetings - preferably at quarterly intervals - were to be held between Weir, Bray and Johns to evaluate the results of the internal audit function and update strategy. According to a file note of Weir's dated four years later, Johns did meet Weir in June 1986 and confined the internal audit to examination of internal
controls and compliance with management policies; the examination was not to include efficiency auditing. After that, the meetings did not, in fact, take place in any structured quarterly way, but on an irregular basis. Weir gave evidence that they met Johns to discuss the internal audit, where it should be directed, and related issues. There were some notes taken of these meetings.

12.19 Mr Ryan said he believed the auditors' internal audit strategy report was made available either to the audit committee or to the board. It was his understanding that there was a complete internal audit of all the operations of Tricontinental. He was not aware at the time that the internal audit was to concentrate on certain systems and not to assess whether Tricontinental's business could be conducted more efficiently.

12.20 An internal audit report for the international division in October 1986 recommended that compliance with divisional guidelines be implemented. Johns wrote to Weir saying he was disappointed with the content of the internal report, noting he had authority to approve any discrepancies. Johns said it was within his discretion to amend any lending policies, including eurocurrency advances to clients with a net worth less than $10m.

12.21 On 4 March 1987 a meeting was held between Johns, Ziebell, Weir and Bray. Ziebell criticised the internal audit saying it was too shallow, with insufficient attention to detail. Johns complained the auditors were running behind their internal audit timetable. Johns and Ziebell apparently formed the view that the internal auditors had insufficient depth of knowledge or understanding of Tricontinental's business. It was suggested that the external audit team should support the internal one. The internal audit programs were also discussed; Weir requested Johns and Ziebell to confirm the direction of such programs. Johns outlined the overall strategy of the internal audit, directing attention to growth areas of the organisation and, in particular, the day-to-day operations of treasury, foreign exchange, capital markets, swaps, EDP and trust areas. The internal audit of the lending area was to receive less emphasis because of the securities in place.
Ziebell, in a diary entry after this meeting, noted that Weir suggested they meet formally more often to discuss internal audit progress. Bray could not recall having any further discussions with Johns, Ziebell or senior Tricontinental management, relevant to the internal audit, during 1987.

Mr Weir said his main point of contact at Tricontinental in the years 1987 and 1988 would have been with Ziebell. During the months of July to September, and particularly in August, he would have had contact with Ziebell almost daily as to the external audit. Throughout the year he said contact would have been at least monthly at some stages, two or three times a month at other stages. Although Mr Weir said his need to see Johns about the internal and external audits was much less frequent, and Johns was far less accessible than Ziebell, he said that he saw Johns several times when finalising the external audit, and for the rest of the year he gave the same estimate as he had for Ziebell - one to three times a month.

The evidence disclosed that some Tricontinental managers were slow in responding to recommendations in the draft internal audit reports. For example, a second draft project finance report was sent to Mr Atlas in March 1987, although the auditors were still waiting for his response to the first draft audit report of November 1986. Mr Johns, who was sent a copy of this report, commented on the auditors' recommendation that credit submissions exceeding $5m be approved by four directors as required by divisional guidelines. Johns noted it was not essential that four directors approve credit submissions as they are not always available, and said that any queries on this subject were to be directed by the internal auditor to him.

In April 1987 Weir acknowledged in a letter to Johns that, despite committing considerable resources to bring the internal audit program up-to-date, their performance of meeting deadlines had been far from satisfactory. Weir attributed this largely to management problems within the audit team. A revised timetable for the 1987 audit was established. Responding to this, Johns again asked that more emphasis be given to capital markets, corporate
funding and cash trusts as opposed to corporate services, project finance and investment banking. Weir then revised the internal audit schedules, replacing the audit for corporate services and investment banking with money market operations and settlements.

(b) **Investment Banking**

12.26 Weir confirmed to Johns they would replace the audit for investment banking. As a result investment banking was not subject to internal audit for the year ended June 1987. Mr Weir said in evidence that there was an attempt to audit investment banking during 1987, but this was frustrated by the fact that there was a lack of documentation to support the investment banking transactions. Bray and Weir agreed at that time that investment banking transactions could be better audited within the external audit.

12.27 Johns, Ziebell, Weir and Bray met on 11 August 1987 to review the 1987 draft accounts. Matters set out in Ziebell's handwritten agenda included investment banking operations, off-shore subsidiaries, tax investigations and the level of provision for contingencies. Put and call agreements were listed under investment banking, with ARABS and Hooker transactions (see TR 19 and TR 13 in volume 3) particularly noted.

12.28 On the subjects of warehousing and insider trading, Mr Weir said there was no written evidence of any concern about these before August 1988. However, during the course of the external audit for the year ended 30 June 1987, he did become concerned about warehousing, knowing it to be an unacceptable practice.

12.29 Mr Weir said it was the Hooker transaction which gave rise to his concern. He said it was quite clear that shares held by Tricontinental were under the control, through a put and call agreement, of both Tricontinental and Mr Herscu. Ultimately the shares were sold with the agreement of Herscu, as he understood it, to cover a debt in Herscu's name elsewhere within Tricontinental. Mr Weir's evidence was that the entire transaction gave rise
12.30 Mr Weir could not recall anything being communicated or discussed with him which indicated that it would not have been possible for Herscu to own the parcel of shares outright. His recollection was that there was no documentation of the arrangement between Herscu and Johns.

12.31 It was in the early part of 1987, Mr Weir said, that he first became concerned about the lack of documentation for investment banking transactions. He realised there were put and call arrangements in particular that were not documented. He believed he became aware of this through one of his staff, most likely Bray. He could not recall whether he took any immediate action. Mr Weir had no recollection of communicating any concerns to either Ziebell or Johns before the 11 August meeting (para 12.27 above).

12.32 Mr Bray had no recollection of discussions or communications in regard to the ARABS transaction, which was recorded as being on a handshake basis. Neither did he recall any discussion of reasons for not copying investment banking documents. He said he looked at the documents but was told not to copy them. His understanding was that they contained confidential information.

12.33 The audit committee, now including Mr Smith, met Mr Weir on 1 September 1987. Weir recorded, in a memo to Bray, the relevant matters discussed. Weir assured the directors that all matters arising from the internal audits were resolved satisfactorily. Mr Ryan raised the query why the directors had not been given any management letters during the year. Weir explained their system of reporting was that minor matters were mentioned to Ziebell and major matters went to Johns. Any matters deserving the attention of the board would be directed to the chairman. As no management letters had been produced, the directors could be assured there were no matters of significance to put before them. However it was
agreed that an external audit management letter for 1987 would be tabled at the next board meeting.

12.34 Weir told the audit committee that investment banking was the major control problem they had struck in the external audit. By this he meant the problem of lack of documentation and the fact that Johns was solely responsible for the approval of, and control over, the investments. Weir's notes recorded him as saying this area "was highly entrepreneurial and lacked appropriate documentation in the Category A (warehousing section)". He said in evidence that he had no recollection of using the term warehousing at this meeting, but was primarily concerned that such investments could be challenged due to the lack of documentation. Weir also noted that Johns was devoting more time to ensuring that documentation for each deal was complete, and he pointed out that regular reporting on the investment banking portfolio was made to the board in Johns' monthly reports.

12.35 There were no specific transactions which Weir raised with the directors. He gave evidence that the only case of possible illegality that he had in mind at that time related to the dealing in Hooker Corporation shares pursuant to the arrangement with Herscu. Although Weir had this concern, his recollection was that he did not mention either Hooker or Herscu at this meeting.

12.36 Mr Weir said that, as at 1 September 1987, he did not know there was any illegal activity carried out in relation to any particular transaction. However he said his overriding concern was the nature of the deals being entered into. This was over and above the control problems - a lack of documentation to support the investment banking transactions that had occurred in that year, and the fact that Johns was solely responsible for the approval and monitoring of the investment banking transactions.

12.37 Mr Weir said he repeatedly brought these concerns to the attention of the audit committee. While he did not recall specific conversations, he relied
on his notes taken at these meetings which included this topic of investment banking.

12.38 As to the 1 September 1987 audit committee meeting, Mr Ryan said he remembered that Elders Resources was a category A investment. In the 1987 report Weir raised the matter of lack of documentation and Johns’ control over that area. Documentation had not flowed down to Ziebell’s area which had cause some errors in reporting. Mr Ryan recalled Weir talking about his concern if Johns fell under a tram. He could not recall Weir saying that category A investment banking activity was highly entrepreneurial. He believed the board thought it was no more highly entrepreneurial than other financial products Tricontinental was involved in.

12.39 Mr Ryan said the information the board had on category A arrangements was that they were another financial product. The holding of shares was backed by a put and call or other agreement so there would be no loss. He acknowledged there was some profit sharing element in a number of them. He also said Johns did not take the board through each category A investment at each board meeting, as Ziebell had stated.

12.40 The real problem with category A transactions, as he understood from Weir, was the control Johns had over them. Documentation was held within Johns’ area and did not get out into other areas. Mr Ryan said the first real case Weir brought to their attention, in September 1987, was the $2.8m in relation to Elders Resources and the fact documentation wasn’t in place. It was incorrectly accounted for because it was too tightly held. This was the first time the committee talked about lack of documentation.

12.41 In a letter dated 23 December 1987, Weir reported to the Tricontinental board on significant matters arising out of the 30 June 1987 audit. He raised the matter of lack of documentation as to investment banking transactions, and noted that the operations of all divisions should be fully documented and
that sensitivity of the information should not be a reason for inadequate documentation, which would expose the group to a number of risks.

(c) Provisioning

12.42 On 11 August 1987, Johns, Ziebell, Weir and Bray met to review the 1987 draft accounts. Ziebell's agenda noted the investment banking portfolio stood at $128m (market value $156m) as at 30 June 1987. Accrued income included $2.7m from put and call option deals. The provision for contingencies was tentatively set at $12m, representing 0.46% of the total assets, which had been the industry average at 30 June 1986, a year earlier. The agenda paper also said that, despite the reduction in its relationship to total assets and shareholders' earnings over the last three years, Tricontinental's provisioning level in 1986 (of 0.62%) had been well over the industry average, and was likely to remain so in 1987 despite the decrease to 0.46% of total assets. Weir had no recorded notes of this meeting and provisioning for the year was not discussed in his statement.

12.43 At the Tricontinental board meeting on 26 August 1987 the draft accounts for the year ending 30 June 1987 were tabled and discussed. The board minutes noted (as required by company law) that steps had been taken to write off bad debts and to make provision for doubtful debts. The board also noted the statement of representation signed by Johns and Ziebell which confirmed that, "No matters of substance or of a material nature have been raised by the auditors ...". The board agreed the audit committee would meet Weir to discuss the annual accounts.

12.44 At that meeting, on 1 September, referring to Tricontinental's provision for contingencies, Weir observed that, although Tricontinental's total assets had increased from $970m to $2.580m in the two years since 1985, during the same period the group provision for contingencies had remained steady at $12m. Although this amount was adequate to cover all known doubtful items, because $6.6m had already been written off directly to the profit and
loss statement as a bad debt, the projected level of provisions for the 1988 audit should be carefully considered.

E. **1987/1988 Audit**

(a) **Strategy**

12.45 Mr Johns included the KPMG management letter of 23 December in the January 1988 board papers. He noted in his report that all matters raised in the letter had received due consideration with relevant action being taken. The January board minutes noted the contents of the report and referred the matter to the audit committee for its next meeting.

12.46 The audit committee met on 24 February 1988. It was agreed the committee would meet before signing the annual accounts, but other meetings would only be held when required. Weir recorded the discussion in a memo to Bray and noted the following points:

- Investment banking controls were recognised to be lacking particularly in the area of documentation.
- It was agreed the auditors would report to the board on any investment banking transactions they came across during the internal or external audits which had not already been reported to the board.

12.47 Mr Weir said his recollection was that the audit committee expressed no discomfort and did not wish to pursue the matter further. This was not what he expected. He later said he would have expected the directors to have agreed to pursue the matter of ensuring that the nature of the deals could not be challenged as warehousing or insider trading. This could have been done by receiving appropriate advice from their legal advisers. Mr Weir said he understood the board met in January to consider the nature of the investment banking deals and confirmed that they were happy with the current status.

12.48 As to provision for contingencies, Weir told Bray that there was no undertaking by the directors to increase the provision. He made the point that the provision would have been tested after the stock market collapse,
and he was assured by those present that it was found to be adequate. He also said that "no doubt the extent of any provision increase will depend upon the profit of the State Bank".

At the February board meeting Ryan, the deputy chairman, confirmed that, with regard to the internal audit, Mr Weir "found it most advantageous to have access to the audit committee however would only do so should he find anything of concern". This continuation of a limitation on the role of the audit committee which had applied from the outset, in spite of a board resolution the previous month that informal audit reports should be reviewed by the audit committee, led to the result that the directors were never formally involved in reviewing internal audit reports. As to the external audit, the board minutes recorded that it was agreed there should be a meeting before the annual accounts were signed off and, if required, a meeting on receipt of the annual management letter.

(b) Investment banking

In a letter dated 20 April 1988, Weir reported to Johns on the results of the investment banking internal audit. The report stated a major objective of the audit was to determine whether the amount taken into profit on category A investments from 1 July 1987 to 29 February 1988 was properly calculated in accordance with Mr Johns' instructions. The audit included the significant profit made on the Elders Resources transaction. Weir observed that the investment banking portfolio was now being reported to the board on a monthly basis. But he said the concern expressed in the management letter to the directors in December 1987, regarding completeness of documentation, still remained. There was no written response by Johns to this report.

(c) Other matters

The audit committee next met on 24 June 1988. Matters for discussion included the internal audit reports, tax planning, and the write-down of long-term investments. In a memo to Bray setting out matters raised at the
meeting, Weir said he had told the directors he was generally happy with internal controls in place although some differences had arisen over the internal audit reports. Weir confirmed the internal auditors were an extension of management and reported to Johns. Johns had expressed disappointment that the internal audit timetable had again fallen behind.

The evidence was not clear, but it seems that, before the June meeting, for the first and only time, Johns did send the audit committee members copies of the internal audit reports from the past six months. A detailed discussion followed on some specific internal reports. Weir believed that discussions included the investment banking report of 20 April 1988.

Mr Ryan agreed it was apparent from Johns' memorandum, dated 22 June 1988, that internal audit reports were then sent to members of the audit committee. However he had no recollection of receiving internal audit reports at any audit committee meeting - other than an EDP audit report. Mr Moyle and Mr Morton also said that the audit committee did not review internal audit reports. Mr Johns said that he took such reports to the yearly audit committee meetings. Mr Weir gave evidence about this happening at the June 1988 meeting. The weight of evidence suggests that it did not occur on any other occasion.

Bray recorded the substance of a meeting with Johns on 30 June 1988, following the audit committee meeting six days before. Due to delays, it appeared the remainder of the 1988 internal audit program was to be deferred or cancelled, subject to certain areas such as capital markets being reviewed. Mr Wallace, an employee of KPMG, was to take control of the administration of the internal audit. He was to tell Johns of any reports which had not received management's response within 14 days.

(d) Provisioning

Weir had requested that provision for contingencies and concentration of risk be discussed during the audit committee meeting on 24 June 1988. He told
the committee that he would have been happier with a somewhat higher provision than the $17.5m sought by the directors. One of the reasons for this was the concentration of lending risks with certain clients. He said in evidence that he had a recollection of the general discussion on the concentration of risk issue at this time as it was connected with the extent of provisioning. Weir had originally suggested a provision of $22m but, after discussion with directors and noting doubtful loans written off, he reduced this to $18m and finally accepted the directors' figure of $17.5m.

12.56 Weir told Bray that Ryan asked for the auditors' attitude to the provision for write-downs of long-term investments in view of the October share market crash. Weir believed the figure involved was around $12m. He had offered some advice but told the committee they must decide whether a write-down was required.

12.57 Mr Weir said in evidence that he did not believe he had any discussions on provisioning with Ziebell during this period. Provisioning was left largely to the chief executive (Johns) and his lending officers. He said he would have had discussions with Johns although he couldn't recall any specific ones. He could not recall any heated audit committee meetings - or meetings with Johns - on provisioning issues. Similarly Weir's staff did not report to him on any heated debate with Johns about provisioning.

12.58 As to the 24 June 1988 audit committee meeting, Mr Ryan said he had certain recollections. He thought Weir indicated he would like to see the provisions a little higher, but didn't believe actual figures were mentioned. He did not recall Weir ever mentioning concentration of risk at an audit committee meeting.

12.59 Ryan also did not recall Weir ever talking about concentrated lending risks as to certain clients. He said the directors were well aware of risks and the levels of exposure. The auditors never mentioned, to his knowledge, the extent of the concentration of risk. He did not recall the issue of investment
banking being raised at this meeting.

12.60 Mr Bray had assembled 'notes for partner' regarding the 30 June 1988 audit. Valuation of investment portfolios was included. A provision of $2.5m was to be made as to non-current investments. Mr Bray thought most probably he had discussed these items only with Weir. Sometimes he would discuss such matters with Johns but usually his discussions were with Ziebell. As to relevant investment banking transactions during the year, Bray had noted Elders Resources, Mid-East Minerals, Quadrax and Interwest. Key points relating to the provision for contingencies included the concentration of risk on the group balance sheet. Mr Bray agreed this was a topic of discussion for the June 1988 accounts. He believed he spoke to Ziebell, and said Weir would have raised it with the audit committee.

12.61 Mr Ryan said he did not recall that the concentrated nature of Tricontinental's loan portfolio was raised at the audit committee meeting on 23 August 1988 as a matter to be considered in determining the appropriate level of provisioning. He recalled Weir's discussion on the provisions for contingencies and his desire to see it a bit higher. Weir talked about the diminution in the value of equities in relation to that provision. Mr Ryan said that he agreed that the provision should have been slightly higher, but that he had "lost that debate" at a board meeting at which the write-offs and provisions were considered.

12.62 The Tricontinental board met on 24 August 1988. The draft accounts for the year were tabled and discussed. It was noted (as required by company law) that steps had been taken to write off bad debts and to make provision for doubtful debts, and that realistic values had been put upon current and non-current assets.

F. Investment Banking

12.63 Mr Weir gave evidence that, following the April 1988 internal audit, he was still concerned about the lack of documentation for investment banking. The
30 June 1988 accounts were reviewed at the audit committee meeting on 23 August 1988. Weir's handwritten notes of the meeting referred to investment banking, specifically as to the Elders transaction and documentation generally. Further comments recorded by him noted "advised board of concern re warehousing and insider trading. Documentation generally improved".

12.64 Weir said in evidence that he had no independent recollection of this meeting but was aided by his own notes and by Ziebell's notes of what he (Weir) had said he would raise at the meeting. He could not recall whether he specifically mentioned warehousing and insider trading as recorded on Ziebell's notes. Neither did he have any recollection of Elders being raised specifically at the meeting, or problems with Elders documentation.

12.65 Mr Weir said he had no positive knowledge of insider trading or warehousing occurring; he would treat it seriously and communicate it to somebody if he had. He never at any time had positive knowledge or had seen documentation which showed that warehousing or insider trading had occurred. His evidence was that he was more concerned about the possibilities of these matters arising. He believed he used Elders as an example of a transaction that could be interpreted as either warehousing or insider trading. Investment banking documentation generally, and the Elders problem, were two separate points to be dealt with. Weir said he explained to the audit committee that documentation was important due to Johns' sole control - if he was hit by the proverbial tram, problems of enforcement would arise. This was unrelated to concerns about illegality, warehousing or insider trading.

12.66 Mr Ryan did not believe the words warehousing or insider trading were ever used at the 23 August 1988 audit committee meeting. He recalled a previous meeting in 1987, where Weir indicated there was a lack of documentation and too much control by Johns, but he could not recall either warehousing
or insider trading ever being mentioned, and said if they had been, there would have been a very fiery session.

12.67 Mr Ryan could not recall any discussion on investment banking at this particular meeting. The key matter for discussion was Weir’s view in relation to the level of contingencies. Ryan did not remember Elders being mentioned. He said that he was later called to the NCSC inquiry in relation to Elders Resources, and that was the first time he had heard of anything of this nature to do with Elders.

G. Credit Risk Internal Audit 1988

12.68 Following upon Johns’ direction to Weir and Bray at the 30 June 1988 meeting, the internal audit of lending was extended to include the area of credit risk management. Weir sent to Johns a draft copy of an internal audit report for the lending division in late September 1988. Bray stated that Johns asked for greater emphasis on lending risks. Bray later decided to distinguish the lending audit from a credit risk analysis audit, which would look at credit risk across all divisions.

12.69 Mr Bray said that, when Johns asked him to give some special emphasis to lending risks, he took it as reasonable that this should include an examination of prudential policies. He seemed to recognise, however, that this sat awkwardly with what Johns had originally said, about not telling Tricontinental how to run its business.

12.70 In November 1988 a KPMG credit risk internal audit team, comprising Mrs Wilson, Mr Duff and Mr Tilley, briefly met Mr Stott to outline the audit tasks. Mrs Wilson and her team went about interviewing various Tricontinental officers as to the credit risk analysis.

12.71 Evidence was given by Mrs Wilson, who supervised the credit risk internal audit in late 1988. Her observation was that there was a very serious deficiency in the understanding of credit risk within the credit department of
Tricontinental. This was not suggested to her by other auditors; she reached the conclusion solely from her appraisals during the audit - backed by her extensive banking experience.

12.72 Mrs Wilson interviewed Stott and Clark in late November. She gave evidence that she was not impressed with Stott's conceptual knowledge or skills. This impression was confirmed by what she was told by other officers of Tricontinental. She was also concerned about Stott's ability to act independently of Johns, who had, in effect, trained him. She and Mr Duff then met other managers including Hunter, Mountford and Ziebell. Ziebell was asked about Tricontinental's large loan exposures. He told Mrs Wilson the board was aware of them through monthly reports, and attempts were being made to reduce them. Mrs Wilson said Ziebell was aware she was not impressed by the state of Tricontinental's balance sheet and gathered he had not heard such criticism from an auditor before. There were no written policies relating to large loan exposures.

12.73 By the time Mrs Wilson met Ziebell, she had formed the view that there was a fundamental lack of conceptual knowledge of credit risk and all issues relating to it at Tricontinental. In her draft letter to Tricontinental reporting on the credit risk analysis, Mrs Wilson stated the audit team believed that credit issues were treated more as a clerical or processing function than as an important management control. This was edited out of the final letter sent to Johns, but it serves to underline Mrs Wilson's evidence about the seriousness of the matter.

12.74 On 1 December 1988 Bray, Mrs Wilson and Duff met Johns to discuss the credit risk internal audit. A heated discussion, at least on Johns' side, ensued concerning the content and direction of inquiries being made by the auditors. Bray said Johns expressed displeasure about questions put to management concerning Tricontinental's concentration of lending risks and particular prudential policies. Johns informed the auditors that these areas, as discussed previously, were outside their scope as internal auditors. Such
matters were not to be considered further and any reports dealing with these matters would not be accepted.

12.75 It is worth quoting in some detail Mrs Wilson's evidence about Johns' outburst on this occasion. In her statement she said:

"When we arrived at Ian Johns' office his secretary notified him of our arrival and he came to the door of his office. He stood there and glared at us and Michael Bray said hello and shook hands with him and then introduced myself to Mr Johns. I held out my hand to shake his hand but he withdrew his hand and said in an angry tone words to the effect: 'So you're the person who has been upsetting all of my senior staff.' This was said in a very aggressive manner. Michael Bray introduced Mr Duff and we then sat down. Mr Johns said angrily to me that he had just come to his office from a management meeting where he had found out about my line of questioning. He accused me of being very rude, and barging into offices unannounced. I asked him to explain what he meant and he said that I had upset one of the managers by walking in without an appointment. I told him that I had asked the manager's secretary if I could arrange an appointment and she had told me to go in and arrange a time with him directly ...

Mr Johns then asked me who did I think I was to waste his manager's time with matters which were outside the scope of the internal audit examination. I told him that I did not think I had wasted anyone's time but I was concerned about the large loans on Tricontinental's books.

He asked me who I was and what right I had to make judgments about that matter. I told him that it was normal practice in all banks to limit exposure to any one company or group of companies. He said that he was not interested in what other banks did and that the last thing he wanted to be was like other banks. He said I did not understand what he was trying to achieve with his bank. I said that that may be so but there are prudential controls that all banks had to observe and he asked me when was I ever going to get the message Tricontinental was different from other banks.

Michael Bray then told Mr Johns that in relation to Tricontinental's written policy guidelines currently in existence, we had found some discrepancies in the approval process. He also said that we had reservations about the competency of Lynton Stott. Mr Johns said that he needed credit officers that were responsive and did not get bogged down in procedural detail. He said that he prided himself on being responsive to his customers and he said that other bankers would not know a deal if they fell over one.
Mr. Johns then said that he would not accept an internal audit report which exceeded the scope of our assignment as he had defined it. Michael Bray said to Mr. Johns that in the absence of instructions to the contrary it was reasonable to assume that the internal audit brief should extend to an examination of Tricontinental’s prudential policies with respect to credit risk.

Ian Johns said that he controlled the internal audit and he had previously informed [KPMG] that the examination of prudential policies was outside [KPMG’s] scope as internal auditors. Michael Bray said words to the effect that he did not recall such an instruction but concentration of risk was within our scope as external auditors and Ian Johns agreed. Mr. Johns then said that if we wrote about matters outside the scope of our assignment, as he had defined it to be, he would either tear up the report or send it back and refuse to pay the bill. He then said twice “Do you understand”? Michael Bray said to Mr. Johns that he had heard him and he said that we would have another look at the whole matter and get back to him."

Bray reported to Weir on the meeting, suggesting the real problem underlying Johns’ expressed concern was that the audit team had dealt with an “achilles heel” of the group in a forthright way. He believed Johns thought the concentration of risk issue was outside what had been agreed to for the internal audit. Bray told Weir the lesson for the future was to remember the politics of the situation and the extent of influence, or lack of it, that general managers had in regard to prudential policies at Tricontinental. Bray felt the audit team could be a little more diplomatic about the way matters were handled.

Mr. Bray said the concentration of risk issues had been anticipated when they were developing the credit risk audit in the July/August/September period. Johns later made it clear he had never intended the expanded lending risk audit to go into that area.

Weir delivered a draft internal audit report on credit risk analysis to Johns at a meeting on 12 December 1988. The report did not consider nor examine prudential policies in place concerning credit risk. Mr Bray said that, by December 1988, Johns had made clear that the auditors were not to examine prudential policies. Weir recorded that he asked Johns at the
meeting to read the report before the auditors signed the letter. Weir said
that the report was not then signed by the auditors, however Johns later
accepted the report and asked Stott to reply to it.

12.79 Johns wrote to Weir on 20 March 1989, thanking him for the report and
assuring him that "your report and your comments have not been forgotten".
Johns said that he had asked Stott to reply by 22 March.

12.80 Weir wrote back to Johns on 29 March 1989 noting they were still waiting
for Stott's reply to the credit risk internal audit report. Stott sent a
memorandum commenting on the report to Johns on 7 April, but this
memorandum was not given to the auditors. On 14 April, Johns wrote to
Weir telling him that Stott had resigned. A final version of the credit risk
report was sent to Johns by Weir on 8 May 1989.

H. Conclusions and Findings
(a) Mr Johns and the internal audit

12.81 The most outstanding feature of this account of the role of the auditors at
Tricontinental is the use of the internal audit system by Mr Johns. It is quite
clear that he needed the auditors to support him in those areas of activity
where he was inexperienced and felt vulnerable. In the Commission's view
it was quite proper and sensible for him to ask the auditors to give particular
emphasis to these sections. But in the areas which he closely controlled -
especially lending and investment banking - the auditors were asked to do
very little.

12.82 Where a confident and competent manager might be expected to welcome
independent advice about areas of possible weakness and opportunities to
increase efficiency, Johns' primary concern was that there should be no
breath of criticism in areas of his direct responsibility. A good example of
this was his quick scotching of any suggestion that it was wrong to have less
than four directors approving credit submissions. Any such criticisms were
to be referred directly to him.
12.83 His insistence that there should be no attempt to tell him how to run Tricontinental was starkly illustrated by his confrontation with Mrs Louise Wilson, whose evidence the Commission has no hesitation in accepting. She was only on the premises, talking to managers, for a short time when she realised how serious the credit risk situation was and how little it was understood by management generally and the responsible manager, Lynton Stott, in particular.

12.84 When Johns discovered the questions she had been asking, he confronted her rudely and made it quite clear that, if she produced a report along the lines she was contemplating, it would be torn up or returned and no fees would be paid. The auditors accepted that, so far as the internal audit was concerned, it was the managing director's prerogative to determine the scope of the audit. The significance of this episode, for present purposes, is how quickly and clearly an outsider identified the undue concentration of risk.

12.85 Johns' attitude to the internal audit process was further illustrated by his failure to provide or seek any formal statement of the role of the auditors. Everything was left to his oral instructions, and an annual strategy document to be approved by him in accordance with those instructions.

(b) The internal audit and the board

12.86 The Commission takes the view that there was nothing in the communication from auditors which should have alerted the directors of Tricontinental to potentially crippling losses in the lending portfolio, or to any improper or illegal conduct in investment banking. In other words, the auditors told them nothing that they did not know already.

12.87 So far as investment banking is concerned, the weight of evidence suggests that, although Mr Weir had concerns about category A transactions, he only conveyed them to directors in most muted terms. It does seem likely that he actually used the expressions "insider trading" and "warehousing" in the course of his discussions but, if he did, it was in the context of appearances,
or misconceptions by others, rather than of realities. He clearly stopped well short of warning directors that such activities were, or might be, on foot. The Commission deals with some cases which have since aroused suspicions in TR 14-19 in volume 3, and in volume 4.

12.88 It could be said that the directors contributed to their own lack of information by not reviewing the internal audit reports on a regular basis. It is to be noted that they did resolve, in January 1988, that the audit committee should review the reports, but that committee, at its meeting the following month, accepted that the auditors would only report to it on an 'exception' basis - where there was something of real concern to be relayed.

12.89 It seems that Johns did distribute a batch of reports before the June meeting, but this was an isolated occurrence. Generally speaking, the directors were content to await special notice of any serious problem arising from the internal audit, and no such notice was given. Even if the audit committee members had reviewed all internal audit reports, there is no reason to believe that their attention would have been drawn to anything of real moment.

12.90 With regard to the external audit, the point at which the auditors would have alerted directors to potential losses, if they had foreseen them, was in the annual provisioning discussions. Here it must be said that there were no alerts of any sort in 1986 or 1987 and only a half-hearted warning from Mr Weir in 1988. He then said that he would have preferred to see a slightly higher provision than the $17.5m proposed by directors - mainly because of the concentration of lending risk with certain clients. This much was suggested by his notes, but he had no independent recollection of such discussions, and Mr Ryan could only recall a suggestion that the provision might have been a little higher, but no mention of figures, or of concentration of risk as a reason for higher provision. He thought the lower value of equities was mentioned as a reason for greater caution.
12.91 Since the debate finally came down to a difference of $0.5m, it cannot be said that the directors failed to heed any significant warning from the auditors about doubtful loans.

12.92 It must be noted that, from the directors' point of view, there is a positive as well as a negative side to the case to be put for them so far as auditors' warnings are concerned.

12.93 They contend that they were entitled to take positive comfort from the fact that the internal and external auditors did not warn them of potential problems. This could not absolve them from their own responsibilities, but they may point to it as a mitigating factor when their role is being critically examined.

12.94 The directors made it clear, in their evidence, that they did place considerable reliance on the auditors, both internal and external, exercising their respective functions, to draw to their attention any departures from guidelines, deficiencies in systems or in documentation, indications that loans were at risk through breaches of covenants, or other matters of obvious concern.

12.95 Whether the auditors were at fault in failing to detect or communicate the deficiencies in Tricontinental's policies and practices, which are highlighted elsewhere in this report, is now a matter to be determined in Supreme Court proceedings. There is likely to be a serious dispute as to both the scope and performance of the auditors' duties at common law and under statute. What is clear is that (putting aside Mrs Wilson's perceptions of concentration of risk, which do not seem to have been fully shared by her superiors and which were never conveyed to the board) they were as ill-informed as the board about the true situation of Tricontinental's loans. The directors are entitled to take some comfort from this fact.
INTERNAL AUDIT REPORTS ISSUED

Accounting

- 6 April 1987 (final)
- 17 July 1987 (final)
- 20 April 1988 (final)
- 2 December 1988 (draft)

Capital Markets

- 24 July 1986 (final)
- 6 May 1986 (final)
- 25 June 1987 (final)
- 29 January 1988 (draft)
- 20 April 1988 (final)
- 3 June 1988 (draft)
- 18 January 1989 Swaps (final)
- 20 February 1989 Futures (draft)
- 19 April 1989 Swaps (final)

Corporate

- 28 April 1988 Extracts from Sydney (draft)

Corporate Funding

- 16 September 1986 Dealing (draft)
- 16 September 1986 Settlement (draft)
- 27 March 1987 Dealing (draft)
- 27 March 1987 Settlement (draft)
<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 June 1987</td>
<td>Dealing (draft)</td>
</tr>
<tr>
<td>19 June 1987</td>
<td>Settlements (draft)</td>
</tr>
<tr>
<td>29 January 1988</td>
<td>Dealing (draft)</td>
</tr>
<tr>
<td>29 January 1988</td>
<td>Settlements (draft)</td>
</tr>
<tr>
<td>20 April 1988</td>
<td>Dealing (final)</td>
</tr>
<tr>
<td>20 April 1988</td>
<td>Settlements (final)</td>
</tr>
<tr>
<td>21 April 1988</td>
<td>(Sydney) (final)</td>
</tr>
<tr>
<td>28 April 1988</td>
<td>Settlements (Brisbane) (draft)</td>
</tr>
<tr>
<td>23 September 1988</td>
<td>Settlements (draft)</td>
</tr>
<tr>
<td>October 1988</td>
<td>Dealing (final)</td>
</tr>
<tr>
<td>21 November 1988</td>
<td>Dealing (draft)</td>
</tr>
</tbody>
</table>

**Corporate Services**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 May 1987</td>
<td>(final)</td>
</tr>
<tr>
<td>20 April 1988</td>
<td>(final)</td>
</tr>
<tr>
<td>November 1988</td>
<td>(final)</td>
</tr>
</tbody>
</table>

**Credit Risk Analysis**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>8 May 1989</td>
<td>(final)</td>
</tr>
</tbody>
</table>

**EDP**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 March 1988</td>
<td>(final)</td>
</tr>
<tr>
<td>23 February 1989</td>
<td>(final)</td>
</tr>
</tbody>
</table>

**Foreign Exchange**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>16 January 1987</td>
<td>(draft)</td>
</tr>
<tr>
<td>1 May 1987</td>
<td>(final)</td>
</tr>
<tr>
<td>25 June 1987</td>
<td>(final)</td>
</tr>
<tr>
<td>10 February 1988</td>
<td>Dealings (final)</td>
</tr>
<tr>
<td>10 February 1988</td>
<td>Settlements (final)</td>
</tr>
<tr>
<td>11 April 1988</td>
<td>Settlements (final)</td>
</tr>
<tr>
<td>Date</td>
<td>Title</td>
</tr>
<tr>
<td>-------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>11 April 1988</td>
<td>Dealing (final)</td>
</tr>
<tr>
<td>21 April 1988</td>
<td>(Sydney) (final)</td>
</tr>
<tr>
<td>28 September 1988</td>
<td>Dealing (final)</td>
</tr>
<tr>
<td>28 September 1988</td>
<td>Settlements (final)</td>
</tr>
<tr>
<td>18 January 1989</td>
<td>Dealing (final)</td>
</tr>
<tr>
<td>18 January 1989</td>
<td>Settlements (final)</td>
</tr>
</tbody>
</table>

**International**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 December 1986</td>
<td>(final)</td>
</tr>
<tr>
<td>14 April 1987</td>
<td>(final)</td>
</tr>
</tbody>
</table>

**Investment**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 April 1988</td>
<td>Funds Management (final)</td>
</tr>
</tbody>
</table>

**Investment Banking**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 April 1988</td>
<td>(final)</td>
</tr>
<tr>
<td>2 December 1988</td>
<td>(draft)</td>
</tr>
</tbody>
</table>

**Lending**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 October 1986</td>
<td>(draft)</td>
</tr>
<tr>
<td>18 May 1987</td>
<td>(final)</td>
</tr>
<tr>
<td>29 January 1988</td>
<td>(draft)</td>
</tr>
<tr>
<td>October 1988</td>
<td>Procedures (final)</td>
</tr>
</tbody>
</table>

**Money Market**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 August 1986</td>
<td>(Perth) (draft)</td>
</tr>
</tbody>
</table>
Payroll

20 April 1988 Personnel (final)
2 December 1988 (draft)

Project Finance

6 November 1986 (draft)
6 May 1987 (final)
20 April 1988 (final)
22 December 1988 (final)

Registry

28 April 1988 Report with extracts (Perth) (Adelaide) (draft)
October 1988 (final)
13 April 1989 (draft)

Trust/Registry

15 July 1986 (final)
1 May 1987 (final)
10 July 1987 (final)
29 January 1988 (draft)
21 April 1988 (draft)
A. Introduction

(a) Evidence to ASC Officers

13.1 Mr Johns, the former managing director of Tricontinental, complied with a number of summonses to attend before officers of the Australian Securities Commission who were also officers of the Royal Commission's staff. On each occasion he gave evidence about his knowledge of a particular transaction which was to be examined by the Royal Commission. In a number of instances the transcripts of these examinations were later tendered in evidence before the Royal Commission so that the evidence of other witnesses could be seen in context. At that time it was intended that Mr Johns' direct evidence would later be available to the Royal Commission, and so his statements to the ASC investigators served the purpose of a preliminary inquiry as to the evidence which he could give. However, after he declined to give evidence about transactions, on the ground of self-incrimination, the Commission accepted a submission that it should disregard the evidence contained in the ASC transcripts; see paras 3.40-41 above.

(b) Evidence to the Commission

13.2 In view of his central role in the affairs of Tricontinental, it seemed appropriate that Mr Johns' evidence should be deferred until the Commission had before it a good deal of background material, and some more specific evidence, from other witnesses.

13.3 It became apparent, quite early in the proceedings, that a number of other witnesses would tend to point to Mr Johns as being the person who received most credit for Tricontinental's rise to its position as "Australia's largest merchant bank", and who might therefore be said to bear major
responsibility for the later collapse of the company. In these circumstances it seemed only fair that Mr Johns should know what others were saying about him before he was expected to give evidence on his own behalf. Accordingly it was intended that he be called in late May 1991.

13.4 Unfortunately, as noted in chapter 3, the calling of Mr Johns was delayed longer than had been expected because of his involvement in a lengthy action in the Supreme Court of Victoria in which Tricontinental, and Mr Johns himself, were defendants. There was then a further delay before arrangements for his legal representation at public expense could be finalised. The course of events which followed is set out in paras 3.21-31 above.

B. Background
(a) Education and previous experience

13.5 Mr Johns made a statement to the Commission in which he described his early history in the following terms:

"I was born in 1953 in Brisbane Queensland. I attended High School and completed my Matriculation in 1970. In 1971, aged 18, I commenced with the Commercial Bank of Australia in Brisbane. I spent 18 months there before being transferred to the Townsville branch where I spent the next two years. I was selected for transfer to the corporate lending division operating in Sydney.

I spent four years in Sydney with the bank prior to leaving it for employment with Euro Pacific Finance Corporation Ltd..... I spent some two years with the merchant bank before being recruited for Tricontinental's Brisbane office in 1980. I was appointed as the assistant lending manager for Queensland. Prior to going to Queensland I spent six weeks in Sydney with Tricontinental.

Tricontinental had been in Brisbane for about eight years but had not been doing particularly well. After approximately two months I became the regional lending manager in Brisbane.... In June 1981 I was transferred to Melbourne as the group operations manager (lending division). My role was to install systems in relation to the lending activities of Tricontinental. I put in place manual lending systems for the collection of fees, recording of limits, repayments, run offs, average margins, etc. The company at that time was"
unable to have access to lending exposure on a daily basis. Monthly updates only were carried out. I put in a system whereby daily updates were available. These were simply banking practices and put into effect some of the matters I had learnt in my early banking employment.

The national lending manager left at the end of 1981 and I was promoted to that position. I co-ordinated the information flow from and to the various regional offices. I was given a portfolio of "doubtful loans" to manage.

In mid 1982 Fred Kempson (the then general manager lending) left the company. Redenbach who was then the chief executive officer of Tricontinental made me the general manager of lending. The general manager of the finance division reported to me. Following the departure of the general manager of the finance division, I merged the finance division and the lending division of the company. In 1983/1984 I was also given responsibility for managing the corporate services division, in conjunction with my role as general manager lending following the departure of the general manager corporate services.

By this stage the company was being managed day to day by Bruce Ziebell (as to administration, accounting and secretarial matters), Bruce Message (as to the liability side of the company's balance sheet which included the money market) and myself. Redenbach, the chief executive officer, did not spend a great deal of time in the country and had little to do with the day to day management of the company.....

In March 1985, while visiting Sydney on company business, I was told to get back to Melbourne urgently for some "good news". I was then told at a meeting which included a number of the SBV directorate, that Mitsui had declined to purchase Tricontinental, SBV would be acquiring one hundred per cent of it and I was to become a director of Tricontinental and was also to continue in my role as general manager, lending and corporate services.*

It is interesting to note, in passing, that Mr Johns is quite adamant that he was told in March 1985 that SBV would buy all the shares in Tricontinental. As noted in our first report, the formal position was that SBV had taken over control of Tricontinental while it made up its mind whether or not to complete a purchase of all shares. The explanation for the apparent divergence of views probably lies in the fact that the board of
SBV recognised that it was most likely that it would proceed with the purchase, and it did not want to suggest to Tricontinental employees, particularly its key managers, that there was any doubt about their continuity of employment.

13.7 In answer to later questions, Mr Johns explained that his work with CBA in Sydney, as an assistant lending officer, was mainly concerned with controlling the flow of documentation and assisting the lending manager in preparing credit submissions and in monitoring loans. There was some client contact but no direct control of accounts.

13.8 His work at Euro Pacific Finance was that of a lending officer, but the functions were similar to those he had been performing at CBA - there was more client contact, but he was still not directly managing accounts.

13.9 Against this background, it must be said that his rise at Tricontinental from 1980 to January 1986 was truly meteoric. It is all the more remarkable when it is remembered that he was only twenty-seven at the beginning of this period and had no tertiary education of any sort. Nor does there seem to be anything in his appearance or conversation - the 'image' he projects - which would cause him to stand out in the eyes of his superiors. It seems clear that he achieved his rapid promotion by sheer hard work and an ability to sell the products of Tricontinental to its customers. He may also have benefited from a lack of competition from other Tricontinental managers.

13.10 It should be remembered that, although Mr Redenbach may have been responsible for a good deal of Mr Johns’ promotion up to 1985, it was Mr Bill Moyle, together with Mr Arnold Hancock and Mr Neil Smith, acting on the recommendation of Mr Jack Ryan, who appointed him as managing director of Tricontinental late in 1985.
(b) Work at Tricontinental 1980-1985 - general manager lending

13.11 As set out in his statement, above, during this period Mr Johns was responsible not only for Tricontinental’s lending operations but also for the finance subsidiary and, later, for the corporate services division. This considerable concentration of responsibilities in Johns’ hands was to prove significant in later years. There is no reason to doubt his claim that he was left quite substantially to his own devices in carrying out these responsibilities. It is clear that, in doing so, he came to know well most of Tricontinental’s major clients, including such people as Christopher Skase and George Herscu.

13.12 There can be no doubt that he achieved results in his role as general manager lending. He made himself popular with borrowers by being swift to respond to their requirements, and in putting together packages which met their needs. From Tricontinental’s point of view, he was continually increasing the company’s share of the lending market and earning a high rate of fees in the process. As will be seen from the financial statistics for the period, set out in para 8.4 of the first report, cash loans by Tricontinental increased from $53.5m in 1982 to $123.9m in 1983, $153.6m in 1984 and $256.9m in 1985. The figures in each case are for the financial year ended 30 June.

13.13 In a statement to the Tricontinental board in November 1984 Mr Johns reported, "lending commitments have increased substantially during [the past five years] and now total $880m" (see para 8.18, first report.) This total figure for all loans clearly represented a considerable, but not excessive, exposure when compared with shareholder’s funds of less than $50m. It could have been suggested that Mr Johns was moving too quickly as general manager lending, and indeed, as will appear later, when he became managing director he saw the need to expand other services of the merchant bank in order to redress the imbalance between lending and those other services.
Circumstances of appointment as managing director

13.14 The reasons for the appointment of Mr Johns as managing director of Tricontinental at the end of 1985 are set out in paras 9.101-104 of the first report. It is obvious that the favourable view of Johns formed by Mr Ryan, during his nine months as managing director, weighed heavily with Mr Hancock and Mr Moyle. The other major factor was that Moyle had been unable to find a suitable outside candidate for the position.

13.15 Mr Ryan reached his own conclusion that Johns had a sound knowledge and understanding of Tricontinental's operations and understood the requirements of the job of managing director. However, before reaching that conclusion, Ryan had discussions with some key officers in Tricontinental who indicated that they had a very high opinion of Johns - at least of his capacity as general manager lending.

13.16 In his statement to the Commission, Johns said that he accepted the position "although I did not then regard myself as completely on top of all of the company's operations; that is I did not know a great deal about the money market operations and I resolved to learn as much as I could upon taking up the position". Later in his evidence, he said that the possibility of his appointment had gone through his mind, "and I thought, no, not enough experience, they needed someone with a greater amount of experience".

13.17 In his statement to the Commission, Mr Jim McAnany, the chief general manager corporate and international of SBV said:

"I was not particularly enthusiastic about the selection of Ian Johns as managing director of Tricontinental. I regarded his experience as too shallow for somebody who was expected to run a merchant bank in tough times ... in my view, the job of managing director required a breadth of commercial skills and banking experience which Johns did not possess. In particular, running a merchant bank involves areas such as liability management, foreign exchange ... There is considerably more to it than corporate banking. My views were not sought on Johns' appointment at the time. I assumed his main attribute for the job was that he, more than
anyone else, was in charge of most of what Tricontinental was doing at the time. I knew that he had a reputation as a hard-nosed wheeler-dealer type. I’m not aware that any formal selection process was engaged in other than one or more attempts by Moyle to attract an individual from other organisations."

13.18 There is no reason to doubt that Mr McAnany did have the views which he has recorded. It was perhaps natural that someone in his position at SBV, and with his background in general banking, would look with disfavour on the rapid promotion of a person such as Ian Johns. However, his concerns were legitimate on their face and it seems a little surprising that Mr Moyle, who was new to SBV himself, did not consult one of his senior officers, who would be conducting a department of SBV which would relate quite closely to the main activities of Tricontinental, about such an important appointment.

13.19 Mr Rawlins was another senior officer of SBV who had considerable doubts about the appointment of Johns as chief executive officer of Tricontinental. He had hoped that a more widely experience managing director could have been found. He felt that Johns was too young and lacked the necessary breadth of experience for such a position.

13.20 Mr Ziebell also said that he thought someone with more experience should have been appointed. He noted in particular that Johns was only in his early 30s and had not worked overseas or in the treasury area. However Ziebell also said that, after his appointment, Johns put a lot of time and effort into learning those aspects of the company with which he was not familiar. He built up a good knowledge in those areas.

C. The First Year - from January 1986

(a) Role of Mr Jack Ryan

13.21 Although Mr Ryan only saw himself as a caretaker managing director for the nine months that he held office, and much of his effort had gone into
negotiating the purchase by SBV of the remaining shares in Tricontinental which it did not already hold, he nevertheless exercised the authority of a managing director on day-to-day matters, and was consulted about all major lending decisions. This was part of the 'round robin' approach to credit approvals which is dealt with in detail in chapters 11 and 15.

13.22 Mr Johns said in evidence that he regarded himself as being "on P plates" for the first twelve months. It is clear that he had regular meetings with Ryan, who gave freely of his time to visit the offices of Tricontinental, in his capacity as the deputy chairman of the board, and made his advice available to Johns at all times. Johns said that these meetings were held on a weekly basis and usually lasted about half an hour to an hour. Both general policy issues and specific transactions were discussed.

13.23 No doubt Johns was glad to have the support of Ryan in the early stages of his career as managing director. However, Ryan gave evidence that there came a time when he was chided by Johns for constantly looking over his shoulder. Ryan said, in effect, that he regarded this as being a reasonable attitude for a managing director who had found his feet, and so he backed away to some extent, although he continued to visit the office regularly in order to look at credit submissions. The two men continued to converse fairly often about matters of current interest.

(b) Changes introduced

13.24 Perhaps the first change made by Ian Johns, when he became managing director on 1 January 1986, was to establish the credit and securities division as a separate entity, divorced from the lending division. This is described in paras 20.45-46 of the first report. This might have been thought to be intended to improve the checks and balances within the organisation, so that the credit and securities division could operate as a check on any over-zealous activities of the lending division. As will be seen later, this certainly did not occur, and it appears from Johns' evidence
that this was not his intention. His concern was merely to release the lending officers from the desk-work represented by credit submissions and letters of offer, and ensure that they spent their time out in the business community 'marketing' Tricontinental's 'products'.

13.25 Mr Johns, in giving evidence, was generally concerned to stress that he had made few changes in procedures or practices after becoming managing director. He did, however, lay claim to implementing a number of internal control procedures for the securities department. He said that he initiated (among other things):

- a procedural check list
- insurance returns
- share monitoring
- processing of letters of offer
- doubtful debt monthly returns, and
- watch lists.

(c) Appointment of Mr Mountford

13.26 Mr Johns did not appoint a replacement for himself as general manager lending until May 1986, when Mr Ken Mountford took up the position. In the meantime Johns had continued to run the lending division as well as performing the duties of managing director. He said in evidence that he wanted to create an atmosphere in which clients felt that they could approach the managing director about their problems, and he would certainly have demonstrated this attitude in the early months of 1986. He said that clients with whom he had developed a close connection in his years as head of the lending division were reluctant to lose their contact with him when he became managing director. It seems likely also that Johns enjoyed the relations which he had with many of his clients, and was himself reluctant to let go of those direct contacts. He said that he had to ease Mountford gradually into the full responsibilities of general manager lending, and that it was twelve months or more before he felt able to
transfer the bulk of his lending responsibilities. He said that, after he had done so, from about June 1988, he remained responsible for only about 30 per cent of the Tricontinental loan portfolio.

However most other witnesses in a position to make an estimate have told the Commission that, at least in money terms, he remained directly responsible for something like 70 per cent of the portfolio until late in 1988. Given his pre-occupation with the Australian Bank Limited ('ABL') merger and other crises from that time onwards, there is no doubt that his day-to-day involvement in lending transactions did then fall away, so there is little conflict in the evidence in this respect. However it does seem that Johns retained control right to the end over client contacts, and important aspects of account management, in a large number of the major lending transactions.

(d) Lack of direction from SBV

In his evidence to the Commission, Mr Johns complained of lack of guidance as to the direction in which SBV wanted him to take Tricontinental after he assumed the role of managing director. He said:

"Basically the senior management of the company got on with the management and reported, as required, to the board. It was basically "one way traffic" as far as the information supply was concerned. There was very little policy direction "imposed" from above. Until May 1989 the company continued pretty much as it had done prior to my assumption of the managing director's role."

He also said that, towards the end of Mr Ryan's term as managing director, a meeting had been sought with Mr Moyle in which it was hoped to gain some idea as to SBV's plans for Tricontinental. However both he and Ryan and Mr Ziebell came away from their meeting with Moyle with no clearer picture of what the bank expected of them. Moyle simply indicated that no major change in Tricontinental's direction was intended, and all that was required was "more of the same".
(e) **Three year plan**

13.30 In order to achieve greater clarity of objectives, Johns himself presented two planning documents to the Tricontinental board in May 1986. These were a three year plan and a budget for the coming financial year. These are dealt with in some detail in the first report at paras 10.46-53. The more significant parts of the three year plan appear in paras 10.49-50. Among the statements made in it were the following:

"Tricontinental will remain principally a secured lender within the private company and second tier public company sectors. Pricing of facilities will continue to reflect reward for risk, unnecessary volume will not be written at low returns. Tricontinental with its total lending commitments of $2 billion plus, now has a profitable base to be more selective with its lending ...

Tricontinental's lending activity over recent years has been opportunity driven and we have developed an appetite for proposals with predictable manageable risk, offering exceptionally high revenue/return opportunity. These opportunities are sourced from existing lending and corporate services marketing activity and with our acquired expertise and capacity to understand risk, it is now proposed to pursue these opportunities on a serious and deliberate basis.

These activities will be substantially property related covering the spectrum of funding risk and non-funding risk transactions...

Contemplated transactions will cover the full ambit of market need:

1. 100% funding property development (de facto joint ventures)
2. 100% funding property acquisition transactions
3. 'put' role transactions covering completed property development risks
4. selected business and equity participation (secondary investment banking function)
5. one-off "venture participation"
6. mortgage divestment/trading activity. Opportunity exploitation to be developed in conjunction with treasury division."

13.31 This passage has been set out again in full because it indicates very clearly the nature of the lending which the new managing director was contemplating.

13.32 The minutes of the board meeting at which the three year plan was discussed show Mr Moyle as sounding a number of significant warnings,
including the fact that Reserve Bank limits on SBV could have an impact on Tricontinental’s expansion, there were clearly going to be risks involved in the strategy, and there was a need to improve reporting to the board "due to the high risks and complexity of a number of the products outlined in the plan".

(f) Profitability

13.33 There can be no doubting the financial success of Mr Johns’ first six months of office. As can be seen by attachment 10A at page 172 of the first report, the managing director was able to show a profit increase, after tax and before extraordinary items, of 175%. Balance sheet assets were also up 101% on the previous year. The financial year was capped for Mr Johns by his being named by the Bulletin magazine as the "young executive of the year" for 1986. The initiative in nominating him for this distinction was that of Mr Moyle.

(g) Approach to merchant banking

(i) ‘Hands-on’ management

13.34 Throughout the hearings of this Royal Commission there have been many references to Mr Johns as a hands-on manager. He made clear in his evidence that he was personally available to any borrower who wished to speak to him. His name actually appeared as account manager on many of the credit submissions which the Commission has sighted. When asked about a list of the top thirty exposures of the bank in 1988 he conceded that he was, in effect, the account manager, either in whole or in part, of approximately half those accounts. This picture was confirmed by the Commission’s review of a list of the forty major loans in default.

13.35 This hands-on involvement was, of course, particularly true in the first five months of his tenure of office as managing director because, during that time, he continued to act as general manager lending. As Mr Mountford became more familiar with the work of Tricontinental in the following
year, he naturally assumed a good deal of the responsibility which Johns had been exercising up to that time. However, as will be seen, Johns remained active in the lending area right up to the integration of Tricontinental into SBV in May 1989.

13.36 Mr Johns’ involvement in investment banking was even greater than in the lending operations. At no stage did he appoint a manager for the investment banking activities. However busy he was, he always exercised that function himself. It is fair to assume that he enjoyed buying and selling large parcels of shares.

13.37 On the other hand, it is probably true to say that his hands-on approach was largely confined to these two areas of lending and investment banking. He certainly seems to have left Mr Bruce Ziebell to get on with the administration of the company and, similarly, he seems to have taken only an appropriate managerial interest in areas such as the money market and corporate services.

(ii) Willingness to take risks

13.38 Right from the beginning of his time as managing director, Johns made no secret of his willingness to accept risks on behalf of the group. His constant references to the subject would tend to suggest that he has something of a gambler’s instinct. In his first three year plan he said “we have developed an appetite for proposals with predictable manageable risk ...” (para 13.30). The 1986 annual report said that “Tricontinental has a philosophy of supporting entrepreneurial starters and growing with them ... Tricontinental is different from most other merchant banks in that it stays close to its clients and ‘gets its hands dirty’ by being supportive.”

13.39 Elsewhere in the three year plan Johns said, “Naturally as the lending book expands potential losses are an accepted possibility, as a lender must take a
risk in order to obtain a profit/margin. Little profit in no risk lending."
(first report, para 22.15).

13.40 In a report to the board in July 1986 Johns said, "Tricontinental is one of the few banks which accepts true risk for reward, most competitors talk with little action. It is acknowledged that management of risk is heavily reliant upon management and systems..." (first report, para 22.52).

(iii) Speed of turn-around

13.41 A constant theme of Tricontinental, and one of its chief selling points, was the speed with which it was able to handle requests for loans, particularly from established clients. There were many references to this in oral evidence, and when the Commission came to examine individual transactions, it found a number of instances in which credit submissions were required as a matter of urgency, or were dispensed with altogether until after the loan had been made, when a submission would be prepared for the record. In some of those cases there would be a short memorandum taking the place of the usual detailed submission; in other cases the approvals of board members were obtained by telephone calls, usually from Johns or, in some cases, Mountford or Stott.

13.42 In his 1986 three year plan, Johns claimed (first report, para 22.15), "although approval turn-around is quick, a necessary requirement in today's aggressive market, assessment is thorough...". This claim was not supported by the evidence. Mr Hue was one of the most senior credit analysts and an impressive witness. He said that his work, and that of other credit analysts, was at all times put under pressure by lack of time and inadequate information. It was Mr Johns' proposals which often caused the most acute problems.

13.43 In his July 1986 report to the board (first report, para 22.52) Johns said, "Tricontinental's success to date has been its ability to structure, understand
D. The Second Year - 1987

(a) Overview

The events at Tricontinental in the years ended 30 June 1987 and 1988 are set out in detail in chapters 11-13 of the first report. The main events for Tricontinental in 1987, which saw the magazine 'Australian Business' naming Tricontinental as the "most improved company" in Australia for that year, were the aborted attempt to float the company's shares, and the stock market crash.

(b) Profitability

Increased profitability was certainly achieved because the profit after tax but before extraordinary items was up 103% on the previous year to a figure of $26.1m. There was some diversification in the sense that lending played a smaller part in profits before tax (35%) than had been provided for in the budget for the year (44%). This was due in part to 13% of total profits being recorded by investment banking, when in fact a loss amounting to 12% of total profits had been budgeted for.

As a result of its perceived "strong underlying earning capacity", Australian Ratings upgraded Tricontinental in May 1987 from A+ to AA-. In its report it referred to "large individual exposures .... [which] should be viewed in the context of the State Bank's $439m equity base." In fact, Tricontinental's four largest exposures totalled $734m. There were seventeen exposures in excess of $50m.
(c) **Proposed float**

SBV's corporate plan for 1987/88, presented to its board in July 1987, provided for the possible sale of Tricontinental. In a memorandum dated 24 August 1987, Mr Moyle recommended that a flotation of all SBV shares in Tricontinental, with SBV repurchasing a 40% shareholding, should be approved in principle. There is no doubt that Mr Johns supported the idea of a public float rather than the alternative - an outright sale. He proposed that he and Mr Ziebell would together be allocated 5% of the shares of the new public company, and be granted an option, or first refusal, over SBV's 40% interest "exercisable at market value or as mutually agreed at any time after the expiration of three years". He said in evidence that he had in mind an overseas bank which he might have been able to interest in the purchase of SBV shares. In early October Mr Johns produced a list of proposed shareholders in the new company. It was his intention to try to place all the shares privately. Some preliminary steps were taken in September 1987 but, before plans could be finalised, the stock market crash of 20 October 1987 put an end to any prospects of a successful float.

(d) **Stock market crash**

The stock market crash had very serious implications for Tricontinental's loan portfolio. A high proportion of that portfolio was secured by share mortgages. Johns said that he worked without sleep in the days immediately following the crash and was upset that only one of the directors, Mr Smith, had taken the trouble to contact him during that time. Johns set up an arrangement under which the value of shares held as security was checked three times each day, instead of daily as had been the case previously. He reported to the board at its meeting of 28 October "...a large proportion of management and staff time has been taken up implementing the necessary calls on all loans where the required share times cover has been eroded. Senior management is continuing to strictly monitor share prices throughout each day to protect the security position".
13.50 At the December board meeting a schedule was provided showing that, immediately before the crash, Tricontinental held shares as security having a total market value of slightly over $2,000m.

13.51 Earlier, at the November board meeting, Johns had reported that contact was being made with clients "on a daily basis to effect full or part margin calls as so desired. It is considered extremely important at this point in time to maintain daily contact with clients and discuss their problems and not to place clients under any undue pressure to force sale of equities."

13.52 He went on to say, "All clients to date, excluding those detailed below, have provided top-up securities in the form of other equities, cash and/or other assets." Only seven clients were named in the attached list.

13.53 It has become clear, from evidence produced to the Commission, that a much larger number of clients than those listed had failed to provided top-up security. Certainly on 22 December a list of sixty-four companies, produced to the internal auditors, showed that twenty-nine of them were in default of their security covenants for having provided inadequate share cover. According to a contemporary note, Mr Neil Hunter told the internal auditor that "many were direct clients of Johns and he was unaware of what action was being taken by Johns in respect of those loans to make them more secure." A similar number of borrowers were shown to be in default of adequate share cover the following February. There is no evidence to suggest that these figures were brought to the notice of the board; indeed all the evidence is to the contrary.

E. The Third Year - 1988

(a) Attempted disposal of Tricontinental

13.54 A good deal of Mr Johns time in the first half, and at the end, of 1988 was taken up with two successive schemes to dispose of the bulk of SBV's interest in Tricontinental. These are described in some detail in chapters
14 and 15 of the first report. The first attempt, through the use of a publicly listed investment company, Pine Vale Investments Ltd, appears to have been a scheme devised by Johns. As noted in the first report, the Commission does not have clear evidence about the proposal and it was relying upon evidence from Johns to clear up a number of doubtful matters. In view of his refusal to give evidence about particular transactions it has not been possible to fill in the gaps. However it seems that the scheme was never very likely to succeed and nothing turns upon the Commission's inability to make further findings on this matter.

13.55 A much more significant move was the proposed merger of Tricontinental with ABL which developed in the last few months of 1988. A full description of the relevant events is given in chapter 15 of the first report. Before the end of the year SBV had acquired ABL and had indicated to the Reserve Bank its intention to merge ABL with Tricontinental, and then to sell most of its interest in the merged entity by way of a public listing.

13.56 Mr Johns was very much involved in compiling a detailed submission for the Reserve Bank, which he delivered to the RBA on 18 January 1989.

(b) Profitability

13.57 As might be expected, the results for the year ended June 1988 were well down on the two previous years. The stock market crash was sufficient to account for this. However total assets still increased by 15% to $3,443m. Total loan commitments increased by 19%. They were now just over $4,000m. Tricontinental's profit after tax, but before extraordinary items, declined by 11% to $23.3m. 50% of the total profit came from lending and 28% from corporate funding. Investment banking provided a loss equivalent to 11% of profits.
Last Five Months - to May 1989

(a) Submission to Reserve Bank on ABL merger.

The submission which Mr Johns delivered to the RBA on 18 January 1989 was very detailed. It was 77 pages long and had attached to it 1000 pages of appendices in nine volumes. The RBA's rather sceptical reaction to the submission is set out in paragraphs 15.33 to 15.36 of the first report. Later developments, outlined in the following paragraphs of chapter 15 of that report, kept the merger proposal alive even though great difficulties were arising. It was only put to rest by the SBV board meeting of 21 May 1989, which integrated Tricontinental into SBV.

(b) Liquidity problems

While SBV was considering how it could meet the requirements which RBA had laid down for "in effect promoting Tricontinental to the status of a licensed trading bank", to use Mr Ian Renard's expression, Mr Johns was becoming increasingly concerned about Tricontinental's liquidity problems. These had been brought about by the delay in the carrying out of the merger with ABL, and the public perception that SBV might soon not be standing behind Tricontinental. The same concerns led to Australian Ratings issuing a "RatingWatch" in January 1989. This, of course, did nothing to assist the liquidity crisis, which reached serious proportions in March.

SBV attempted to assist Tricontinental, first by purchasing a number of its assets - although this course was not supported by Mr Johns (see paras 15.69 and 15.70 of the first report) - and secondly by the issue of a letter of comfort to the governor of the RBA which is set out in paragraph 15.72 of the first report. Although Johns was critical of the asset sale initiative, he was unable in evidence to suggest any other course which could have been taken.
(c) The press and the market place

13.61 The events leading up to the integration of Tricontinental and SBV on 21 May 1989 are fully set out in chapter 17 of the first report. It is now clear that, from 11 May, when investigative journalists published articles critical of Johns and his dealings, and of Tricontinental's loan portfolio, the end was in sight.

(d) Integration

13.62 Mr Johns resigned from the Tricontinental board on 30 May 1989 (see para 18.69 of the first report). He was employed for some time as a 'consultant' to assist in the integration process and was still signing certain memoranda in June 1989. After that he disappeared from the scene.

13.63 In speaking of the integration, Johns was inclined to suggest that Tricontinental's position was made worse by the actions of SBV when the loan book of Tricontinental was taken over. He said:

"... when I was stripped of power on 21 May, in my mind at that point in time, Tricontinental was still in existence. What happened to the loan portfolio and what happened to the corporate clients after that date, I am not fully au fait with and I think you would have to look at every one of those corporate collapses to find out why they collapsed and ... what then eventually happened to the Tricontinental loan ... If it was managed differently and I mean managed on a day to day basis, if the State Bank personnel had not been instructed to look at each client and each file and assess it as if it was going to be a new loan from the State Bank from day one, but actually took a true view on the security matters, the position may be different today. I mean, the State Bank, in my understanding and from what I saw in April/May, they went in there on a hunt, they didn't want it, and they just started causing its downfall from the start."

13.64 Later he said that he was not saying there would have been a different result if SBV had managed things differently - he was only saying it was possible. He had no particular Tricontinental client in mind when making the statement.

13.65 In fact the Commission found no evidence to support the suggestion that
SBV was too harsh with Tricontinental’s borrowers or failed to give proper consideration to any requests for extension of time after integration. In fact, as will appear, the Commission takes the view that if there is any criticism to be made of SBV’s handling of these issues after integration, it is that there were arguable instances when steps to enforce security, or otherwise effect recovery of loans or parts of loans, were unduly delayed. There were also cases where further funds were advanced in attempts to enable borrowers to complete projects and trade out of difficulties.

G. **As Account Manager**

(a) **Number of accounts controlled**

13.66 As already indicated, Mr Johns saw himself as a ‘hands-on’ manager and this involved, in particular, maintaining a close relationship with many borrowers. It is clear that, until well into 1988, Johns was the account manager for 70% by value of Tricontinental’s loans although, as that year progressed, he handed more matters over to Mountford. Indeed by the end of the year and in early 1989, pressure of other work may well have reduced the percentage of cases he was handling on a day-to-day basis to as little as 15% of total value. As Johns pointed out in his evidence, from February 1989 he was in Sydney two or three days a week, in the office of the Australian Bank, of which he had been appointed managing director.

13.67 In addition to those accounts which he directly controlled, Johns frequently saw a new borrower who came with an introduction, or expressed a wish to talk to him. He would consider the loan being sought by the new client and would give an indication of support or otherwise. If he did support the application he would usually dictate a memorandum to the credit division, indicating the broad terms of his agreement and asking for a credit submission to be prepared. If he was not interested in watching the progress of the transaction himself, another officer, from the lending division, would be nominated to act as account manager.
(b) Extent of control

13.68 Generally speaking, when Johns was account manager for a transaction, his control of it was complete. There was no suggestion that he ever consulted with any other officer of Tricontinental before reaching a decision. Nor were there any effective checks and balances in the system which might have allowed any substantial questions to be raised about the decisions he had reached. The most that could be said is that, if Mountford or Stott wanted to suggest, having looked at the details of the transaction, that there should be some additional covenant required or further security taken, Johns would listen to their suggestions and, if he thought fit, would adopt them. Those three witnesses all agreed that this did happen on a few occasions.

13.69 It should be said that, in the Commission’s view, Mountford and Stott would not have held back from criticising a decision of Johns because they were afraid of him. It would rather have been because they respected his judgment and, in any event, did not have access to all the information - particularly about future intentions - which Johns would have received from the client. Often they did not have ready access to him, because he was interstate or otherwise too busy. The practical result was that, when Johns made a decision in principle, that decision was not challenged by other staff.

13.70 If the senior managers provided little by way of checks and balances, even less could be expected from the credit analysts. Johns gave evidence about what he expected of analysts in the following passage:

"... what was expected of credit analysts in assessing as objectively as they could a client’s ability to service and repay. What were the expectations you had? --- That cash flows would be obtained, financials would be obtained, and the analyst would apply a [notional] interest rate to the loan, which was basically 20% per annum, and that would have to be serviced."
13.71 This indicates the largely clerical nature of the role which credit analysts were expected to perform. Those credit analysts who gave evidence confirmed that this was the way they saw the job themselves - particularly in cases where the proposal for the loan had come forward in the name of the managing director.

13.72 In other words, the credit analysts were not supposed to draw attention to any possible flaws or weaknesses in the loan proposal, or in any other way act as devil's advocates.

13.73 This was confirmed by Johns in a further passage of his evidence:

"... did you expect the credit submissions should identify the down side in proposals or not? --- No. Your down side [in] proposals would be identifiable in the risk factor against the security you had taken ... it was really up to the individual members of the credit committee or the board to identify their down side in relation to the lending factor, the percentage they were going to lend against the asset. ... If it was a property that was being secured, they would take a view on that property and what the location was, whether it was fully tenanted with prime tenants or whatever."

13.74 So far as the credit committee was concerned, Mountford or Stott might raise a minor issue with Johns, as already indicated, but (with the exception of one instance - see para 13.108 below) there is no suggestion in the evidence that any other member of the credit committee, or the committee as a whole, acted in the slightest way as a brake on Johns' lending.

13.75 When he was making decisions within the limits of his own discretion ($6m after March 1987, see para 22.20 of the first report) he regarded himself as free to depart from the approved lending guidelines to whatever extent he saw fit. He indicated that had been the case before he became managing director and he was merely continuing that practice.

13.76 However, other directors said that they had always understood that guidelines would not be departed from when a discretion was being
exercised. In other words it was a precondition of the exercise of a discretion that guidelines were being adhered to. They received some support for this view from a board minute of 28 May 1986 which recorded, "In response to a question, the managing director assured the board that all submissions tabled were within the various internal guidelines and policies." When this passage was put to Mr Johns, he said that he did not recall it.

13.77 The ultimate check on Johns' lending intentions, when the total of loans for the particular borrower exceeded $6m was, of course, the board's round-robin system of approvals.

13.78 This is dealt with in detail in chapters 11 and 15. It is sufficient for present purposes to say that, if Johns received an unfavourable response from any director, he immediately communicated with that director in the hope of persuading a change of mind. In this he was usually, but not always, successful. His position would undoubtedly have been weaker if the directors had been meeting around the board table, with all or most of them present, and able to hear each director's concerns about any particular aspects of the loan under consideration. Those concerns might well have fed upon each other in a way which could not occur under the round-robin system, unless one director took the trouble to contact another about a particular loan. This did occur, but not very often.

13.79 In fact it is clear that Johns at times anticipated the decision of the board by informing a potential borrower that the loan would be approved, even though it had not yet gone to the board. Johns was also able to influence the decisions of the board by the selective nature of the material supplied in the credit submission. Johns took advantage of the fact that the credit submission was drawn up, in effect, as a sales document, designed to produce a favourable answer. Possibly worrying information was often omitted, and no attempt was made to highlight any risks that might be
apparent from a careful study of the material provided. As Johns said in the passage of evidence last quoted, it was for the individual director to identify the risks for himself.

13.80 Of course, in a number of important cases, the directors had no documents in front of them at all at the time they were asked to approve a particular loan. They were contacted, usually by telephone, by Johns or another senior officer and given an outline of the proposal. Johns said that, when this procedure was followed for reasons of urgency, a copy of the credit submission which was later drawn up would be sent to directors for their information. In fact the evidence makes it clear that this was not done, and that there were some cases in which information appeared in the later credit submission which directors claimed never to have been told.

13.81 Further evidence of Johns' almost total control of the situation arises from the number of occasions he felt able to make changes to loan proposals after the credit submissions had been approved by members of the board. He said in evidence that he only approved "minor variations", such as a change in the lending ratio from 70% to 72 or 73%. Elsewhere he said "... it was in my discretion to do minor amendments [to pre-conditions] if they weren't ... drastic or dramatic changes to the structure of the loans".

13.82 However, cases examined by the Commission illustrated that Johns felt perfectly free to change the identity of the borrower from one company, for which details had been supplied in the credit submission, to another associated company which was not referred to in the submission; see TR 12 (Entrad) and TR 13 (GSH Finance), for example. He also, on several occasions, accepted a complete change in the purpose for which the loan was sought or in the nature of the security offered.

13.83 Johns' dominance of the lending portfolio of Tricontinental extended also to its monitoring. He conceded in his evidence that problem loan reports to
the board were confined to defaults in interest or repayment. There was no regular system for reporting to the board any other form of default - such as breach of a security covenant - which might have given rise to concern amongst board members. And even where interest was concerned, Johns would give instructions to delete from the report to the board any borrowers who were notoriously slow about interest payments and who could therefore be expected to make those payments only after being hounded to do so.

(c) Relations with clients

There can be no doubt that Johns maintained very close relations with most of Tricontinental’s more substantial clients. Johns agreed that Tricontinental had a number of large exposures to a relatively small group of regular clients. His marketing approach was to satisfy the client and let that client advertise for Tricontinental, thus producing a snowball effect. In this way the majority of new business for Tricontinental came from existing clients and referrals or introductions from those same clients.

Johns made no secret of his attitude and, as already noted in para 13.38 above, he was proud of "a philosophy of supporting entrepreneurial starters and growing with them". He wanted to "consolidate our clients’ loyalty and minimise the appeal of any alternative ...".

Mr Mountford gave evidence that Johns was involved with all the clients of any magnitude. Most of them would discuss their medium terms plans and strategies with Johns, who did not always record or pass on that information. Mr Ziebell said that he didn’t believe it was a healthy situation that Johns had a personal relationship with a number of clients.

Mr Atlas summed up the situation very well when he said that, as Johns controlled so many clients and had controlled them for a number of years,
the clients only wanted to speak to him. "If senior staff made decisions which did not suit that client the client would go directly to Johns."

Johns' closeness to his major clients did not mean that he failed to drive a hard bargain. With only rare exceptions, the fees which he charged were at least substantial and sometimes extraordinarily high. There was one case in which the fees charged to a particular client, Mr Abraham Goldberg, for advice given, were so exorbitant as to suggest that, in fact, payment was being made for some other services rendered which were not stated (see paras 109-113 of TR 12 in vol 3).

Generally speaking, the only evidence of Johns as the "hard-nosed lender" which the board had thought him to be at the time of his appointment, came from these high fees which were charged, and from an occasional firm letter of demand for top-up security or payment of moneys due. More often, the evidence shows Johns to have been a very accommodating lender, particularly to long-standing clients. In fact, all the evidence suggests that, in pursuing his objective of getting close to clients, Johns lost his capacity to be objective. He gives the impression, through his actions, of identifying with their problems and being anxious to support them to the best of his ability. This showed up in his constant willingness to 'restructure' loans in difficulty, thus putting off the evil day. In some instances the extraordinary arrangements accepted by borrowers also testified to their desperation.

As he said himself, in his evidence, "Tricontinental was always prepared to consider any loan proposal. If the business was good enough, a means could always be found to do the business". Later he said, "... I used to tell our marketing staff that if you’re going to say no to a borrower, you had to give a reason and you had to justify the no to the borrower to be able to assist him either (a) go somewhere else, or maybe package the loan up in a different way ...".
(d) Quality of decisions

13.91 As might be expected from the influences just reviewed, the quality of Johns' lending decisions suffered. In his anxiety to please his clients by a quick turnaround of proposals and a uniformly sympathetic approach, decisions were often made with inadequate consideration. It seems that, after being selected 'young business executive of the year', in 1986, Johns developed an inflated idea of his own infallibility. He was too much inclined to accept at face value everything that his clients told him, and to reach his decisions on the basis of a few key facts or opinions. As already noted, he consulted with no-one and trusted his own judgment implicitly.

13.92 In arriving at his decisions, Johns tended to concentrate on the fees that could be earned and the apparent security offered. He showed little concern as to whether interest payments could be made from current earnings, and was often willing to capitalise those payments; he was easily satisfied as to the source of ultimate repayment of the loan - a vague reference to sale or refinancing seemed to be sufficient; and, in particular, he always seemed to be prepared to accept by way of security shares in, or a debenture mortgage over the assets of, the operating company which was to service the loan. He seemed not to appreciate that, if that security ever had to be called up, because the loan had not been serviced, the chances were that share security would be of little value; and even a debenture charge could prove useless unless assets were carefully valued on a 'fire-sale' basis.

H. As Investment Banker

13.93 Mr Johns conducted the investment banking business of Tricontinental virtually single-handed. Over 90% of the investments he made were within the limits of his discretion, and so did not require board approval. They were, however, noted by the board at each meeting, and category A transactions were explained orally; see paras 15.460-474.
In the case of 'category A' facilities, which were entered into on behalf of a client, there was normally a put and call option, or some other arrangement which was supposed to produce the result that Tricontinental could not lose on its holding of the shares and stood a good chance of sharing in any profits that were made. However, many of the arrangements which Johns entered into, particularly before the internal auditors complained about it, were either not documented at all or were inadequately documented. This later resulted, in some cases, in Tricontinental being unable to recover under arrangements which were supposed to have been agreed. It is apparent from Johns' own evidence that these category A transactions were not properly understood, at least by some members of the board. In particular, he said that the chairman, Mr Smith, frequently asked him to explain again the nature of these transactions.

One possible explanation for the apparent vagueness of some of the arrangements under category A is that they, in fact, often involved warehousing shares for a client who was prevented by legal limitations, or market sensitivities, from purchasing them in its own name. It was not at all convincing to argue that client confidentiality justified a lack of documentation in Tricontinental's records. Several cases looked at by the Commission had the hallmarks of warehousing, or possibly insider trading; but in no case was the evidence sufficiently clear to enable a firm conclusion to be reached. And only one of the instances appears to be sufficiently serious and clear-cut to warrant further investigation.

I. As Chief Executive Officer
   (a) Relations with senior staff

There can be no doubt that Mr Johns was a dominant chief executive officer of Tricontinental. He worked hard himself, and he expected his senior managers to do the same. One reason for his falling out with Mr Stott was his perception that Stott was no longer fully committed to the task
of driving Tricontinental towards even bigger and better results. Generally speaking, the senior managers responded to this challenge, and Johns seems to have enjoyed their loyalty to a high degree. Those who gave evidence all spoke of his strong personality and general dominance in Tricontinental, but none of them sought to blame him directly for Tricontinental's failure.

13.97 Similarly Johns, in his evidence to the Commission, did not generally seek to criticise his immediate subordinates. He was however concerned to stress, on a number of occasions, that decisions were made by 'management' rather than by him personally. In other words he sought to involve his senior managers in the general responsibility for decisions taken. He described Hunter and Stott as his left and right hands, implying that he relied heavily upon them for the proper presentation of credit submissions and reviews, in the case of Stott, and for the taking and monitoring of securities in the case of Hunter. In the case of Mountford, Johns said that it took him some twelve months or more after his appointment in May 1986 before he felt confident about putting a full general manager's work-load on Mountford. In view of Mountford's experience, there seems no good reason why work could not have been transferred to him a good deal earlier and in larger quantities than it was. It is reasonable to infer that Johns enjoyed the lending work and was somewhat reluctant to let go of it - and his clients were equally unwilling to part with their direct line to the managing director. Johns and Mountford seem to have worked together amicably; Mountford served his managing director loyally and Johns appeared to be well satisfied with his performance.

13.98 In other areas of Tricontinental, such as administration, treasury and corporate services, Johns seems to have been prepared to delegate in a normal fashion and allow the managers of those divisions to get on with their jobs with little interference.
In general, it must be said that, in spite of the demands which he put upon them, Johns enjoyed good relations with his senior managers - apart from Stott in the later stages.

Immediately after his appointment as managing director, Johns established a management committee which consisted of the general managers of all divisions together with, for a time, Mr Stott, the assistant general manager credit and securities. Mr Atlas, who was not a member of the committee, said in evidence that Johns had given him to understand that the role of the committee was to set guidelines for future growth, review operations, set budgetary goals and directions for Tricontinental and monitor financial accounts. Johns himself, in his evidence, said that the management committee was mainly looking at budgets, divisional results on a monthly basis, staffing and matters such as those.

The membership, role and function of the management committee are dealt with in some detail in the first report at paras 20.5-23. Its final role, as suggested by Johns' evidence, may have amounted to rather less than had originally been intended. Nevertheless it does seem as though the committee provided a forum at which any general manager could have raised issues concerning the directions in which Tricontinental was heading, or the health of the organisation.

(b) Relations with other staff

There was general agreement among witnesses that Mr Johns was not an easy man to work for, though he did have a number of redeeming features. Thus Mr Hunter, who seems to have been close to him over a number of years, said that he believed that Johns was a tough boss and sometimes unreasonable in his expectations, for example about leave-taking. Mr Atlas said that Johns was aggressive and could be intimidating to younger staff. On the other hand he could always talk to Johns about a problem, and Johns was quick to grasp a potential opportunity and had an excellent
memory. Ziebell said Johns had a gruff exterior and was capable of arrogance and bad temper, but he could also be extremely generous. Stott said that, later in 1988 and early in 1989, Johns' general demeanour became increasingly autocratic and totalitarian. He belittled and abused members of staff, including Stott himself. All this evidence was reflected in the evidence of junior staff.

13.103 There can be no doubt that Johns maintained pressure on his staff at all levels - this was particularly true of the credit analysts who were frequently expected to prepare credit submissions at very short notice. He expected long hours to be worked and was difficult, at times, about the taking of holidays. However it must be said that, in all this, he led by example.

(c) Hours of work

13.104 Johns gave evidence that he worked somewhere between 70 and 90 hours a week. This estimate would be consistent with the general picture of his working habits as given by other witnesses. He also said that, in his early years as general manager, he would only take a week of leave here or there and would not use his full entitlement. However, after his marriage, his wife insisted that he take reasonable breaks and he then began to take two weeks leave at a time. Even when he was away, he would ring his office regularly to make sure that everything was running smoothly and to discover if there were any urgent matters to be dealt with. He said, "It was difficult to get away from the place; it was in the blood."

(d) Willingness to delegate

13.105 One of the problems about Mr Johns' style of work was that he tried to do too much himself. He clearly held on to far too much of the lending division's work, acting as account manager for, at least, most of the largest loans - until pressure of work on the ABL merger forced him to delegate a lot more. He also ran the investment banking business as a one-man operation.
Neither of these could be described as good management practices, and when asked about any regrets that he might now have about his work as managing director between 1986 and 1989, he said that he probably should have had more experienced senior staff, and should have delegated more.

(e) Credit committee

The composition and formal functions of the three Tricontinental credit committees are dealt with in the first report at paras 20.24-29. The only committee which the Commission has looked at in any detail is the lending and underwriting commitments credit committee, and the Commission has only been concerned with its lending transactions.

However effective the lending credit committee may have been in dealing with proposals put forward by the less senior lending officers, the only possible conclusion is that it was ineffective in handling any proposals in which Mr Johns was closely involved. Although, as noted earlier, Mountford or Stott might occasionally make some minor suggestion to Johns about one of his transactions, the credit committee was quite often faced with a submission which Johns had already approved under his discretion, and in other cases the submission bore his name as account manager. In these circumstances it can only be concluded that the real purpose of circulating those submissions to the credit committee was to keep its members informed of what was happening in the lending area. There was almost no possibility that any of those submissions would be turned down by the credit committee. If the matter was within the managing director's discretion, the credit committee had no power to disallow it; in cases where proposals originated from the managing director, witnesses could only remember one occasion when the managing director accepted the view of the credit committee that the matter should not proceed - because of circumstances of which he had not been aware. Mr Mountford said that this occurred in late 1988 or early 1989.
(f) Internal audit

The managing director's complete control of the internal audit process has been dealt with in the last chapter. He used it, quite properly, to check particularly those areas of Tricontinental where, because of his inexperience, he felt vulnerable. On the other hand, he was intolerant of any suggestion that the audit might touch on any area of his own decision-making. He did not want to be told how to run Tricontinental. In this way he, and the board, were deprived of potentially useful outside advice on any of the major issues affecting lending policies and practices.

J.

As Board Member

(a) Relations with other board members

Johns gave evidence of the high regard he had for Mr Moyle. He said "There was never any formal reporting lines between myself and Bill Moyle, but I always considered informally that I did report to Bill Moyle. At board meetings, if there was ever a matter on the table which some of the directors weren't sure of, they would always turn to Moyle for his opinion ...".

Later in his evidence he described Mr Moyle as "a very experienced banker, very experienced ... as a merchant banker [with] a great wealth of knowledge." He also said, "... I did spend more time talking to Bill than other directors. ... when he did want something I jumped to it. ... He was a lot older than I was, and had a lot more experience than I had. He was very well connected in the industry."

So far as Mr Ryan was concerned, Johns said that Ryan's ability as a merchant banker was limited, but that he was keen to learn and to keep his "ear and nose close to the ground" and know what was going on. He was glad to have a weekly discussion with Mr Ryan while he was 'on his P plates' but protested at Ryan looking over his shoulder after he felt he was
on top of the job. He said that after this time, if he needed to talk to a
director, it would normally be either Smith or Moyle.

13.113 Mr Ryan believed that, from the beginning, Johns resented board
interference. He considered that he should be fully in control and believed
he had the capacity to run the business virtually by himself. After Johns
won the 'young executive of the year' award in 1986, Ryan detected a
change in Johns' attitude. "He became much more arrogant and strong-
minded. He seemed to regard himself as virtually infallible."

13.114 Mr Smith, the chairman of Tricontinental during the relevant time, who
might have been expected to have a particularly close working relationship
with Johns, said that:

"Mr Johns' behaviour at board meetings never caused me any
concern. On occasions he became a little impatient with repetitive
questioning on some particular aspect of the company's operation or
because of comments made at the board table that he regarded as
irrelevant to the subject-matter under discussion. However he
always answered any queries that were raised and provided any
information that was sought."

13.115 It is perhaps significant that, at the crucial SBV board meeting on 21 May
1989, the view was express by Mr Morton that "Smith and Johns are
close." When Smith had been invited into the meeting to express his views
as chairman of Tricontinental he had said, among other things, that he had
declined to sack Johns following a discussion with the Premier, because he
did not have sufficient proof of wrong-doing to warrant such an action. He
also volunteered the statement that Tricontinental was undoubtedly a "one
man band (Johns)".

13.116 It seems reasonable to conclude that Johns and Smith in fact enjoyed a
good working relationship, and Smith had some admiration for Johns' abilities and was less critical of his manner than some of the other directors were.
For example, there was no love lost between Johns and Rawlins. Johns said in his evidence that, because Rawlins knew more than he did about treasury matters, he was constantly sniping at Johns in this area.

The circumstances of Mr Rawlins' resignation from the board of Tricontinental in May 1988 are fully set out in paragraphs 18.45 to 18.67 of the first report, and need not be repeated here. It is difficult to escape the conclusion that Rawlins was one of the only two board members - the other being Mr Ryan - who could see that Johns was becoming too autocratic and that his powers needed to be reined in. When he took his concerns directly to Mr Moyle, saying that unless Johns' powers were restricted he would resign, Moyle elected to back Johns rather than Rawlins. He said in evidence, "Mr Rawlins asked me to do something which was not within my power to do, I do not know how I would have curbed Mr Johns any more effectively that he could have curbed Mr Johns ...". This can only be categorised as a weak response from the chief executive officer of the sole shareholder in Tricontinental. Although Mr Rawlins’ appointment to the board of Burdett, Buckeridge & Young Limited, the stockbroking joint venture with SBV, was perfectly sensible, his removal from the board of Tricontinental can only be seen as a victory for Mr Johns. It left him free to carry on as before, without having to face his most severe critic at board meetings. As Mr Moyle told the Commission, "I had already perceived that Mr Rawlins' concerns about Mr Johns was approaching the disruptive stage".

K. Conclusions and Findings

(a) Appropriateness of initial appointment

The Commission has identified a number of serious failings which are now apparent in Mr Johns' management of Tricontinental, many of which were no doubt related, at least in part, to his age and lack of experience on appointment.
Nevertheless the Commission does not accept that his appointment constituted negligence on the part of those involved. It was clearly, with hindsight, a bad error of judgment. But in view of his success, up to 1985, as a lending manager left pretty much to his own devices, the impression he made on Mr Ryan, his general acceptance by other senior staff, and the absence of any obvious competitor, the Commission cannot say that the decision to appoint him was unreasonable.

(b) Responsibility for systems and practices

In his evidence, Mr Johns made the point that the systems in operation at Tricontinental during his time as managing director were, almost entirely, inherited from his predecessor Mr Redenbach's time. He also argued that he had received no guidance from either the board of SBV or from its chief executive officer, Mr Moyle, as to how Tricontinental should be run. When he and Mr Ryan sought guidance during Mr Ryan's term as managing director, all that Mr Moyle indicated to them was that there should be "more of the same".

The Commission is prepared to accept that both these claims are justified. However it must also be said that Johns was given a very free hand in his role as managing director and there is no reason to think that he could not have made any changes that he wished in the systems or practices of Tricontinental. The fact that he showed comparatively little interest in making changes may well be attributed to his youth and inexperience. Whatever the reason, it must be concluded that, by 1988 at least, those systems and practices were in place because they suited Johns' style of management and assisted him in his aims.

(c) Responsibility for strategic planning

Mr Johns must be given credit for initiating a three year plan soon after he became managing director, and for the amendments to that plan which were put in place during the years that followed. He had sound ideas about the
need for Tricontinental to diversify its activities and, in particular, to give more emphasis to those services which attracted fees without involving credit risk to Tricontinental.

However, although some steps were taken to develop corporate advisory and other fee-based activities, little was achieved by way of balancing Tricontinental's lending activities. In view of the fact that Johns himself put most of his effort into investment banking and acting as account manager for almost all the largest loans of Tricontinental, it is not surprising that Tricontinental's activities remained seriously out of balance. In fact, of course, Tricontinental's acquisition of 'assets', in the form of loans to clients, generally exceeded the budgeted figures.

(d) Responsibility for decisions leading to losses

There can be no doubt that Mr Johns must accept the primary responsibility for these decisions. This is so for the following reasons:

(i) It was he who developed the policy, in his three year plan and in annual reports, that Tricontinental would pursue high risk for high gains. This was to take the form, particularly, of becoming involved with innovative and adventurous new businesses and "growing with them". The unspoken corollary was that, if the businesses failed, Tricontinental would suffer with them. And if enough of them failed, Tricontinental would also fail. This was the inevitable consequence of lending amounts exceeding Tricontinental's capital base to a significant number of different borrowers.

(ii) In most cases the primary decision to grant the loan which ultimately failed was in substance made by Johns alone. The potential borrower dealt directly with him and it was he who agreed to make the loan, specified the conditions on which the loan would be made, and sent it off to the credit department for a credit submission to be prepared in accordance with his instructions.
(iii) In fixing terms and conditions for each new loan, it was Johns’ practice to concentrate upon the fees which would be earned and the apparent security which was to be taken. From a study of the large number of credit submissions for which he was directly responsible, it is possible to conclude that, so far as he was concerned, security was all-important, and the question as to how a loan was to be serviced was a problem for the borrower rather than the lender. In these circumstances, his frequent failure to obtain adequate security must be a matter for severe criticism. Time and again he accepted, as the basic security for a loan, either shares in the operating company which would generate the income to service and repay the loan, or a debenture mortgage, with an unrealistic value, over the business of that company. He seems to have been quite unconscious of the obvious fact that, if the security ever had to be called upon it would be because the borrower was in serious financial difficulties; in that situation the chances were that any company upon which it was depending for its income was also having considerable difficulties; it therefore followed that the value of that company’s saleable assets, or of the shares in that company, would be seriously depleted, if not extinguished. A further matter for criticism was that, where security was taken in the form of a mortgage over shares, there was nothing to stop the borrower from pledging the most valuable and realisable assets of its business to another lender, leaving the value of the business as a whole greatly reduced.

(iv) All this activity of Johns’, in agreeing to loans and settling the terms and conditions of them, was done without any checks or balances from other senior managers or credit analysts. It is clear that once Johns had made a decision - which he invariably did without consultation - the credit analysts regarded their task in preparing the credit submission as being basically clerical, with no suggestion that they should draw attention to any potential defects in the loan. Similarly, Stott and Mountford might occasionally make a helpful
suggestion about a loan which Johns had initiated, but they did not see it as any part of their tasks to examine his decisions critically and draw attention to potential risks in them. They both had respect for his judgment which appeared, until about March 1989, to have produced good results for Tricontinental.

(v) Johns saw to it that the submissions which went to the board, seeking approval for those transactions which he had commenced, were framed in such a way as to stress the profits and the security of the loan and not to draw attention to any high risks involved.

(e) Responsibility for not fully informing the board.

Although it is clear that, in many instances, Johns did not make a full disclosure to his fellow directors, who were asked to approve a loan, of all the possible risks inherent in it, the board must also share responsibility for this circumstance. Some at least of the deficiencies were apparent on the face of the credit submissions and, although it was generally agreed that Johns gave adequate answers to questions put to him by other directors, his impatience with any close questioning was very apparent. Mr Ryan was particularly conscious of it, and it eventually became too much for Mr Rawlins, who complained about the managing director's "cavalier attitude to doubtful debts as the board was not always fully informed" and, when he could get no backing from Mr Moyle, he resigned.

The credit submissions put to the board were obviously deficient in a number of ways:

(i) The financial details of the borrower, or any related company from which cash flow had to come, were quite often out of date or entirely absent. When financials were given, they frequently took the form of management figures, although audited results should have been available. There was no process for making audited results available to the board later if they differed significantly from the management figures supplied in the credit submission.
(ii) Whether or not financial details were provided, there was often no indication as to the precise source from which interest payments would be made. And the source of ultimate payment was often stated in broad terms such as 'sale of assets or re-financing'.

(iii) The purpose of the loan was often not clearly stated. The directors were quite willing to accept a statement such as 'purchase of shares in listed companies' and leave the approval of the particular purchases entirely to the managing director. The expression 'working capital' was frequently used as a description of the borrower's purpose. In a number of cases which have come to the notice of the Commission, this description has proved to be quite misleading. In any event, Johns apparently believed it was within his discretion to approve any change in the purpose stated in the credit submission. While he had this attitude, of course, it mattered little what the credit submission gave as the purpose of the loan.

(iv) There was no attempt in the credit submission to highlight any of the risks involved in the proposed loan or, indeed, any departures from guidelines which the loan represented. Mr Johns made it quite clear in his evidence that he regarded it as the responsibility of each director to decide whether any risks which could be identified by carefully examining the credit submission, were commensurate with the fees which he had determined for the loan in question.

(v) The suspect nature of the security offered in a number of cases, for reasons set out above in para 13.125(iii), should have been just as obvious to the directors as to Mr Johns. There were many cases, when shares were provided as security, where it must have been apparent that, if the security were called upon, it could not be expected that the shares would retain the value they held at the time the loan was granted.

13.128 There were other less obvious ways in which the credit submissions presented over Johns' name as account manager, based on information
supplied by him, and approved by him as a member of the credit committee, were deficient. Thus information was sometimes quite misleading. The following examples will suffice:

(i) **Atoll - TR 1**
This is a case where approval of the main facility was given by directors without a written submission. However, Johns gave evidence of his belief that a submission created after approval would go to directors for information. In any event it is fair to assume that the later submission contained everything that was told to directors in the first instance. That submission failed to state that the borrower was in default of security covenants for a very much smaller facility. And when the time came to renew the facility, some eight months later, important information in Johns' possession, concerning the financial position of the persons directly involved with the loan, was withheld from directors.

(ii) **Tibham - TR 3**
Johns and Mountford were jointly responsible for this credit memorandum. Johns had put the deal together in the first place and given Mountford the necessary instructions to draft the credit memorandum. The credit memorandum did not indicate that the $45m facility was for a leasehold over airspace, or make any reference to the requirement of development or building approvals. The memorandum stated that the chief security would be a first registered mortgage over the site. A careful study of accompanying papers would have shown that the borrower was to have a 99 year lease over the site. It would not have shown that only airspace was involved. The directors were not told that the reason for urgency was that payment for the 99 year lease was overdue. Nor were they told that development approval had not even been sought from the local council.

(iii) **Mainsel - TR 4**
As in the case of Tibham, Johns had the initial dealings in the
present case and was the co-author with Mountford of the first credit submission. That submission was deficient in that it did not distinguish between the 25% of the site which was freehold and the 75% which would only become freehold after construction was almost complete. Security was said to be a first registered mortgage over 192 Anne Street Brisbane, without indicating that this only related to one-quarter of the site. Other items of security listed were much more problematical than this freehold mortgage.

(iv) EDL - TR 5

Once again Johns and Mountford were jointly responsible for the initial credit memorandum. The memorandum stated that the proposed acquisition of a company known as Intellect Electronics Limited by the Essington Group was "part of Malcolm Edwards' plans for an entertainment division." Mr Edwards gave evidence that this was untrue and in fact the purchase was forced upon him by Johns and Mountford as the condition of a further facility which he badly needed for Mainsel. In August 1988 Johns had lent a total of $10m to Intellect and another company in the Rothwell Group. Although expressed as a loan, the transaction amounted to a purchase because there was, apparently, no intention that the moneys would be repaid. The loans had deliberately been split between the two companies so that they could be made within Johns' discretion and he would not have to inform the board that he was dealing with Rothwells.

(v) DAC - TR 6

Johns was the account manager for these complex transactions. The credit submission of October 1986 for $20m to enable DAC to bid for Enacon, was seriously deficient in that it did not refer to Tricontinental's existing exposure to DAC through Smith and Lane Holdings and Rocado Holdings facilities. A significant internal review of DAC in October 1986 was not referred to in any later submissions put before directors. When the Smith and Lane
Holdings facility went into default in July 1988, Johns instructed Mr Hunter to exclude it from the summary of non-accrual loans and the arrears reports to the board. In November 1986, Johns put forward a credit submission to approve a $5m facility to Churchill Leisure Industries, to provide bridging finance until the receipt of the proceeds of a rights issue, to raise $5.3m, were received. The submission did not disclose the fact that the proceeds of that rights issue were already committed to repaying the previous Amaldela facility.

(vi) Qintex Limited - TR 7
Johns was responsible for this confusing credit submission. The cover sheet may have shown $50m or $25m when it was seen by directors. The recommendation was for a facility of $25m. Johns signed a letter of offer for $75m.

Finally, Mr Johns obviously regarded himself as being free to change the identity of the borrower, or to vary or disregard preconditions which were contained in the credit submission and upon which other directors may well have relied. Because earlier credit submissions were never placed before them when they were asked to extend a loan, or make an additional loan, directors seldom, if ever, became aware of such changes by the managing director.

Johns' attitude to his fellow directors, as evidenced by the wide range of transactions reviewed by the Commission, was not one of seeking to share responsibility. One could well have imagined that a young managing director, having older and much more widely experienced directors on his board, might have wanted to involve them in the real decision-making process. He might have wanted to discuss pros and cons with them in a frank manner and try to arrive at a consensus as to the wisdom of a particular loan.
There is not the slightest evidence of any such attitude on the part of Mr Johns. He clearly regarded the round robin process of loan approvals as a formality to be complied with, and his fellow directors as a source of possible obstruction to his plans, which had to be overcome. If any of them expressed doubts about a particular loan transaction which he had arranged or endorsed, they had to be persuaded of its desirability.

(f) Responsibility for failure of duty as a director

It will be apparent, after what has previously been said, that the Commission takes the view that Mr Johns failed in his duties as a director in a number of ways. It must now give consideration to whether proceedings should be taken against him under s229(2) of the Companies (Victoria) Code.

Whereas the other directors have all submitted themselves to detailed examination by the Royal Commission, and undergone a great deal of stress and embarrassment in the process, Mr Johns has chosen to give evidence only on the most general matters and has pleaded the danger of self-incrimination in refusing to give evidence about any of Tricontinental's transactions. It certainly seems appropriate that he should be publicly called to account for his breach of duty as a director. That question will be dealt with in the final section of this chapter.

In so far as Mr Johns may have been guilty of conduct more serious than a failure to act with reasonable care and diligence in the performance of his duties as managing director, these matters will be the subject of a confidential report in volume 4. This will involve, in particular, consideration of his conduct as the manager of all Tricontinental's 'category A' investment banking transactions. Since he is already awaiting trial in relation to one such matter, it is appropriate that anything further the Commission wishes to say on that subject concerning Mr Johns should be in confidence, at least for the time being.
Possible breaches of s229(2) of the Companies (Victoria) Code

13.135 Counsel assisting, in their final addresses, submit that in the great majority of the lending transactions considered by the Commission, an action would lie against Mr Johns for breaches of s229(2) of the Code. This provides a maximum penalty of $5,000 for an officer of a corporation who does not, at all times, "exercise a reasonable degree of care and diligence in the exercise of his powers and the discharge of his duties." Counsel identified 18 cases in which they argued that such a prosecution could be brought.

13.136 The Commission has given most anxious consideration to this question, particularly bearing in mind the factors mentioned in para 13.133. However, in the final analysis, it has not been able to conclude that such proceedings would be justified. It has reached this conclusion for several quite different reasons.

13.137 In the first place there are the positive arguments which can be put in Mr Johns' favour. The most obvious point to be made is that he has not been heard in his own defence; and it has been convenient for most of the witnesses who have given evidence to attribute a major share of the blame for what happened to Tricontinental to its managing director. This failure to give evidence was, of course, by his own choice. He reached the conclusion that he would not give any detailed evidence on the basis, presumably, of fresh advice received late in the Commission's hearings. The Commission prefers to believe that it was late advice which he accepted because, if he had intended at all times to take this course, then the Commission was deceived over a period of many months, during which time it made representations to Government about legal assistance which he would need for the 6-10 weeks he would be giving evidence. See also paras 3.19-3.23 above, and para 3 of Appendix 7, below.

13.138 However, those circumstances seem to point to a change of heart rather than a deliberate deception. The Commission questions whether the late
advice was well-conceived, since Mr Johns has deprived himself of the opportunity to put his case publicly. But he has made his choice and the Commission must do the best it can in the absence of his evidence.

The Commission has been careful not to draw any general adverse conclusions about Mr Johns by reason of his concerns about self-incrimination. On the contrary, the Commission has tried at all times to see matters from his point of view, even without the assistance of his evidence. But when sworn evidence has been given which is, on its face, quite credible, the absence of any contrary evidence from Mr Johns has left the Commission with no choice but to accept the material put before it.

Among the matters which the Commission has been prepared to take into account in Mr Johns' favour are, first, his youth. He was appointed managing director at the age of 32, so his knowledge of business affairs and his experience of a variety of economic climates and corporate situations was necessarily limited. As explained in chapter 10, he inherited a situation which was fraught with danger, particularly in the high concentration of exposures to a comparatively small number of very daring entrepreneurs. And all this occurred in the euphoric atmosphere of the late 1980s when older, and more experienced, heads than his were being turned by the frantic competition for a share of the financial market. To put the matter in its most favourable light, many of his failings could be put down to an over-enthusiastic view of the state of the economy or an over-zealous concern for Tricontinental's market share.

There can be no question about Mr Johns' dedication to his job. He worked extremely long hours, drove himself hard all the time, and tried to master those aspects of Tricontinental's business with which he was unfamiliar. Further, although he was well paid by ordinary banking or commercial standards, there is no evidence to suggest that he indulged in any elements of a high lifestyle - apart perhaps from taking some interest in
horse racing. His workload did not permit him to enjoy the so-called good life.

Where Mr Johns can properly be criticised is in his management style. He was arrogant - in the dictionary sense of "having an exaggerated opinion of his own ability". He arrogated to himself far too many of the day-to-day decisions of Tricontinental - particularly those in the fields of lending and investment banking. He did not consult with other senior managers in these areas; he resented criticism, particularly within those areas which he saw as his own; and he discouraged any genuine checks or balances which might have called his decisions into question.

All this resulted in a number of bad decisions being made in haste and after quite inadequate investigation. To the extent to which other directors were involved in decision-making in the lending area, they became victims of the speed of action with which Johns was so determined to impress his clients, and which, so often, resulted in inadequate or defective information being put before directors.

As well as leading his fellow directors into very dangerous lending decisions, Mr Johns also saw himself as free to change those decisions in major ways without further consultation, or reporting back to the board what he had done. These changes, seen in a number of cases, involved the substitution of a different borrower, a complete change in the purpose of the loan, the substitution of a quite different form of security, or the waiving of an important precondition to drawdown.

And when loans turned sour, as so many did, Mr Johns was most reluctant to admit the fact. He would do anything he could to delay such an admission - including sending good money after bad in the hope that, somehow, the client would be able to retrieve the situation.
13.146 Although these were very serious faults in Mr Johns' administration, they amounted to an improper course of conduct, rather than a series of cut breaches of duty. It is one thing for the Commission to be satisfied of its findings, after hearing detailed evidence over twelve months, and receiving a large number of carefully considered submissions. It would be quite a different matter for a court, applying criminal standards of proof and divorced from a detailed knowledge of the general background and atmosphere, which has become so familiar to the Commission, to be satisfied of a failure to "exercise a reasonable degree of care and diligence" in a particular transaction. Difficulties would be compounded by the very poor documentation available in a number of instances. Some of the worst decisions were reached as a result of telephone conversations, either between Johns and some of his fellow directors, or involving the use of some senior officer as an intermediary. In the great majority of cases, the other persons concerned now have little or no memory of what was actually said in these important conversations. The general nature of the conversation is apparent from whatever documentary material is available, but the details are lacking.

13.147 In many cases, the details of a conversation between Mr Johns and another director will have depended upon his previous conversations with the potential borrower. If these were recorded by Mr Johns at all, the record usually only contained the merest outline of what was said. In many instances, no record at all has been found. If proceedings were brought, it would be for Mr Johns to decide whether to give evidence or not. Either way, the difficulties facing the prosecution would be considerable.

13.148 In any event, the Commission has very grave doubts as to the appropriateness of using s229(2) for the purposes of criminal prosecution. If it is to be used at all, it must be in relation to clearly defined actions; it is not practicable to apply it to a general course of high-risk behaviour. And another practical defect of the section is that the potential penalty -
$5,000 in the worst case, is out of all proportion to the very high costs which would be involved in bringing to trial any case which might be contemplated arising from Tricontinental's collapse.

The truth of the matter is that, although Mr Johns must accept a major share of the responsibility for that collapse, his faults lay in his over-confidence in his own abilities, and in a management style which kept so many major decisions to himself, rather than in his failing to exercise care and diligence in any particular instance. Arrogance, lack of business acumen, lack of candour amounting at times to deviousness, and unwillingness to admit error, are all personal failings. They ought not to be treated as if they were criminal offences.
CHAPTER 14

THE PERFORMANCE OF TRICONTINENTAL'S MANAGERS

A. The Questions To Be Asked

14.1 In reviewing the way in which the senior managers of Tricontinental carried out their duties, it is necessary to bear in mind the underlying purposes of such inquiries. The most basic purpose is to find out what part the managers played in the matters or events which "have caused or contributed to the present financial position" of Tricontinental or "the financial losses suffered by" Tricontinental (term of reference 3).

14.2 Further, the question must be asked whether "the affairs, activities and transactions" of Tricontinental "were adequately or properly supervised, directed or controlled" by these managers (term of reference 5).

14.3 In considering these questions, it is also necessary to ask whether the managers, if they were "executive officers" within the meaning of the Companies (Victoria) Code ("the Code"), exercised "a reasonable degree of care and diligence" in the discharge of their duties (s 229(2) of the Code and terms of reference 1 and 2). There is no suggestion, in the evidence before the Commission, that any of the managers dealt with in this chapter obtained any improper personal benefit from the exercise of their managerial functions. In two cases, counsel assisting submitted that the evidence disclosed a failure to act honestly in respect of a loan transaction, within the technical meaning of that term as used in s229(1) of the Code. The Commission does not accept those submissions; see paras 14.80-81, and 14.357-361. See also paras 14.48-51.
B. The Identification of Key Managers for Present Purposes

14.4 In accordance with its terms of reference, the Commission has concentrated on those areas of Tricontinental’s operations where substantial losses occurred. This involves, in particular, the lending, project finance and credit and securities divisions, and the investment banking business.

14.5 The Commission has examined privately several transactions of the international division and has considered publicly two transactions involving the corporate services division. However neither of these divisions contributed in any significant way to Tricontinental’s losses, and no evidence was found suggesting any illegal, improper or corrupt conduct. Accordingly, the roles of the managers of these divisions are not dealt with in this chapter. The same is true of the treasury, futures broking, foreign exchange, and investment and funds management divisions.

14.6 The senior managers whose roles are covered in this chapter are Mr Ken Mountford, the general manager lending, Mr Lynton Stott, the assistant general manager credit and securities, Mr Neil Hunter, the group manager securities, and Mr Warren Atlas, the assistant general manager project finance. These managers reported directly to Mr Johns, who personally managed the investment banking business. Although Mr Hunter formally reported to Mr Stott, it is clear that he enjoyed a good deal of independence and that Mr Johns normally dealt directly with him.

14.7 These were the managers who were best placed to have influenced the course of events which led to Tricontinental’s losses and its eventual collapse, from Australia’s largest merchant bank, to one of Australia’s most significant corporate failures.
C. Kenneth Wilson Mountford

(a) Background

14.8 Mr Mountford joined Tricontinental in May 1986 as general manager lending and international. In 1987 his position became that of general manager lending when the international sub-division was merged into a separate international and foreign exchange division.

14.9 Before joining Tricontinental, Mountford had approximately twenty years experience with Westpac Banking Corporation ('Westpac') and its predecessor, the Bank of New South Wales. Approximately twelve years was spent in various lending departments. For nine of those twelve years he was primarily engaged in lending to the top three hundred companies. He had no formal professional qualifications.

14.10 Mountford considered that lending to the top three hundred companies involved the same fundamentals as lending to Tricontinental's clients. However, he considered himself to be experienced in a different part of the market from that in which Tricontinental operated. He believed the lending undertaken by Tricontinental, such as lending for construction finance or equity investment, to be a different type of lending from that which he had known before.

(b) History at Tricontinental

14.11 Of his three years employment with Tricontinental, Mr Mountford said:

"It took me approximately twelve months to get to grips with Tricontinental's operations. I spent this time getting to know the practices, procedures and philosophy in place within Tricontinental. Tricontinental had in place a system of general guidelines designed to give new staff a 'feel' for the company. ... The guidelines did not provide step-by-step procedures for assessing loans as new staff were only employed on the basis they had prior experience within a lending institution. ... It took me some time to get to know staff systems and functions."
Mr Johns said, "There was a phasing in period for Mr Mountford to allow him to find his feet and to find the systems of Trico. [He] probably took a good 12-18 months before he really came on stream as general manager."

14.12 Mountford was employed by SBV after its integration with Tricontinental on 21 May 1989. He remained in that employment until March 1990.

(c) Functions

14.13 Before Mountford's employment with Tricontinental he had several discussions with Mr Johns during which Johns told him that, as general manager lending and international, he would be responsible for the administration of lending operations and the administration of the international division's lending transactions (specifically eurocurrency loans).

14.14 No job description was given to Mountford when he began his employment with Tricontinental. However, a general description of his responsibilities is found in Tricontinental's submission to the Reserve Bank dated 18 January 1989:

"... to control and direct Tricontinental's lending area to ensure lending proposals are in accordance with the board's requirements and that all lending arrangements entered into provide an acceptable return within the risk constraints assessed. In addition, he is responsible for ensuring that the spread of lending complies with the group plan with respect to industry coverage, client credit worthiness, amount of loan and client size."

14.15 Mr Mountford's account of his responsibilities at Tricontinental included the following:

(i) meeting daily with the Victorian regional manager;
(ii) receiving weekly reports from regional managers in relation to lending proposals and problem loans;
(iii) membership of the credit committee;
responsibility for the co-ordination and follow up of most problem loans - after the stock market crash in October 1987, 70% of his time was related to problem loans;

(v) membership of the management committee which met with Mr Johns on a weekly, or at least fortnightly, basis; Mountford would report to the committee the actions being taken to effect loan recovery;

(vi) informing Mr Hunter of the various actions and initiatives being taken concerning problem loans - to assist Hunter in the compilation of monthly problem loans reports;

(vii) some peripheral involvement in the preparation of the 'operational report - lending', which formed part of the managing director's monthly report to the board; and

(viii) full control of the files for which he was responsible - his major clients had facilities in the range of $30m to $40m; larger facilities were controlled by Johns.

14.16 Once a loan had been 'marketed' by the lending department, a credit submission was then prepared by the credit and securities department and approval for the loan obtained. The facility then came back to the lending department for monitoring unless it was a loan under the direct control of Mr Johns. Mountford considered Johns to be the supervising officer, or account manager, for approximately 70% in dollar value of Tricontinental's loans.

14.17 Mr Wigginton, assistant general manager lending from May 1988, reported directly to Mountford. He said in evidence that he had a good working relationship with Mountford. Wigginton considered Mountford to be a "very capable banker" and manager.

14.18 However, Mr Gynther, regional manager of lending for Victoria and Tasmania from July 1985 to January 1987, said in evidence that he "didn't
believe Mr Mountford had the ability to do the job", and considered Mountford lacking in experience and judgment.

(d) Relationship with Ian Johns

14.19 Mountford first came into contact with Johns during his employment at Westpac. While employed by Westpac, Mountford was responsible for Tricontinental's money market account and was instructed to reduce Westpac's exposure to Tricontinental. Before his recruitment by Tricontinental he had four or five discussions with Johns, which persuaded him that he should join Tricontinental.

14.20 In his capacity as general manager lending and international, Mountford reported directly to Johns. During his initial two years with Tricontinental, Mountford met Johns almost on a daily basis to discuss Tricontinental's loan portfolio and administrative matters. In the later part of 1988, Johns' work load increased due to the proposed merger between Tricontinental and Australian Bank Limited. Mountford's meetings with Johns became less frequent. They would meet on average every second day and would discuss loans in default at least twice every week.

14.21 Mountford made the following comments about Johns:

(i) "In matters relating to lending, Johns was a very strong-minded and a forceful personality. As far as I was concerned, I respected his business acumen. If a loan submission did not originate from him he appeared to maintain an open mind on the approach to be adopted to the loan submission."

(ii) "Whenever I regarded a loan as doubtful, I raised my concerns with Johns. He always managed to reassure me that problems could be solved. I perceived he had a flair for trading out of problems."

(iii) "My view was that clearly [Johns] was a dynamic leader and I greatly respected certain capacities. His capacity of recall, his marketing skills and ... to effectively be account manager for 70% of the book was something I admired. It was certain that he wasn't the easiest person to work for, but [on] balance, I respected his skills, his judgment, and at the time I had no reason to be
concerned about any other matters that have subsequently appeared before courts. I thought his sincerity and integrity was without doubt."

14.22 Mountford had a limited social relationship with Johns and no business relationship with him outside Tricontinental.

(e) Awareness of, and responsibility for, deficiencies in systems.

14.23 The only lending guidelines issued to staff during Mountford's employment with Tricontinental were the lending guidelines dated June 1986 (unchanged since November 1984) and their 1988 amendments. Mountford considered that these guidelines "did not represent rigid policy but were intended to convey general guidelines to new and junior lending staff".

14.24 Before the October 1987 stock market crash and up until early 1989, Tricontinental had a manual system for monitoring the value of shares held as security. According to Mountford, the system relied on market value as the monitoring measure. It did not review the asset backing of the shares, except in isolated instances. Following the stock market crash, Tricontinental would update the market values of shares held as security, and calculate the shortfall, three times daily. Mountford considered that Tricontinental was very quick in seeking top-up. The notes of an interview with the internal auditors on 29 November 1988 recorded that Mountford wanted a far better system for monitoring shares and that he considered the system of "... manually prepared revaluations and reports [led] to embarrassing mistakes." He gave evidence to the same effect. He said that a computer-based system linked directly to the Stock Exchange would have reduced the time taken and the potential for manual error. However, he did not consider that the lending department's ability to monitor the position was compromised by the absence of such a system.

14.25 Mr Mountford thought the separation of the lending division and the credit and securities division essentially provided for the credit area "to undertake
an independent assessment from the lending or marketing area, without undue influence from the lending team. However, to have the credit decision process kept totally separate, in his opinion, meant that there was some double handling. He said that, with the aid of hindsight, the only change he would make to the credit submission process was that the analyst compiling the credit submission would be in the lending stream. But the overall credit risk control, the monitoring of policy, and indeed assessments of credit, would be undertaken by a separate credit team.

14.26 According to the notes of an interview between Mr Mountford and the internal auditors on 29 November 1988, Mountford was aware that there was no policy about peak exposure to any one client group. He said in evidence that until he started working for SBV, after the integration of Tricontinental into SBV, he was not aware of any understood or arranged ceiling or limitation on the loans Tricontinental could make. He had relied on the managing director or the board to step in if understood limits were being exceeded. He was aware that, although gearing levels were constantly monitored, they had not always been observed by Tricontinental.

14.27 Mr Mountford considered that the system whereby credit submissions were passed around to credit committee members, rather than discussed in committee could, in hindsight, have been better. He said "I think it would be beneficial had we had regular meetings to discuss credit proposals. It would have given everyone a better understanding".

14.28 He considered Tricontinental's exposure to property to have been around 50%, and he was at no time concerned about that level of exposure. However, following the 1987 stock market crash, he was concerned about the level of exposure to equities.

14.29 Mr Mountford said that the credit committee was constantly monitoring the progress of particular facilities. The members were regularly exposed to
either internal reviews or fresh submissions with regard to any particular client. Where a loan was approved under the individual discretion of an officer, all relevant documentation, including the credit submission, would go to credit committee. In his opinion, this meant that the credit committee was well informed as to the manner in which Johns and other officers were exercising their discretion. He considered that he had "a real appreciation of what was happening in terms of lending division".

(f) Responsibility for changes or improvements in systems or practices.

14.30 The industry exposure limits were in place when Mr Mountford arrived at Tricontinental and they did not change during his three years there. He saw nothing wrong with these percentages and so made no suggestions for change.

14.31 He did believe that it was appropriate for him to have some input into the prudential policies and practices concerning the lending function. He believed this responsibility extended to dealing with the appropriateness of borrowers, concentration of lending risk in terms of total exposures to groups or individuals, and the type and adequacy of security taken. Although, at the time, he considered that he had fulfilled those responsibilities adequately, he has said that, "In hindsight of the losses, I have a question mark in my mind". Mr Mountford was unable to expand on this comment in his evidence other than to say, "If we [had] put ceilings on equities, the losses in isolated cases wouldn't have been as high".

14.32 He said that, although monitoring problem loans, anticipating further problem loans and watching for the emergence of problems in other loans were an important part of his function, the idea of creating an early warning system that might enable better management of problem files was not specifically discussed with the group managing director or at any
management meetings. This is despite an internal auditor's report on credit risk analysis dated December 1988 which stated:

"... the current method of identifying potential bad debts relies heavily on the actual failure of a client to meet a financial obligation due to Tricontinental.... It is recommended that a higher priority be given to monitoring the potential failure of a client's obligation to Tricontinental, with relevant policy directives to be added to the appropriate sections of the existing policy documents."

14.33 Mountford said that the lending guidelines were essentially in place when he joined Tricontinental in May 1986 and that he simply added to them from time to time. In a memorandum to Mountford and Stott dated 17 February 1987, Johns requested a paper be prepared for presentation to the board detailing Tricontinental's policy in regard to margin lending. This paper was included in the managing director's report for February 1987, which contained a section headed "lending guidelines - public listed companies". This purported to provide directors with an "update of current policy and guidelines ... in view of the sustained bull market and potential volatility". These guidelines differed considerably from those contained in the existing (June 1986) lending guidelines. The June 1986 guidelines were expanded to identify circumstances in which increased cover was required and where lower cover would be acceptable. Security requirements, such as a first registered share mortgage, lodgment of scrip, signed blank transfer, and supporting guarantees were added. Additional monitoring controls were also included. This paper was later incorporated into the January 1988 lending guidelines, and Mountford was named as the source.

14.34 In response to a request from Mr Ziebell, Mountford prepared a memorandum dated 18 January 1988 recommending certain variations and additions to the lending guidelines. The memorandum contained two significant amendments. The first provided expressly that the board could exercise its discretion to approve certain facilities that would otherwise breach the lending for construction guidelines. The second provided that, following the severe downturn in the share market, Tricontinental generally
required higher than minimum share cover and/or the capacity to meet margin calls to be clearly demonstrated before a facility was made available. The amendments, which were included in the guidelines dated July 1988, are shown in Attachment 22A to the first report.

14.35 In a memorandum dated 5 May 1989 Johns told Mountford that, "Directors are seeking a complete re-assessment of credit policy which is to be discussed at the next board meeting and therefore your comments and thoughts would be appreciated." The memorandum also contained the following amendments suggested by the board:

"All clients to demonstrate ability of repayment not refinancing.
More rigid limits on security of shares. Minimum 1.5 times and acceptable shares limited to well traded stocks.
Higher scaling factor to apply to debenture mortgages and only stock and debtors. Stock term, debtor quality etc. to be taken into account.
Property development - no 100% funding or carried interest. Maximum lending ratio 75% of valuation unless separately insured."

In response, Mountford suggested some important changes to the lending guidelines. These are set out in paragraph 15.278 below. The suggested amendments were sent to Johns on 14 May 1989, and he passed them on to board members two days later. The events of 21 May 1989 overtook this belated push on the stable door.

14.36 In a memorandum dated 30 May 1988, Mountford informed Ziebell that the credit department's existing reporting of group exposure was undertaken on related shareholder percentage basis, for example:

holding company $10m assessed at $10m
subsidiary (greater than 40%, say 70% owned) $10m assessed at $7m
related company (less than 40%, say 30% owned) $10m assessed at $3m

Mountford recommended that a change to the group aggregation policy be introduced, however, it is not clear from the memorandum how this change
was to operate. The recommendation was never implemented and Tricontinental continued to assess group exposure on the basis outlined above.

(g) Possible breaches of law or of a duty of care

On the basis of their analysis of transactions entered into by Tricontinental, counsel assisting have identified a number of instances in which they submit that Mr Mountford committed a breach of s229(1) or (2) of the Code or, at least, a breach of a common law duty of care. This section considers those allegations.

Quatro, Disctronics and Pro-image (TR 2)

A $25m "bridging" facility was provided to Quatro Limited ('Quatro') by Tricontinental in early 1989. This was then amended to a $10m facility. Part of the security for this facility included an irrevocable assignment over the proceeds of a facility to be provided to Mr Kavanagh (a director of the companies in the Quatro group) by the Bank of New Zealand. Mr Mountford later agreed to vary the security by deleting the irrevocable order to the Bank of New Zealand and accepting additional Pro-image shares in its place. In agreeing to delete the irrevocable order he no doubt took into account the advice of Wigginton, who said it had "a plethora of preconditions such that it is virtually worthless". But he was also agreeing to a reduction in the amount of the facility (to $10m) and a change in the source of repayment.

Mr Mountford was the officer responsible for the day-to-day operation of this account from about November 1988. Although the day-to-day operation was handed to Wigginton in January 1989, Mountford maintained a supervisory role in his capacity as general manager lending. He agreed, in evidence, that the variation in security should have been referred to the board for approval, and said that it was very unusual for him to have assumed authority to approve a variation in this way. Mr Ryan said that he
was surprised that the changes to this facility had not been referred back to the board of directors, and did not consider that Mr Mountford had authority to implement them without referring them to the board. Mr Moyle agreed with Mr Ryan.

14.40 In the Commission’s view, Mountford acted outside his authority in varying the security and other terms of the facility without reference to the board. It has been submitted on his behalf that he would have spoken to Johns about the variation to the facility and that Johns was obliged to inform Tricontinental’s directors of the variation. However, Mountford’s seniority within Tricontinental, his experience and expertise and his responsibility for this facility required him to exercise his judgment independently. Even if, in the circumstances, Johns was obliged to inform Tricontinental’s directors, this did not affect Mountford’s duty to act only within his authority, and to refer matters outside his authority to the board for approval.

14.41 The submission by counsel assisting argues that action should be taken against Mr Mountford under s229(2) of the Code for his failure to exercise a reasonable degree of care and diligence by independently varying the Quatro security without informing the board. Counsel for Mr Mountford submit that, at all material times, the officer who had the day-to-day control of the account was subject to Johns’ control. It is further submitted that Mountford accepted the variation in the security at the direction of Johns.

14.42 In view of the doubts as to the value of the security, and as to the precise role played by Mr Johns, together with the fact that Mr Mountford obviously believed that he was acting in Tricontinental’s best interests - and that may have been so - the Commission does not believe that any action should be taken against Mr Mountford over this matter.
Tibham Pty Ltd (TR 3)

14.43 Tibham Pty Ltd (‘Tibham’) was a wholly owned subsidiary of Essington Developments Ltd (‘EDL’) and was formed to acquire and develop the Bondi Junction bus/rail interchange site in Sydney. Tibham was to acquire a 99-year lease of airspace over the site and purchase adjacent freehold properties. EDL intended to undertake a combined retail and residential development at the site. Mr Mountford was involved in a number of important aspects of the $65m Tibham facility. In particular, on instructions from Mr Johns, he prepared an urgent credit submission in the form of a memorandum addressed to directors Smith, Ryan and Carr, requesting them to approve a facility of $20m and another of $45m. The $20m was for a purchase of shares in an unnamed company (which was in fact Ariadne Corporation Ltd (‘Ariadne’)). The $45m was stated to be for settlement and holding costs of the bus/rail interchange site. The submission on the Tibham transaction of counsel assisting contends that the credit memorandum dated 2 November 1988 was deficient in a number of respects. It did not state that the shares to be purchased were Ariadne shares. It did not state that the $45m facility related to a leasehold over airspace, nor make specific reference to the lack of development approval for the project.

14.44 Mr Mountford said he knew there were gaps in the credit submission and decided to leave it brief and wait for questions from directors. He added that a lot of information relevant to a director’s approval was missing from the material provided. Although he knew the Bondi Junction site was primarily leasehold, he was not familiar with it and did not know much about the proposed development. He knew that development approval for the project to be built on the site had not yet been granted. He said in evidence that obtaining the development approval was crucial to securing a joint venturer, and that without development approval the project was doomed. Despite this, neither the leasehold interest nor the lack of development approval was clearly mentioned in the credit memorandum,
although these matters were apparent from a careful study of the accompanying papers.

14.45 Counsel assisting submit that an action could be brought against Mr Mountford for failing to exercise reasonable care and diligence, contrary to s229(2) of the Code, in compiling and presenting the credit memorandum. Mr Johns’ extensive involvement in negotiating and approving the Tibham facility does not necessarily limit Mr Mountford’s duty to exercise reasonable care and diligence. The question which arises is whether a reasonable person in Mr Mountford’s position would have recommended the submission be approved by the board on the basis of such apparently inadequate information. Counsel submit Mountford had the expertise and experience to identify deficiencies in the information provided to him and require additional information before the submission went to the board for approval. Despite the urgency of the credit submission, his decision to wait for questions from directors may have been unreasonable, as the credit submission made no specific reference to the most significant aspects of the facility, namely, that it related to a leasehold interest over airspace and that development approval had not yet been granted.

14.46 In their submission on the Tibham transaction, counsel for Mr Mountford contend that Johns, although not the account manager for Tibham, had a close working relationship with the directors of Tibham and the companies within the Essington group. For this reason, he kept a very tight rein on his staff when they sought to deal with the management of Essington group companies. They also submit that Johns appeared to provide the Essington group with favourable treatment in granting facilities, in an endeavour to promote the group as a client of Tricontinental. In their submission, Johns approved the facility and Mountford simply implemented those instructions and was effectively directed by Johns as to this transaction. Mountford had only a couple of hours to prepare the credit memorandum of 2 November 1988, and there was little opportunity for further inquiry by him. They
stress that he made attempts to confirm information provided to him and obtain further information. As Johns was conducting the negotiations, Mountford assumed the directors were fully informed as to the background of the transaction.

14.47 In determining Mr Mountford’s potential liability under s229(2), the Commission must decide whether Johns’ prominent role in the Tibham transaction entitled Mountford to act on Johns’ instructions and assurances without seeking further information to provide to the directors. Given that the facility was outside Johns’ discretion and required board approval, a further question is whether it was reasonable for Mountford to provide scant information to the board and assume that Johns had more fully informed the directors of the details of the proposal. These questions are dealt with in paras 14.352-353 below.

14.48 Another matter for the Commission to consider is that Mr Mountford signed two letters, concerning the Tibham facility, which did not accurately reflect the status of Tricontinental’s consideration of the loan request, nor the purpose for which the loan was granted. A letter of 2 November 1988 to Mr Edwards said that the internal credit committee of Tricontinental had that day "supported a $65m commercial bill facility for the consideration and approval by Tricontinental’s board". In fact the credit committee had not considered the proposal at that time and did not do so until 16-18 November 1988. Mountford said the statement was included as a tactic to keep Mr Edwards enthusiastic. The letter also stated, "The purpose of the facility is to assist with acquisition of the bus/rail interchange site, Bondi Junction", and made no mention of the Ariadne share purchase.

14.49 On 3 November 1988 a letter of offer was sent to Tibham. The purpose of the facility was stated as being for the acquisition of the bus/rail interchange site, associated pre-development costs, capitalised interest and financing costs. Again, no reference was made to the financing of the
Ariadne share purchase. Although the letter of offer was signed by Mr Mountford, he claimed that he had nothing to do with it having been drafted so as to show only the single purpose stated. In the submission of counsel assisting, Mr Mountford's conduct in signing the first, and possibly the second, of these letters may amount to a failure to act honestly in the exercise of his powers and the discharge of his duties contrary to s229(1)(a) of the Code. They submit further that his actions may also be contrary to s229(1)(b), however, further inquiries would be necessary before any conclusion could be reached on this point.

Counsel for Mr Mountford submit that he did not act contrary to s229(1)(a) or (b) in signing the letters of 2 and 3 November. First, the letters were sent to the chief executive officer of Tibham, the borrower, who presumably knew well the purpose for which the funds were being sought from Tricontinental. Secondly, they submit that Mountford was acting in the interests of Tricontinental, subject to the direction of Johns, and that he was not acting for any collateral purpose. Nor did he obtain any personal gain or advantage.

While accepting that the letters did not accurately state the circumstances of the loan and its approval, the Commission agrees that Mr Mountford was seeking no personal advantage, direct or indirect, and that the misstatements were of little substantive significance to Tricontinental or the Essington group. No action should be taken against him on these grounds.

Mainsel Investments Pty Ltd (TR 4)

The facility to Mainsel Investments Pty Ltd ('Mainsel') was provided to acquire and develop a site in central Brisbane on which it was at first proposed to build the world's sixth tallest (and later the world's tallest) building. Mr Mountford played a significant role in the Mainsel facility and was account manager. Counsel assisting submit that the original credit submission, recommending the approval of a facility of $31m to be applied
for the purchase and development of a commercial site, should have been far more comprehensive, better researched and more analytical. The credit submission for this facility was certainly defective and ambiguous, if not positively misleading, in that it failed adequately to explain the nature of the security taken. Tricontinental relied heavily on the value of the site for repayment of the facility. However, a number of preconditions had to be met before freehold title to the larger part of the site could be transferred to Mainsel and, until this occurred, Mainsel could not provide Tricontinental with a first registered mortgage over about 75% of the site.

Mr Mountford was aware of this aspect of the security before the first drawdown. He acknowledged the effect of this situation on Tricontinental's security, and agreed that it was crucial to inform the directors and that this had not been done in the credit submission.

In addition, drawdowns in excess of $8.5m were subject to a number of preconditions being met, including the obtaining of development approval for the project to be built on the site. After discussion with Johns and the client, Mountford agreed to permit drawdowns before development approval had been granted, in excess of the $8.5m approved by the board. The board was not informed of this. In evidence, he agreed that it was dangerous to permit further drawdowns without development approval being in place and that, in hindsight, it may have been better to inform the board of the further drawdowns.

In their submission on the Mainsel transaction, counsel assisting contend that an action could be taken against Mr Mountford for his failure to exercise reasonable care and diligence, contrary to s229(2) of the Code, in investigating the Mainsel proposal and in the manner of its submission to the board. Counsel assisting suggest that a reasonable person in Mountford's position, with his purported level of skill, would not have recommended that the board approve this facility without drawing critical aspects of the security to the attention of the board. They also submit that
an action under s229(2) may lie for Mr Mountford's failure to inform the board of drawdowns in excess of those the board had authorised, on the basis that a reasonable person in his position would not have permitted additional drawdowns before a vital condition (the granting of development approval) had been met, without notifying the board.

14.55 Whether or not it was reasonable in the circumstances for Mountford to rely on Mr Johns to inform the board is a matter which the Commission must consider. It is apparent on the evidence before the Commission that Johns, although not account manager for the Mainsel facility, had a close working relationship with the directors of Mainsel. Mountford had the day-to-day running of the account, but Johns would be advised if there were any major changes to what was approved.

14.56 In their submission on the Mainsel transaction, counsel for Mr Mountford argue that he acted at all times on instructions from, or in conjunction with, Ian Johns. They submit that Mountford recommended the facility upon the preconditions imposed upon it, and that it was in fact Johns who later waived the preconditions. Mountford said in evidence that he did not consider that he had the authority to vary the terms and conditions of the Mainsel facility. He added that he initially resisted unauthorised drawdowns; however, the client then spoke to Johns. Johns assured Mountford that government approvals would be forthcoming and told him to proceed to drawdown. In relation to the quality of the credit submission, his counsel submit that the criticisms raised by counsel assisting would have been met had the preconditions stipulated by directors been adhered to before drawdown. On this basis, it is their submission that Mountford did not breach s229(2) in the manner in which he investigated the Mainsel proposal and supervised the preparation of the credit submission.
Mr Mountford acknowledged that the difficulties in obtaining a freehold mortgage over a large part of the site were not apparent from the credit submission. The directors who approved the facility said in evidence that they did not appreciate the true position in relation to the railway land, or the significance of the valuation being based on an assumption that the entire site was freehold. Mr Moyle gave evidence that it was his belief that Tricontinental had mortgage security over the whole property, and had he known it was otherwise he would not have agreed to lend. Mr Ryan said he was unaware, until giving evidence to the Commission, that freehold title to the railway land could not be obtained until construction had been completed and the Commissioner for Railways had taken up office space. He added that had he known the effective security was only over a small portion of the property, worth $8.5m, he would not have agreed to the original facility.

As in the Tibham transaction, the Commission must ask itself whether Johns' knowledge of the facility and relationship with the borrower in any way reduced Mountford's responsibilities as general manager lending, or modified his statutory duty under s229(2). Did Mountford's awareness of deficiencies in this facility strengthen his obligation to ensure that directors were adequately informed of all aspects of the facility, or was he entitled to follow Johns' instructions and assume the board had been, or would be, told of the dangers inherent in the course of the action being undertaken? This matter is dealt with in paras 14.354-356 below.

Essington Developments Ltd (TR 5)

In March 1989, Tricontinental provided Essington Developments Ltd ('EDL') with a facility for $6.5m (later increased to $8.5m) to allow EDL to purchase the assets of a company called Intellect Electronics Ltd ('Intellect') to which Tricontinental had a significant exposure. Intellect had been a subsidiary of Rothwells Ltd ('Rothwells'), to which Tricontinental had provided a $6m facility in exchange for Rothwells taking...
over two Tricontinental non-performing loans. Tricontinental had been looking for a purchaser for Intellect since at least October 1988. In February 1989, Intellect's manager had valued the company at $2.32m, and at that time Tricontinental faced a loss of $4.03m with the situation worsening. In March 1989 EDL acquired the assets of Intellect using funds provided by Tricontinental and, in return, Tricontinental extended and increased the facility of EDL's subsidiary, Mainsel Investments Pty Ltd ('Mainsel'), by $16.5m.

14.60 Mr Mountford had a significant role in the EDL facility. He initiated and negotiated the facility and, together with Mr Johns, prepared the initial credit memorandum. Counsel assisting submit that this credit memorandum failed to provide critical information. Initially, it failed to disclose either the quantum, terms or purpose of the facility. In addition, it failed to disclose a lending/security ratio of 215% on the initial facility of $6.5m. A related exposure to another Essington group company was not disclosed and there was inadequate analysis of the borrower's credit history and its servicing and repayment capacity. Counsel assisting further submit that the security on the facility was flawed. The primary security was a charge over certain assets to be acquired by the borrower. EDL had previously given charges over these assets in favour of Bank of New Zealand and Mr Mountford had been informed of this. He initiated and structured this facility to a member of the Essington group without adequately informing the board of the implications - at a time when he was aware that two major Essington projects, Tibham Pty Ltd and Mainsel, were in deep trouble, neither having secured development approvals or joint venture parties and takeout finance.

14.61 Notwithstanding that he saw the proposal as "opportunity driven", it can be argued that a reasonable person in his position would not have attempted to remove a $6m debt to Intellect from Tricontinental’s books by increasing Tricontinental’s exposure to the Essington group at a time when the group’s
major projects were in trouble. On this basis, counsel assisting submit that Mr Mountford was at fault in this transaction in the ways that have been indicated.

14.62 In October 1988 EDL had been mooted as a potential purchaser for Intellect. Mountford expressed some reluctance to involve EDL as he was hopeful Tricontinental could resolve its difficulties with Intellect. His counsel submit that, once it became clear to Mountford that Tricontinental's position in relation to the original Intellect facility was deteriorating, the risk profile changed and Mountford considered bidders such as EDL. They submit that the credit memorandum provided a detailed background to the proposal. They note that it was an informal submission drafted by Mountford who gave evidence that, at the time, he was working extremely long hours and Tricontinental was under extreme pressure due to liquidity problems.

14.63 As to the adequacy of the credit memorandum, they contend that this may have been supplemented by information provided by Johns or Mountford and that, as no evidence was heard from the approving directors or managers other than Mountford, the Commission cannot find the information provided to the directors inadequate. For the same reason, the security provided cannot be categorised as inadequate. They acknowledge that the security provided was already subject to a number of charges in favour of Bank of New Zealand. As to taking security of $2m for a loan of $8.5m, Mountford said that Tricontinental was dealing with a "workout proposal" and was not governed by guidelines in the conventional sense. His counsel add that the purchase of Intellect's assets by EDL was said in the credit submission to be part of a market strategy which was intended ultimately to result in the sale of Intellect to Ariadne Ltd at a substantial profit to EDL.
The Commission accepts that the circumstances of this transaction were so unusual as to make it difficult to reach any firm conclusions about Mr Mountford's role in it. Certainly he was trying to assist Tricontinental, in its difficult last weeks, to rid itself of a bad debt. In doing so, he only helped to produce a worse result. But the Commission is not satisfied that his conduct amounted to a breach of duty, or should otherwise be condemned.

Kahmea Investments Ltd (TR 9)

The Commission examined three facilities provided to Kahmea Investments Pty Ltd ('Kahmea'), the private investment company of Mr Christopher Skase. The security for these facilities was almost exclusively in the form of shares or convertible notes in Qintex Limited ('QL'). Kahmea owned a 52% shareholding in QL. Security cover shortfall existed in relation to the Kahmea facilities at various times from January 1988. In February 1988 there were potential security shortfalls of $15m on facilities 1 and 2. In June 1989, Mr Mountford approved the release of QL shares valued at about $1.4m, which were held as security for facility 3 and were in excess of the required cover for that facility. At the time this security was released, he was aware that the security shortfalls for facilities 1 and 2 totalled $33m.

His counsel's submission on the Kahmea transaction draws attention to the fact that, despite the release of QL shares by Mountford, 1.25 times cover was maintained on facility 3 as a result of additional QL shares being lodged by Skase when he requested an additional $1.5m drawdown on that facility. Counsel assisting submit that authorising the release of this security, when aware of a $33m security shortfall in relation to the Skase group, may amount to a breach of s229(2) of the Code.

However, it must be noted that, at the time, Tricontinental had no guidelines for the release of security in excess of the cover required under
the letter of offer. In addition, directors Carr and Ryan had approved facility 3 on the condition that it was to be treated as a "separate facility". Neither could recall the reason for imposing this condition, but it may have influenced Mr Mountford's decision to release excess security on facility 3 even though there was a serious security shortfall on facilities 1 and 2.

14.68 It is worth noting, in passing, that it is unlikely that Mr Mountford's conduct in relation to the third Kahmea facility contributed in any material way to the loss suffered by Tricontinental. By 6 October 1989 the security shortfall on the three Kahmea facilities totalled $40m. Shortly afterwards the shares of QL were suspended by Australian Stock Exchange Limited. Tricontinental's large security holding of QL shares was virtually worthless. The inclusion of the shares released by Mountford would not have improved Tricontinental's position in any material way. Thus the release, though very questionable even in the absence of guidelines, is not a fit subject for action against Mr Mountford.

Markland House Ltd (TR 10)

14.69 Mr Mountford had the carriage of the Markland House Limited ('Markland House') facility, and responsibility for providing directors with the appropriate information and documentation. He was the only member of the credit committee to consider the proposal. Counsel assisting submit that the short credit memorandum for the original facility for $6m was characterised by a lack of information. It contained only the barest essentials and failed to provide any adequate information as to the financial strength of the borrower or its subsidiaries. It contained no financial documents or analysis. Markland House was a new client for Tricontinental - directors could not have had any background knowledge of the borrower. The memorandum contained almost no credit risk analysis, the only comment being a negative one, namely, "Hill concedes that cash flow is tight". Mr Mountford admitted in evidence that directors could not
have made a fully informed decision on the proposal due to lack of financial data.

14.70 Counsel assisting submit that Mr Mountford failed to investigate properly all relevant matters, to inform approving directors of all relevant matters and to provide those directors with any appropriate credit submission. They say that, in recommending approval of the $6m facility, he failed to exercise a reasonable degree of care and diligence, contrary to s229(2) of the Code. It must be noted that this $6m facility was never drawn down; instead the revised proposal, discussed below, was adopted.

14.71 In their submission on Markland House, counsel for Mr Mountford argue that detailed financial analysis was probably not called for, due to the short-term nature of the facility (180 days) and the adequacy of the security, in particular the put option. They stress that approval of the facility was subject to the precondition that the put option agreement was to the total satisfaction of Tricontinental's solicitors. They submit that Mountford did not breach s229(2) as he was not an executive officer within the meaning of that section and he was subject to the direction and control of Johns. They submit that, without the evidence of Johns, it is not possible to conclude what instructions were given to Mountford and what information was given to other directors. They argue that it cannot be concluded on the evidence that there was an insufficiency of information or a failure properly to inform the approving directors. In their submission, even assuming a lack of merit in the proposal, it cannot be concluded that Mountford was negligent.

14.72 In relation to the revised proposal which led to facilities of $7m and $9m to Markland House, Mr Mountford said in evidence that the two proposals together were "risk-reward related" transactions. The $7m facility was for working capital and was secured primarily by a charge over Markland House's 50% interest in Coogal Properties Pty Ltd ('Coogal') and an
assignment to Tricontinental, by way of security, of a put option between Essington Securities Pty Limited and Markland House for $7.5m.

14.73 The related $9m facility was provided to enable Markland House to purchase shares held by Tricontinental in Kimberley Securities Limited and non-recourse mortgages held by Tricontinental against Poltaz Pty Ltd and Chard Holdings Pty Ltd ("the Chard/Poltaz mortgages"). The effect of these transactions was that Tricontinental had lent $9m to avoid recording a loss of $5.78m - so long as the loan did not collapse. Mountford acknowledged that this was a very high risk proposal. He advanced the proposal for approval knowing of adverse market place rumours about Markland House, including the suggestion that it was having trouble balancing its money market book.

14.74 Mr Mountford's counsel submit that there is insufficient evidence as to the manner in which approvals were given, to enable the Commission to say with confidence what events took place in obtaining that approval. That submission is accepted but, in spite of Mountford's evidence that he would not seek directors' approval without a paper being before them, it appears from all the evidence that directors' approval was probably obtained orally, in the absence of any short-form credit submission.

14.75 Counsel assisting submit that the board was clearly not provided with sufficient information as to the borrower, its subsidiaries and other relevant aspects of the proposal. They submit that Mr Mountford again failed properly to investigate all relevant matters, to inform approving directors of all relevant matters, and to provide them with an adequate credit submission. It is the submission of counsel assisting that, in recommending approval of the two facilities for $7m and $9m, Mr Mountford was in breach of s229(2) of the Code.
14.76 On the other hand, Mr Mountford's counsel submit that the total security for the facility was $21.74m, resulting in a favourable lending to security ratio of 73.6%. However, this analysis does not deal with a number of significant defects in the proposed security. The value of the mortgage of the Coogal shares and put option was seriously compromised by a shareholders' agreement and, in any event, Tricontinental had agreed to finance the exercise of the put option. Nor did Tricontinental ensure that the proceeds of asset sales had to be applied to a reduction of Tricontinental facilities. The value of a charge taken over shares in Yalfa Investments Limited (a 65% subsidiary of Markland House) was based on net tangible asset backing, with no analysis of actual realisable value. These shares in fact turned out to be worthless. Tricontinental's additional security consisted only of a charge over the assets of Markland House and guarantees from various Markland House subsidiaries. The assets of Markland House consisted of shares in those subsidiaries and loans to those subsidiaries. Tricontinental did not take any charge over the actual operating assets of the subsidiaries. When the subsidiaries failed, other lenders enforced their security leaving Tricontinental with nothing. Tricontinental undertook no analysis of the subsidiaries' ability to fulfil their obligations under the guarantees and obtained no security from those subsidiaries.

14.77 In response to counsel assisting's contention that the strategy which proposed a profit to Tricontinental of $6.57m was wholly dependent upon Markland House staying healthy, Mountford's counsel refer to two sections in the transcript where Mr Mountford discussed the "downside risk strategy". On this basis, they submit that Mountford had a proper basis for making a decision and recommendation. However, this strategy was based on the assumption that the put option was good, and ignored the inherent flaws in the exercise of the option referred to in the last paragraph.
His counsel further submit that Mountford did not breach s229(2) in recommending approval of the facilities as he was subject to the control and instruction of Johns and the transaction was appropriate, although high risk. They finally submit that, even if it is accepted that the proposal lacked merit, 17 April 1989 (the date the revised proposal was approved by the directors) was a crisis day at Tricontinental and Mountford was under a great deal of pressure, so he should not be found to have been negligent.

The credit submission prepared for the revised proposal post-dated approvals by the directors and played no role in the process of credit risk analysis. However, that submission omitted to mention the fact that, after the facility had been approved and on the day Markland House drew down $10.3m on the facilities, Tricontinental had entered into a side agreement with the Essington group in relation to the put option to be exercised for $7.5m, which in effect meant Tricontinental had agreed to finance its own security, at least for twelve months. Nor did the submission draw attention to the existence of a shareholders' agreement which, in most circumstances, overrode the put option. Mr Hadley, the account manager, later summarised the difficulties faced by Tricontinental as a result of the shareholders' agreement, in an SBV credit submission dated 3 October 1989. The earlier submission also falsely stated that $3.42m of the $9m facility was to be for working capital purposes, when in fact it was agreed with the borrower that these funds were to be used to purchase the Chard/Poltaz mortgages from Tricontinental.

Mr Mountford was responsible for supervising the compilation of this credit submission, permitted the submission to be advanced over his name and adopted the contents of the submission when it was advanced. On this basis, counsel assisting submit that action could be taken against him for failure to act honestly in the exercise of his powers and the discharge of his duties, contrary to s229(1)(a) of the Code. Alternatively, these actions may
have amounted to a failure to exercise a reasonable degree of care and diligence, contrary to s229(2).

14.81 Counsel for Mr Mountford stress that the credit submission was prepared after approval had been given. Mountford said in evidence that there were a lot of deficiencies in it and he probably should not have signed it off. However he agreed that the submission was "a dead letter" - a note for the file and no more. Counsel also argue that it is clear that Mountford was acting in the interests of Tricontinental, subject to the direction of Johns, and did what was expected of him in the circumstances. They submit that there is no evidence that Mountford was doing anything other than working for the company as best he could and clearly not to obtain any personal gain or advantage, and therefore it would not be possible to sustain a charge of a breach of s229(1) against him. These matters are dealt with in paras 14.357-361 below.

(h) Exculpatory factors

14.82 Mr Mountford's position at Tricontinental was clearly overshadowed by the dominance of Mr Johns. He said that, "Tricontinental was very much the personal operation of its managing director, Johns" and, "There were many client relationships about which no-one but Johns had full knowledge". Although Mountford considered Johns to be autocratic rather than dictatorial, he recognized that, for a general manager's position, "...the roles that I [performed] in terms of decision-making weren't perhaps as great as [in] some other comparable merchant banks".

14.83 Johns directed Mountford to instruct lending officers not to tell clients that Tricontinental had a self-imposed limit in relation to lending to a particular client. Mountford said that, "The group managing director was quite hostile at that situation occurring. In other words, that [for] all facilities which were sought for a major client, we should not indicate that we have a ceiling."
Mountford was required to operate the lending department in an environment that differed greatly from that which he had experienced at Westpac. He said:

"Speed and service were very much a characteristic of Tricontinental's culture and image. Tricontinental prided itself on being able to turn loan applications around in a very short time. Money was often advanced within two weeks of a loan application being made. On one occasion I recall a major facility being made [available] some 60 hours after the loan application was made."

He added:

"There was constant pressure on the credit committee to keep the process of loan approvals moving. ... Tricontinental developed a reputation for speed. Borrowers were prepared to pay a premium for a speedy turnaround for credit submissions and an attentive relationship".

In addition to the pressures imposed as a result of the speed at which officers were required to operate, pressure was also created because Tricontinental was, according to Mr Mountford, invariably understaffed. He added, "Generally speaking, Tricontinental's staff was young, enthusiastic and inexperienced".

Mr Mountford said that, by June 1988, he was concerned about Tricontinental's direction and the increase in his work-load. Although he thought seriously of resigning, he said that he was:

"... enticed by Johns' plans of creating a large entity with an increased capital base. Johns indicated to me that Tricontinental would shift its priority emphasis from lending to corporate advisory, funds management and other areas of operation. This change of focus would take the pressure off the lending division to produce Tricontinental's profits".

Although Mountford was general manager lending he estimated, as noted above, that approximately 70% of the loan book (in dollar terms) was effectively controlled by Johns. Johns was regarded by many borrowers as both group managing director and their account manager. According to
Mountford, if a facility began with Johns, he would usually delegate responsibility for monitoring the file to an analyst in the credit department rather than to Mountford or a member of the lending department. This contradicts Mr Stott’s evidence that Johns’ files were generally looked after by Stott and Hunter from the credit department and a member of the lending department, usually Mountford or Wigginton. Johns said in evidence:

"I tended to end up with a lot of large exposures and until Mountford became active, I may have been account manager for something in the order of 70% by value of the loan portfolio. ... After Mountford became active, I delegated more down to Mountford, he delegated some onwards. I also delegated some to Atlas in the project finance area. During Mountford’s time, I would only be guessing, but I would say that I retained under my control 30%.”

He added:

"I handed over the loan portfolio to Mr Mountford over a 2 year period. I was critical of Mountford at one stage when I advised him to get an assistant general manager, and he stated ‘no’, he didn’t need one at that point in time, although he got one later. If he had got one earlier, I would have handed more work over to him a lot quicker."

Mountford ‘inherited’ a number of Tricontinental’s problems. For example, when he joined in May 1986, there were significant facilities in excess of Tricontinental’s balance sheet. This practice continued during his employment, but he did not consider that it was something he should have raised with Johns. He said that, "...to impose prudential limits when individual exposures were in excess of Tricontinental’s own shareholders’ funds...would have significantly cut across our capacity to write large loans."

Internal auditors recognised the lack of influence that general managers had over matters such as prudential policies. They were also instructed by
Johns, in December 1988, not to raise the issue of risk concentration with general managers.

(i) Mountford's involvement in the events of 20 May 1989

On the morning of Saturday 20 May 1989 Mountford met Johns, Ziebell and others in the offices of Tricontinental (see para 17.17 of first report). Johns told the group that the chairman, Mr Smith, required an update of problem loans. Mountford said in evidence that, at that time, he was not aware there was to be a meeting of the SBV board the next day and did not know why Mr Smith wanted the problem loans report.

Mountford commenced writing the problem loans report at approximately 8.30 am and left Tricontinental's offices at about 1 pm to host some guests of Tricontinental at the Carlton Football Club. He said that, as he departed before the final compilation of the memorandum prepared by Johns, he cannot recall a doubtful debts figure of $64m being recorded in that memorandum. The function performed by him on that day was to update the problem loans report for April 1989 by referring to the relevant files.

The report, signed by Johns and Ziebell, estimated Tricontinental's bad and doubtful debts for the period 1 January to 30 June 1989 to be $64m "on a worst case scenario". Of the 14 facilities that made up the $64m estimate, the Commission examined three in public hearings (Atoll, Amaldela and Churchill Leisure) and three in private meeting. Another facility from this list was also the subject of general, rather than specific, evidence.

The report also referred to two accounts "subject to recent press speculation". One of the accounts involved a group of companies. The Commission reviewed two facilities from the group and the other account mentioned, all in private meeting. The report went on to name three accounts the subject of "potential press coverage". These facilities
(Quatro, Disctronics and Dallhold) were examined by the Commission in public hearings.

14.94 The provision for losses in respect of the loan portfolio as at 30 June 1989, as contained in the published financial statements, was $351.6m - specific provisions of $251.6m, and a general provision of $100m. Mountford said that the different methods of valuing security adopted by SBV and Tricontinental may have accounted for a significant component of the difference between these figures. He said:

"I'm aware from my time with State Bank, and as part of Mr McAnany's team as assistant general manager, that [State Bank's] assessment of provisioning encompassed ... substantially different approaches to security values to what we at Tricontinental had adopted, particularly in terms of scrip".

D. Lynton Edward Stott

(a) Background

14.95 Mr Stott's banking experience began in 1969 when he joined the Commercial Bank of Australia Limited. He held various positions within that bank before commencing employment with Euro Pacific Finance Corporation Ltd ('Euro Pacific') in November 1978. At Euro Pacific he was employed as a lending officer and was later promoted to the position of analyst. When he left Euro Pacific in August 1980 he was assistant to the trade finance manager. Stott had no professional qualifications although he did part of a course in accounting, known as the certificate of business studies, between 1979 and 1981.

(b) History at Tricontinental

14.96 Mr Stott joined Tricontinental in August 1980 as a senior analyst. In February 1989 he was appointed corporate lending officer with an essentially marketing role. In January 1982 he was appointed operations controller. This position involved scrutinising credit submissions on an Australia-wide basis before those credit submissions were submitted to the credit committee or the board. In September 1983 he was appointed group
manager credit, where his role was once again to screen credit submissions which went to the credit committee or board. At this time he was also appointed to the credit committee. In January 1986 he was promoted to assistant general manager credit and securities, a position he held until his resignation in April 1989.

(c) Responsibility and capacity

Of his position as senior analyst at Tricontinental, Mr Stott said that, "My training consisted of 'hands on' experience in putting together corporate lending submissions. I was never given any formal or structured in-house training at Tricontinental".

As assistant general manager credit and securities, Stott reported directly to Mr Johns. The group manager credit, Mr Alistair Clark (November 1986 - January 1989) and Mr John Maddison (from January 1989) and, in theory at least, the group manager securities, Mr Neil Hunter (from 1985), reported to Stott. In his statement to the Commission, Stott said:

"I asked Johns why I did not enjoy the title of general manager. Johns replied that the credit division was a new division and he inferred that I would eventually become a general manager. This did not eventuate notwithstanding my request on at least one occasion that my title be reconsidered. In any event I was recognised as head of the department in spite of the title assistant general manager."

Mr Johns said in evidence:

"I thought it would be a big lift for [Stott] to go from ... group manager of credit to general manager at the beginning of 1986 and I thought I'd stage it in two stages. His work did not differ despite the change in his title. He headed up the division. I regarded him as having the skills to manage the division at that point in time."

In a letter to Johns dated 9 December 1988, Mr Barry Weir of KPMG Peat Marwick Hungerford said:

"You will recall that in recent discussions with yourself, our audit team mentioned that they had some reservations about the level of conceptual credit skills evident within the credit and securities operations department. We believe that credit issues are treated
more as a clerical or processing function than as an important management control.

We are not sure that the 'current assistant general manager' status of the head of this department reflects recognition of relative skills or diminishes the relative importance and management incentive of this position. Certainly, we believe that a higher priority needs to be given to the functioning of this department....

Therefore, some attention needs to be given to upgrading the skills in the credit and securities operations department to a higher level of management expertise....

We suggest either that a new appointment as general manager be made, or that the present incumbent receive training and an elevation of status to reflect the importance of this area."

Mr Stott said he rejected the internal auditors' suggestion that credit issues were treated more as a clerical or processing function than as an important management control. However, having reviewed a large number of these submissions, the Commission is satisfied that the description is entirely accurate.

14.100 The notes of an interview between the internal auditors and Mr Mountford on 29 November 1988 record Mountford as saying that, "the credit department are too slow at processing credit applications and don't work hard enough". Stott said he has no recollection of Mountford raising this issue with him.

14.101 Mr Wigginton stated that he did not consider Mr Stott was providing an appropriate degree of leadership and direction as the assistant general manager credit and securities. He believed that, during the course of negotiations concerning Australian Bank Limited, Mountford and Johns discussed the appropriateness of Stott carrying on that role.

(d) Functions

14.102 A job description for Mr Stott, dated 7 May 1986, set out the principal objectives and a list of duties for his position as assistant general manager
credit, securities and lending operations. The four principal objectives were, "assessment of credit submissions, efficient operation of the credit, securities and lending operations area, liaise with all divisions within Tricontinental and staff control." Stott said he would agree that these were the principal objectives of his position. Stott's duties were listed as follows:

(i) ensure all credit submissions meet Tricontinental's lending guidelines and provide an acceptable return within the risk constraints assessed;
(ii) organise the preparation of support papers for submissions to the board;
(iii) co-ordinate client and money market deadlines to ensure that Tricontinental's security position is protected at all times;
(iv) oversee the group manager credit's duties;
(v) oversee the group manager securities' duties;
(vi) liaise with regional lending managers and lending staff in all states;
(vii) select, appraise and develop subordinate staff and provide promotional and remuneration recommendations; and
(viii) support the group managing director.

Of his role in the credit analysis process at Tricontinental from 1986 to 1989, Mr Stott said:

"Once credit analysts had received what they and the group manager credit, assistant manager credit and lending personnel considered to be the necessary information, the analyst prepared a loan submission setting out terms and conditions and annexed the supporting documentation. Draft loan submissions were then forwarded to the group manager credit, the assistant manager credit, the lending officer involved and myself. They screened submissions and verified the conclusions of the analysts. I discussed the draft credit submissions with my deputies and when it was prepared in final form, received a copy in [my] capacity as a member of the credit committee."

In the normal course, credit submissions prepared by Stott's staff would come to him for review and comment. He said if the submission was
found to be inadequate he would return it to the staff member who prepared it and ask for further information. He agreed that although some of his staff had limited experience in credit analysis, he, with the benefit of 20 years banking experience, was vetting each credit submission.

14.104 As group manager credit, from September 1983 to January 1986, Stott received credit submissions prepared by analysts. He said, "If I was not satisfied with the security provided, the covenants proposed for the loan submission or any other aspect of the proposed loan, I rejected the credit submission until the deficiencies had been rectified. I usually queried aspects of every credit submission that came to me for approval". He added, "It might be typos - I mean, it's very simple, but that's all part of those aspects. It would also be [querying] anything that appeared factually incorrect on the information that was provided .... anything that looked abnormal". Other evidence given to the Commission also suggested that many of the queries referred to were in matters of presentation, rather than of substance.

14.105 During cross-examination Mr Clark was asked what input the credit department had as to the nature and extent of the security. He said, "[Johns] was quite [amenable] to coming back to him - and Lynton Stott did this on numerous occasions - say 'We should have this' or 'We should have that as items of security'...". Mr Maddison also gave evidence that, as members of the credit committee, Stott and Mountford sent back a significant number of credit submissions for corrections, additional information, further security and additional covenants.

14.106 Stott was appointed to the credit committee in September 1983. He was also a member of the investment banking credit committee and the foreign exchange credit committee until the latter was disbanded in 1986 or 1987 and the lending credit committee became responsible for foreign exchange
matters. Of his role as a member of the investment banking credit committee, he said:

"My involvement ... was necessary given my responsibility in relation to supervision of contingent exposures to borrowers in my capacity as assistant general manager credit. In practice, however, Johns' discretionary share purchases were invariably completed by the time he requested a credit submission to be prepared. Hence the submission was merely a record of the transaction previously entered into. I did not participate in any decision by Johns or Green to purchase shares within their discretions. My role was confined to the task of supervising the preparation of credit submissions after the event and the recording of Tricontinental's exposure. On a few occasions I queried Johns as to why Tricontinental was purchasing particular shares. On other occasions I expressed my concern where I considered Tricontinental was becoming over-exposed to a particular borrower and Tricontinental had purchased shares in that borrower."

Stott was appointed to the management committee by Johns in January 1986. From 10 December 1986, he was the only assistant general manager present at management committee meetings. He continued to attend management committee meetings until 15 May 1987. Mr Stott described his exclusion from the management committee in terms set out in paras 14.107

14.107 Stott was appointed to the management committee by Johns in January 1986. From 10 December 1986, he was the only assistant general manager present at management committee meetings. He continued to attend management committee meetings until 15 May 1987. Mr Stott described his exclusion from the management committee in terms set out in paras 20.11 and 20.12 of the first report.

14.108 Mr Bruce Ziebell considered the exclusion of Stott from the management committee was related to his status as an assistant general manager. His views are recorded in para 20.13 of the first report.

14.109 Stott was responsible for the circulation of credit submissions requiring board approval to the four directors (including Johns), who were thought to be available on a particular day. He said, "In relation to some extremely large credit submissions (which could also involve excessive group exposure) Johns instructed me to ensure that all directors received the credit submission and confirmed their approval". He was also responsible for chasing up directors who had received submissions, to ensure that a quick response was obtained.
Stott, the group manager credit and the assistant group manager credit were the only staff authorised to sign input forms used to compile the corporate exposure status report. The information used to prepare the input forms was taken directly from approved credit submissions or accepted letters of offer (see paras 22.97 - 22.99 of the first report). Stott considered the corporate exposure status report to be "... an extremely important document as it showed Tricontinental's limit on exposures to a particular borrower (other than contingent liabilities) and provided the foundation for an overall summary for Tricontinental's total exposures".

Mr Stott and other credit and securities division personnel prepared a number of reports. These included:

(i) A lending division summary for the board (see para 22.91 of the first report) prepared by Stott which disclosed precisely how much had been lent by Tricontinental during the previous month, relevant outstanding approvals, total lending commitments and a projection of foreseeable lending commitments for the following month. He prepared this paper monthly in draft form and forwarded it to Johns. The lending division summary was included in the managing director's report to the board under the heading 'operational report - lending'.

(ii) A schedule of equities for the board, setting out Tricontinental's exposure to various companies through the holding of their shares as securities (see paras 22.93 and 22.94 of the first report).

(iii) Large exposure reports for SBV, detailing committed and uncommitted facilities over $5m (see paras 22.102 and 22.103 of the first report). Mr Johns said in evidence, "I instructed Mr Stott to do it [prepare the large exposure list] regularly. I would check with him every now and again to see whether (a) he was still doing it and (b) whether we were getting the reciprocal list, because I didn't want it going just one way". Stott assured him that the report was provided regularly to SBV.
(iv) One-off reports in response to requests by the board.
Stott said, "I never appeared before the board to answer any questions in relation to any report prepared by my area of responsibility. I cannot recall being asked by Johns or Ziebell to follow up any issues arising from these reports in response to directives from the board".

Although Mr Stott was nominally in charge of the securities department, which was responsible for the monitoring of the prices of shares held as security, he was not involved in the preparation of the reports produced as a result of that monitoring.

Mr Johns gave evidence that, if members of the lending area were extremely busy, Stott would be asked to attend meetings with potential clients, and that Stott had a few clients he would handle himself rather than in conjunction with Johns, Mountford or other lending officers. He added, "There [was] no other member of credit and securities department who was also an account manager".

(e) Relationship with Ian Johns
Of his relationship with Mr Johns, during the period Johns was general manager lending, Stott said:

"Although I felt intimidated by Johns at a personal level, I had no qualms about challenging him at a professional level if I was of the view that certain aspects of a particular credit submission he had approved were questionable (for example, I challenged him on occasion about the need for additional guarantees and covenants). We would have a cordial discussion during which I would express my views on the credit submission. Sometimes he agreed with my views, sometimes he did not. However, as general manager lending, Johns was the final adjudicator in respect of loans which were within his discretion and I was obliged to accept his decisions."

This statement is supported by Mr Johns, who said, "I can recall Stott on a number of occasions making suggestions to increase security or obtain
covenants from the borrower in relation to loans approved by me under discretion. These suggestions were adopted."

14.115 In his statement to the Commission, Stott said:

"During the latter half of 1988 and early 1989 my previously satisfactory working relationship with Johns began to deteriorate. Whilst I believed Johns was under pressure at this time in relation to the transaction involving Australian Bank Limited, our relationship deteriorated for a variety of reasons."

Stott identified these reasons as being:

(i) "Johns general demeanour became increasingly autocratic and totalitarian. He belittled and abused members of staff, including me";

(ii) Johns was "extremely irritated" when Stott left for a family holiday in May 1987. When he returned, he had been excluded from the management committee; and

(iii) Johns blamed Stott for Tricontinental's failure to recover approximately $14.5m from an underpinning agreement executed by HDFI Limited in relation to a borrower (Selkis Pty Ltd). Stott said:

"after Tricontinental lost the Court action .... Johns appeared to blame me for the loss which I felt was totally unjustified. Johns continued to bring the matter up which I found extremely annoying. After working for Johns for six years, I had had enough. In early April 1989 I resigned from my position with Tricontinental. Johns did not appear to be disturbed".

Stott gave evidence that his involvement in the Selkis transaction was very limited as the documentation was prepared in Sydney over a weekend when he was on holidays.

14.116 Mr Mountford said in evidence, "Mr Johns had expressed some concern to me that perhaps Mr Stott's level of commitment had waned in recent times, and the timing of that was around February 1989. He was considering the appointment of a general manager credit". He added, "Lynton had problems with the group managing director and I perceived that his level of
dedication was waning for the position. ... but I don't feel I have the whole explanation [for] the problems [in] their relationship*.

(f) Awareness of, and responsibility for, deficiencies in systems

In his statement to the Commission, Mr Stott said, "Based on my knowledge of the workings of other merchant banks (which came to my attention when Tricontinental took part in a syndicated loan) I believe Tricontinental's covenants and the degree of monitoring were comparable to prevailing industry standards at the time."

As assistant general manager credit and securities, Stott did not implement any in-house training procedures for analysts. Some analysts were sent on a one week course conducted by Swinburne College and attended other external courses.

Stott considered that Tricontinental's management regarded the lending guidelines, "... as general indicators rather than rules. They were not seen as rigid and exhaustive but as a framework in which Tricontinental's lending operations could operate ... it was up to lending officers and those involved in the approval process to determine the extent (if any) to which lending guidelines were exceeded".

Mr Stott said he had no obligation to report to Mr Mountford and that theoretically the lending department and the credit and securities department could operate in ignorance of each other. Despite Stott's statement that he believed, "... in practice [the two departments] worked fairly closely together", there are a number of examples of a lack of communication between them. One such example is the conflicting evidence given by Stott and Mountford in relation to the method for valuing shares held as security. Stott said that Tricontinental always looked at the NTA (net tangible assets) value of shares, both before and after the October 1987 share market crash. According to Mountford, the system for
monitoring the value of equity held as security relied on market value as the monitoring measure and the asset backing of the equity securities was only reviewed in isolated instances. In fact, the day-to-day monitoring of share prices was based on the buy price of shares, usually as reported by the Financial Review or Reuters. However, the transactions provided examples of NTA values of shares being looked at by Tricontinental at the time a facility was granted or increased (eg GSH Finance Pty Ltd and Atoll) or for the purposes of an internal review (eg Kahmea) or an enforcement decision (Qintex). Johns said in some instances, for example Qintex, it was necessary to look at the true asset value behind the scrip, whereas in margin lending, reliance was placed on the market value of scrip.

14.121 A further example of the lack of communication between the departments relates to the responsibility for the day-to-day administration of Mr Johns' accounts. Stott said Johns' files were looked after by himself, Hunter and people from the lending department, mainly Mountford and Wigginton. Mountford's evidence was that Johns would usually delegate responsibility for monitoring his files to an analyst in the credit department and not to Mountford or a member of the lending department. The evidence on this point is unclear, as various witnesses appeared to have different definitions of "looking after" and "monitoring" a file.

14.122 Stott said that staff turnover was always a problem, however he considered it to be a general industry problem in the period 1983 to 1987, rather than a problem peculiar to Tricontinental. In his statement to the Commission, Mr Johns said, "I often told Stott to get more staff if he felt they were required." He said, "Mr Stott was satisfied with the amount of staff he had. If he wasn't he got more staff." In view of the general requirement for managers to keep within budgets, it is doubtful if this statement of Johns can be taken at face value.
Stott said the issue of prudential standards relating to group exposures was talked about on a few occasions. He said exposures to individual entities which were members of particular groups were listed on all credit submissions, "... so that people were well aware of what those total figures were at any given time". The notes of an interview between Stott and the internal auditors dated 23 November 1988 state:

"There is no facility in the existing system to group clients into a parent hierarchy, in order to establish exposure to a group of related companies. This is recognised as a major weakness of the system and has been placed as a high priority requirement of the current review of the computer systems. At present a manual report showing exposure by client group for exposure over $5m is prepared on a monthly basis."

In his statement to the Commission, Stott responded to a suggestion in a draft internal audit report, dated 9 December 1988, that the credit division saw loan exposures in isolation rather than in a proper context. He said:

"There was no computer system in place which co-ordinated Tricontinental and SBV exposures to enable a 'group exposure' to be determined, although I am unable to recall if there was a manual system of recording Tricontinental and SBV's combined exposures".

When asked whether he ever had the opinion that Tricontinental was excessively exposed to one particular borrower, Stott said:

"There were occasions [with] the larger clients that ... my personal thought was that possibly it was becoming excessive".

He added:

"I thought that in a few of the larger [facilities] the exposure was, in terms of Tricontinental's base, possibly a little bit too large".

However, he said:

"... apart from those few exceptions ... I was reasonably comfortable with that excessiveness ... until October 1987, because obviously a lot of those exposures had shares backing them".

Stott considered that, as Tricontinental was a wholly owned subsidiary of SBV, it was reasonable for Tricontinental to take into consideration SBV's
capital base. When asked how that attitude affected his approach to his recommendation of submissions, Stott said, "... I certainly felt more comfortable with the State Bank owning the 100% and basically if ever required then obviously I would have thought that they would step in".

14.126 Stott believed the June 1986 lending guidelines had been written by Mr Mountford. He said the basis of this belief was that every general manager of a department had to produce their respective guidelines for their department. In fact, the lending division guidelines were in place before Mr Mountford commenced his employment in 1986. Stott also thought the credit procedures manual had been drawn up by Maddison and Clark some time in 1987. As to his involvement in the preparation of the manual, Stott said, "... I was given the draft, ... I read through it, and I virtually didn't have much to say because everything that should have been said was basically already in there. In fact, I was quite impressed with the way [they] put the thing together". He thought the manual was based on material that already existed within Tricontinental, namely, the lending guidelines, draft letters of offer and credit submissions. In fact, the credit procedures manual was prepared by Mr Paul Hue, a senior credit analyst, in 1988. It was prepared upon Mr Hue's own initiative and was a compilation of various memoranda and documents relating to Tricontinental's policies and practices, and of some fundamental principles of credit risk analysis. It does seem rather strange that Mr Stott had so little knowledge of, or input to, this important document within his department.

14.127 Stott considered that, although the guidelines were exceeded from time to time, they were not ignored. He estimated that the lending procedure guidelines were not complied with in about 20% (by number) of the transactions and that the credit procedure guidelines would also have been departed from approximately 20% of the time.
The credit department was responsible for the conduct of internal reviews of established loans. These reviews were aimed at checking and updating basic terms, covenants and reporting requirements. It was the responsibility of the lending officers to obtain the necessary information, and provide it to the analyst who would prepare the review. Mr Stott could not recall having any input into the conduct of internal reviews, responsibility for which was assumed by Mr Clark.

Stott said it was appreciated that SBV could be lending money to the same clients as Tricontinental, but he could not recall seeing any information from SBV regarding its corporate loan exposures. The credit procedures manual did not contain a requirement or indication that the exposure of the SBV to a particular client should be taken into account by Tricontinental when considering granting a facility to that client.

A report by Arthur Andersen & Co ('Arthur Andersen') dated 30 September 1990 stated, "The files which we have reviewed confirm the deficient manner in which Tricontinental assessed risk in the credit evaluation and monitoring process". The particular deficiencies identified by Arthur Andersen were put to Mr Stott during his examination. The deficiencies and his responses were as follows:

1. The concentration of risk. Tricontinental had extended facilities to six groups of related entities for amounts in excess of $100m. A further five groups had been extended facilities in excess of $50m. Stott said he did not consider the concentration of risk to be a cause of the collapse of Tricontinental. He said, "The board was fully aware of those risks, and they were obviously quite relaxed [about] those risks". Although he conceded that the exposures became more of a concern after the October 1987 stock market crash, he said, "...I guess it goes back [to] standing on the back of the State Bank".
2. Inadequate analysis of borrower servicing repayment capacity, that is, the failure of credit submissions or supporting data to analyse in any meaningful way the ability of the borrower to meet its obligation from its own cash flows. Stott said that cash flows are an important criteria for the credit risk assessment process; however he estimated that proper cash flow analysis was only conducted in about half of the transactions he was involved with. [As has been shown in chapter 11, it is clear that Tricontinental's chief emphasis was on security rather than on means of repayment, and there was little, if any, "proper" cash flow analysis.]

3. Inadequate analysis in forecast projections. Arthur Andersen found that there was rarely any evidence that forecasts or projections had been subjected to a critical review of significant matters such as the reasonableness of assumptions and sensitivity to changes in assumptions. Stott said he was not always satisfied that there had been an adequate analysis of forecasts or projections, and that where he was dissatisfied the submission would be queried and sent back for clarification.

4. Securing loans by way of share scrip when money was lent to finance an acquisition, which resulted in Tricontinental effectively becoming a subordinated creditor of the company acquired. Stott said this did not create problems until after the 1987 stock market crash.

5. A tendency to repackage loans by transferring them to a different, usually related, borrower without enhancing Tricontinental's security position and often with a further advance of funds. Stott had no connection with the borrowers used by Arthur Andersen as illustrations of this "good money after bad", and Johns and Mountford decided whether or not it was appropriate to restructure loans. Stott said that the principle behind this was to transfer risk to a financially stronger related company in a workout situation.
6. Obtaining valuations of assets held as security, but failing to assess critically on what basis these valuations were performed. For example, valuations of property and assets were performed on an open market basis rather than on a mortgage basis. Stott said he always thought valuations were conducted on the basis that they were for mortgage purposes and that open market value was only used in isolated instances. [The Commission certainly came across cases in which this was a valid criticism of the credit and securities division.]

The Arthur Andersen report went on to say:

"The deficiencies noted above are pervasive across the Tricontinental loan book. These deficiencies when combined with the lack of effective checks and balances over Johns' lending decisions are prime reasons why the losses of Tricontinental have been incurred. Failure to comply with policies and procedures and deficiencies in particular policy documents identified to date are by comparison relatively minor contributions to loss."

Stott considered that the causes for the demise of Tricontinental were external factors, namely, the 1987 stock market crash, the deregulation of the banking industry and the pilots' dispute. He did not believe there to be any other significant or relevant causes. He conceded that the lack of effective checks and balances over Johns' lending decisions may have been a contributing factor, but only a minor one.

In his statement to the Commission, Stott said that by 1987/88 there was an increasing number of quick turnarounds of large facilities. These were approved at board meetings or by Mr Johns speaking with board members and obtaining verbal approvals. No reference was made to any of the credit committee members.

Stott did not consider the lack of direct contact between the credit department and the borrower to be a weakness at Tricontinental, as lending officers, who had contact with borrowers, ought to have been more
experienced than analysts. He also said that he did not think the "round robin" credit committee procedure resulted in credit or prudential risks not being debated openly, as individuals would discuss matters between themselves. However, he said that this may have been a problem if credit committee members were not trained in credit evaluation.

In December 1988 Stott received a letter from the internal auditors attaching a draft internal audit report. The letter requested him to provide comments in relation to the draft report. Although the report contained a number of criticisms of Tricontinental's credit risk policies and procedures, Mr Stott never provided his comments to the internal auditors. In his statement to the Commission, he said:

"One of the reasons I did not reply was that many of the recommendations in the draft report had been communicated to Peat Marwick by myself or my staff. Another reason that I did not reply was that I resigned in April 1989 and I had not had sufficient time to gauge whether some of the recommendations were feasible. In addition, many of the recommendations were in fact tasks or developments which were already being undertaken to improve and update Tricontinental's reporting techniques by the expansion of its computer system."

Stott also said in his statement that the draft report made comment in respect of matters which related to lending and other areas, for which he had no responsibility. However, during his examination before the Commission, he could only identify two areas mentioned in the report which were outside his control, namely, futures broking credit control and default loans. Although Stott said he did not receive any reminders or follow-up in respect of his non-response to the draft audit report, Mountford gave evidence that he spoke to Stott about the failure to respond and offered assistance. There are also a number of letters in evidence which indicate that the matter was followed up with Stott. Stott said that he has no recollection of follow-up by the internal auditors, Johns or Mountford.
14.135 Stott was asked about Tricontinental's practice of preparing a credit submission after a facility had been approved by Johns. He said this provided a check to ensure a person was using his discretion correctly and provided a record of the exercise of individual discretions. However, he said that once the decision to grant a facility had been made under a discretion, nothing could be done to affect that decision.

(g) Responsibility for changes or improvements in systems or practices

14.136 As noted above, Stott said that he could not recall whether he had any input into the credit procedures manual. He had seen a draft of the manual and considered it to be quite good and to contain everything it ought to have contained. Stott had no input into the lending guidelines.

14.137 In his statement Stott informed the Commission that all loans approved by the lending, investment banking and the international and foreign exchange credit committees were documented or ratified and recorded on the computer system as an exposure. He stated that, "Although loans were approved by the relevant lending authority and funds were advanced prior to the preparation and ratification of credit submissions, I assumed that if there were defects in this procedure, the board would have stepped in to change the procedure."

14.138 Stott considered most policy changes, for example changes to the guidelines, would have emanated from the management committee rather than the board. However suggestions from the management committee would go to the board for consideration before they were implemented.

14.139 After his exclusion from the management committee Stott was still able to make recommendations about his own division, although he was not consulted about other divisions. He considered he was effective in the suggestions he made regarding his own area of responsibility and gave the
example of "fixing up a system on the computer". He said he was involved in the establishment of a computer system which could show actual exposures, including contingent liabilities, on a day-to-day basis. The system had been tested and "... seemed to be working quite well" when he left in 1989.

Stott said in evidence that he felt he had a role to play in the establishment of prudential policies. In a memorandum to Stott and Mountford of 17 February 1987, Johns requested a paper be prepared for presentation to the board detailing Tricontinental's policy in regard to margin lending. This paper was presented to the board at the meeting of 25 March 1987 and was later incorporated in the 1988 lending guidelines. However the guidelines identify Mountford alone as the source and do not mention Stott.

A memorandum from Stott dated 7 October 1983 set out the procedures to be implemented in the processing of a credit submission. Stott could not recall the circumstances in which this memorandum was written by him, nor whether it alone constituted the guidelines for analysts at that time.

Possible breaches of law or of a duty of care

On the basis of their analysis of transactions entered into by Tricontinental, counsel assisting have identified only one instance in which they submit that Mr Stott committed a breach of s229(2) of the Code or, alternatively, a breach of a common law duty of care.

Qintex Ltd (TR 7)

In November 1985, Ryan, Moyle, Rawlins and Hancock approved a credit submission which, on its face, indicated that Tricontinental was to provide $25m of a $75m syndicated facility, with two other banks contributing $25m each. Approval was given by the directors on the condition that Tricontinental's total exposure to the Skase group should not exceed $75m. In February 1986 a credit submission to extend the term of the facility was
prepared. This credit submission stated that the existing facility was $25m, that current usage was $52m, that current commitment was $75m and that the facility formed "part of the $75m syndicated facility which TCL is forming". The total exposure to the Skase/Qintex group was shown as $89.455m, including $25m for the facility sought to be extended. This was reduced to $66.55m using Tricontinental's methodology for calculating group exposures. In fact, because there was no syndication in place or in immediate contemplation, the exposure was $50m greater.

Mr Stott presumably vetted, and certainly recommended, this credit submission but, despite being aware of the level of exposure to the Skase group, he made no attempt to draw specifically to the attention of the approving directors the fact that their $75m group maximum exposure condition was being exceeded.

In the Commission's view, the real vice of this particular submission was that it referred to "a syndicated facility of $75 million ... which [Tricontinental] is currently in the process of forming". The two proposed partners in the syndicate had both indicated by mid-December that they would not be taking part, and no other participant was currently being considered.

However Mr Johns was the account manager. He had control of the facility; and Mr Stott could not know what information or clarification he had given to other board members. In these circumstances it would seem unfair to blame Mr Stott, either as head of the credit and securities division, or as a member of the credit committee, for the misleading reference to the syndication.

Counsel assisting also drew attention to the fact that, in January 1986, Mr Stott apparently authorised a drawdown of $2.75m for a range of purposes (including a deposit on a hovercraft) which bore no relationship to the
share purchase which was the expressed 'purpose of facility'. However the
evidence is not clear that it was in fact Mr Stott who gave the necessary
authority and, if he did, it is likely that he checked first with his managing
director. The Commission, while noting that this is typical of the poor
quality of record-keeping in Tricontinental, is unable to go beyond the
general responsibility of the account manager (in this case, Mr Johns) in
allocating any blame for this irregularity.

(i) Exculpatory factors

14.148 In his statement to the Commission, Mr Stott said, "There was always a
degree of pressure placed on me in relation to credit submissions as the
relevant lending officers were subject to a performance budget and were
keen to write as much business as was possible. Regional managers were
also subject to performance budgets". Mr Mountford said, in his statement
to the Commission, "It appeared to me that Tricontinental's credit
department was constantly under time constraints and for the most part
carried a heavy work load".

14.149 Stott said, "Speed was a feature of Tricontinental's culture". He added,
"Tricontinental, among a number of merchant banks was recognized for its
quick turnaround of credit submissions. The intention was for credit
submissions to be processed through the system as quickly as possible".

14.150 Stott saw himself as a senior officer of a separate division and considered
that he should have been a member of the management committee. He said
he felt alienated from the decision-making process at Tricontinental after
his exclusion from that committee.

14.151 Of the foreseeability of the October 1987 stock market crash, Stott said, "I
think it was pretty widespread that there was obviously going to be a
correction in the stock market...everybody knew there was going to be a
correction in that market, but nobody ever thought how monumental that correction [would be] and it was all overnight."

Mr Stott was clearly not in a position to influence the granting of a loan that Mr Johns wanted to grant; he did not feel it was appropriate to speak to a director behind Johns' back. If he approached Johns directly, he may have, on occasion, been successful in effecting slight variations to the conditions of a particular loan, but nothing that went to the heart of the loan. Stott agreed that once Johns had determined that it was appropriate to grant a loan on certain broad conditions, then any challenge to that would have to have come from the board rather than from Stott himself.

E. **Neil Edwin Hunter**

(a) **Background**

Mr Hunter joined Tricontinental in February 1982 as banking operations officer. After 12-15 months his title was changed to manager securities. In 1984/85 his title was changed again to group manager securities. He held this position until August 1990. After September 1990 he was employed for some time by SBV as a consultant in respect of Tricontinental's securities.

Before joining Tricontinental, Mr Hunter was employed by the Commercial Banking Company of Sydney Limited between 1961 and 1981. He worked in the branch securities department, starting as a junior officer and progressing through the department to third in charge. He eventually became a branch accountant in 1972 and was appointed branch manager in 1976, which position he held until shortly before joining Tricontinental. He had no formal professional qualifications.

In his statement to the Commission, Hunter said:

"When I was initially appointed to banking operations officer in February 1982 at [Tricontinental], I felt I was capable of dealing with all security aspects ... because I had come from a trading bank
Mr Hunter said in evidence that the facilities he had dealt with at Commercial Bank of Sydney Limited differed from those he came to deal with at Tricontinental. Of his experience with the former bank he said, "... I was only a manager in suburban branches mainly dealing with small businessmen and housing loans".

(b) History at Tricontinental

In his statement to the Commission, Mr Hunter made this comment on the effect of SBV’s acquisition of Tricontinental in 1985:

"Life at [Tricontinental] did not change much after the 1985 acquisition by SBV. SBV appeared to have little input into the management and day-to-day operations of [Tricontinental]. SBV didn’t come in and review or change things or suggest a tightening up of procedures. SBV made no changes which had any impact upon the operations or procedures of the securities division."

In evidence, he said that this statement was confined to the securities division.

(c) Functions

A job description from 1986 for Mr Hunter’s position of group manager securities set out the principal objectives and a list of duties for that position. The principal objectives were, "To ensure that at all times Tricontinental’s position in respect of any loans is fully protected and without risk and to ensure that internal procedures in relation to the securities department are maintained in the correct manner." The duties were listed as:

(i) preparation of letters of offer,
(ii) instructing solicitors in the preparation of security documents (in respect of facilities originating in Victoria only),
(iii) the perusal of all security documents in respect of all new facilities, for all offices, as to correctness,
(iv) attendance at settlements where required,
(v) instigation and maintenance of internal systems in relation to securities,
(vi) general liaison with interstate offices, solicitors and clients in relation to any matter relating to securities,
(vii) the audit of securities for all offices.

Mr Hunter said the job description contained a fair statement of what he considered to be the principal objectives of his position. He also considered the list of duties to be an adequate statement for 1986; however, some time after 1986 he also became responsible for preparing the problem loans report and had some involvement with particular problem loans.

Mr Hunter's job description indicates he was responsible to the assistant general manager credit and securities, Mr Stott. But he said in evidence that, in practice, he reported directly to Mr Johns and to a lesser extent to Mr Mountford. Hunter agreed with the proposition that, "Mr Stott exercised very little supervision and was quite happy for [Hunter] to run the securities area as [he] saw fit."

From December 1982, at the request of Johns, Hunter and Stott audited the security divisions of interstate offices of Tricontinental. Hunter said:

"I endeavoured to look at every loan file, although in later years (from 1987) this became much harder due to the increasing work load of the securities division. ... our audit of securities was not specifically directed at problem loans. We checked that the securities held and the covenants stipulated in the letter of offer were complied with. However, it was not a part of the securities audit to check the correctness of things such as cash flows or other financial data. ... we also did spot audits to ascertain whether reporting covenants were being complied with."
Johns said, "Hunter was...continually told that part of his function was to conduct internal securities audits and to check the lending operation systems at other offices, and I reminded him of these matters from time to time."

Hunter said in evidence that these audits of interstate securities departments uncovered a number of errors or instances where guidelines were not being followed. As a result of the discovery of these discrepancies, it was decided, in about 1983 or 1984, to centralise the securities function Australia-wide so that one centralised area was responsible for all Tricontinental security documents. In his statement to the Commission, Hunter said:

"As a result of the restructure, the Melbourne office's function differed quite considerably. After 1984/85 all letters of offer were prepared in Melbourne and despatched to the interstate offices for checking, signing and despatch. The Melbourne office was vetting all security documents Australia-wide, including valuations, and ensuring all the terms of the interstate office's letters of offer had been complied with before the Melbourne office's approval was given for the drawdown of funds. That structure remained the same until May 1989."

In his statement to the Commission, Hunter described the process of preparing securities after the securities department was centralised. The securities department would be given a copy of the credit submission that had been sent to the relevant approval authority, and would prepare a letter of offer in anticipation of approval. Once approval was obtained, the securities department would be given a copy of the approved credit submission. Any conditions of approval noted on that credit submission by the credit committee or directors would be incorporated into the letter of offer, which would then be forwarded to the borrower. Once the accepted letter of offer was received by Tricontinental, a copy of that letter would be sent to one of the panel of solicitors, requesting that firm to prepare the necessary security documentation. Hunter said:
"... I was aware, due to the dealings I had with the various solicitors with whom [Tricontinental] dealt, that as part of the preparation of the security documents, the solicitors completed company searches in respect of the borrower and any corporate guarantor or corporate provider. In addition, the solicitors undertook searches of the relevant titles of any freehold or leasehold properties. There were no searches to bankruptcy or the creditworthiness of directors effected by the solicitors."

The securities department used a pro forma letter of offer. Additional covenants required by the lending officer or approving authority would be added to the letter of offer where these were specified in the credit submission or as a result of the approval process. In his statement to the Commission, Johns said:

"During early 1988 Hunter suggested that a standard letter of offer for use Australia-wide be prepared. I agreed. A pro-forma was prepared with input from all TCL panel solicitors. I continually asked Hunter for the final document, which took some 12 months to produce."

Later in evidence he added:

"I don't think Hunter ever really finished the pro forma letter of offer. Letters of offer did eventually have a reasonably standard form, allowing, of course, for variations in terms of the specific needs of the specific facility."

Hunter described the securities department's involvement in the credit approval process as follows:

"The security division had very little input into a credit submission except if [a lending] officer asked us what types of securities [Tricontinental] should get. ...generally speaking by the time the submission reached the securities division the securities had been: (a) finalised or agreed with the client; and (b) approved by the relevant approval authority. ... It was not the duty of the securities division to analyse the adequacy or appropriateness of security taken in support of any specific loan applications. I did not analyse the pros and cons of the lending decision. This was the task of the lending officers, the lending manager, the [managing director], the credit committee and the board. Once the letter of offer was sent and accepted by the client, I would then take steps to ensure that all securities were in place prior to drawdown. It was a mechanical task, not involving any process of evaluation."
This is supported to some extent by Mr Johns' evidence that:

"I regarded Mr Hunter along with Mr Stott, as my left and right hands. But I did not expect Mr Hunter to take any role at all in dealing with the pros and cons of a lending decision as to creditworthiness. I did not discourage him from reporting to me, for instance, on his monitoring process. I describe him in relation to certain transactions as an account manager for monitoring covenants."

However, contrary to Hunter's perception, Johns considered that:

"The securities division had the responsibility to advise the lending officer if it considered that additional security should be taken."

14.165 Hunter said that, before issue, the letter of offer would be checked by himself or by the assistant manager of securities, to ensure accuracy and completeness. He said he felt his job was more mechanical than analytical and that he had no involvement in the analytical side. The securities department relied on the legal advisers to ensure the enforceability of documents.

14.166 Hunter said he regarded the lending officers as being responsible for ensuring reporting conditions contained in letters of offer were satisfied as, generally, it was the lending officer who insisted on the reporting conditions being part of the loan agreement. In 1984 or 1985 he conducted a review of the special conditions and reporting conditions contained in all letters of offer. He then sent a memorandum to each regional manager asking that they satisfy themselves that the reporting conditions were being met as provided by the letter of offer. He did not repeat this exercise, because, as he said in evidence, "It was the responsibility of each lending officer to monitor the receipt of reporting conditions, but I saw it as part of my responsibilities, as in the audit function, to check that they were obtaining that information."

14.167 In his statement to the Commission, Mr Hunter said the monitoring of share prices was the responsibility of the securities department. After the
October 1987 share market crash, Hunter, Mountford and lending officers were instructed by Johns to make calls to Tricontinental’s borrowers to seek top-ups of security. Hunter said, "I was instructed by Johns that should a facility not be topped-up (particularly in relation to interstate offices), they were to be immediately advised to the [managing director] and the general manager lending." A draft of the internal auditors’ report for October 1986 stated, "The review of the share scrip register revealed instances where the share scrip held as security was below the cover required for the lending". Hunter said the issue of inadequate share scrip security was never raised with him by the auditors. He said it was not a concern of the securities area but rather a concern of the lending officers. He added, "... we were mechanically preparing the share return whereas it was generally the lending officers’ position to obtain top-up security".

In relation to the enforcement of securities, Hunter said:

"In respect of a default where it was decided it was appropriate to enforce the security, the securities division would receive instructions from the relevant lending officer or [managing director] to have solicitors serve a demand and we would do that. Generally speaking, anything that was undertaken by the securities division in respect of a defaulting loan would be subject to instructions from the relevant lending officer."

From approximately August 1987, Mr Hunter was responsible for the preparation of the problem loans reports which were submitted to the board. He said this report was prepared on the information supplied by regional managers and that he "...accepted the information supplied by the regional manager or his staff as being correct because each problem loan was also reported to either the [managing director] or the general manager." In the case of Johns’ files, the report from the regional manager would simply say "refer IMJ". Hunter said where there was such a reference, he approached Johns to obtain details of the current position of Johns’ clients. This information would be incorporated in the problem loans report. Where Mountford had assumed control of some of Johns'
loans during the six to nine months period before May 1989, he would speak to Mountford to obtain the information necessary for the preparation of the problem loans report.

The minutes of the Tricontinental board meeting of 19 April 1985 state, "The board agreed that a summary is to be tabled each month of these credit problems rating them as to the doubtfulness of their financial recovery. The schedule is also to include management's estimation of any anticipated loss". It was Hunter's responsibility to prepare this summary. He said that, while the summary did not rate a facility as to doubtfulness of financial recovery, "It usually stated if we thought that a provision had to be made or if we believed full recovery would be made". He said he wrote the comments in the light of reports provided by the regional managers or, in the case of loans administered by Johns, based on what Johns told him. He considered it was never his judgment about the likelihood of recovery that was required; he was merely reporting someone else's judgment.

Hunter said, "The securities division was not responsible for assessing securities other than ensuring it obtained copies of the necessary valuations". However, Mr Johns gave evidence that:

"Hunter, as head of the securities division, was responsible to read and assess valuations received directly by his division, including valuations for all loan applications made to me and either approved by me under discretion or referred to the credit committee. [He] was also required to read and inspect valuation reports during internal securities audits of other offices."

In respect of freehold property, Hunter said it would normally be a condition precedent to approval that a valuation by an independent valuer be obtained for mortgage purposes. He, or the assistant group manager securities, had the discretion to select a valuer unless Johns stipulated a particular valuer for a particular facility. The assessment of the value of securities other than land, for example mortgage debentures, was undertaken by credit analysts. In relation to real estate and other specialist
valuations, for example those relating to mining, Hunter said, "I ensured that the valuation appeared satisfactory and that nothing was said that suggested any future problem about the value of the securities. It was not my role to go behind the valuations that were obtained from professional external valuers."

A number of times while giving evidence, Hunter stressed that his role was a mechanical, rather than an analytical one. There is evidence to suggest that his role could have been more significant, but he tended to avoid responsibility. He said in evidence, "I had quite a bit of dealings with clients through Ian. Quite often I went to meetings with him with clients." He said the purpose of his attendance at these meetings was to answer any queries in relation to letters of offer or securities and that he was introduced to clients as the point of reference in relation to letters of offer and securities should Johns not be available. He added that he had a "very passive role" at these meetings, except when he was asked a direct question by Mr Johns or the client. Johns said, "I did not begrudge Mr Hunter speaking to clients or making contacts with clients - he did speak to a number of clients. I did not stop him. He was a long term employee and a number of clients got to know him over the years. It was just through general chatting with him that I knew he was talking to clients."

In a memorandum dated 3 November 1986, Johns informed Mountford, Stott, and other relevant managers that, from that date, Mr Hunter would assume full control of default and doubtful debts, as well as overseeing full responsibilities for lending securities. Hunter said he did have full responsibilities for lending securities. However, he said that Johns and Mountford had control of default and doubtful debts and that he had only limited involvement. He considered his involvement in default and doubtful debts was limited to the preparation of a problem loans report and managing a particular problem loan he inherited (not one reviewed by the Commission) and a couple of other minor facilities. The minutes of the
management group meeting of 8 July 1988 state, "The managing director asked Mr Mountford to review Mr Hunter in his role of managing default loans". Hunter said in evidence that neither Mountford or any other senior manager ever discussed or reviewed with him this "role of managing default loans". He said he did not consider that he had a role in actively managing default loans and that any involvement with such loans would be at the direction of Mountford or Johns. Mr Johns said in evidence, "At one stage Hunter was in charge of problem loans and Debbie Wall was in charge of securities, but Hunter did not perform that function to the satisfaction of Mountford and myself."

In his evidence to the Commission Mr Mountford said, "...as far as intensive management of [problem loans], the files were totally controlled by Neil Hunter and myself and we sought the support of our regional managers in their consultations and their discussions with solicitors and advisers, but essentially it was driven from my office." When this statement was put to Hunter during his examination, he said, "It would be correct to say that the files were totally controlled by Mr Mountford, but I had involvement with them [at] his direction." Hunter said it was "totally incorrect" to say that the problem loans were totally controlled by himself and Mountford. He said he had some involvement in seeking the support of regional managers in their consultations and discussions with solicitors and advisers. Mr Johns agreed with Mountford's comments but said, "Hunter, in spite of instructions from me, did not assume responsibility for managing problem loans. He was only prepared to act on express instructions from Mountford and myself. Later, Mountford took greater control in this area". He also said, "At one stage we allocated Hunter to the special task [of chasing up bad debts], but he did not rise to the occasion or did not undertake the responsibility."

In his statement to the Commission, Hunter said, "As far as being actively involved on a day-to-day basis with the problem loans, there was only one
loan that I actually inherited and saw through to the extent of Tricontinental getting its money back. All other problem loans were the responsibility of the relevant lending officer or the general manager lending or the [managing director]. A schedule of accounts and arrears as at the end of August 1988 identified Hunter as the account manager for a number of facilities. Hunter said he was not the account manager for those facilities as he did not have any contact with the clients and that he was simply acting on instructions from the account manager, namely Mr Johns. He said that Johns had the overall responsibility for these files and that he was merely carrying out specific tasks at the request of Johns.

The notes of an interview between the internal auditors and Hunter on 23 November 1988 stated, "The incidence of bad and doubtful debts is considered satisfactory and as being consistent with the client base for whom facilities are made available." It was put to Hunter during examination that the interview notes suggested that he had a role in excess of that which he described in evidence before the Commission. In response he said, "It would not be my position to make a statement that the incidence of bad and doubtful debts is considered satisfactory and as being consistent with the client base. I would not have been saying that." He said he had no recollection of this interview with the internal auditors.

When being examined in relation to annual reviews, Mr Ziebell said, "The securities area would be looking at the security we had for the debt and ensuring that that was still a viable security." Mr Hunter said in evidence that, to the extent that Ziebell’s evidence suggested that he had a function of initiating a review of the ongoing viability of securities, that was not correct.

Asked whether there was any aspect of Tricontinental’s business for which he did not have control of securities, Hunter said, "I had nothing to do with the investment portfolio." However, during cross-examination, he said he
had involvement in the preparation of some put and call options in connection with Tricontinental's investment banking activities, in particular, Interwest, Quadrax, Kulim, Australian Racing and Breeding Stables and Elders Resources. He said his involvement was limited to "the preparation of a document, acting under instructions once again".

(d) Relationship with Ian Johns

Mr Hunter made the following comments about Johns:

"I have a lot of admiration for Mr Johns' ability, particularly given his age when he was appointed managing director, but he was a tough man. He worked hard, and he expected everybody else to work hard...he was a demanding boss, but on the other side of the ledger he could be very pleasant company socially. If anybody was in trouble over anything he would give them his last dollar if he could, but work was work". He added, "...he was an extremely hard worker. He certainly led by example".

In his statement to the Commission, Hunter said, "Johns ran a very 'hands on' operation and I would say he had an intimate knowledge, through discussions with various officers, of each and every bad loan, including any of the loans he had written himself." He said in evidence, "Mr Johns ran very hands on and was always very interested in what his clients were doing and kept very close to them."

As discussed in section (c) above, Hunter was responsible for the preparation of the problem loans report. This report comprised three sections, namely,

(i) summary of arrears/default loans,
(ii) summary of non-accrual loans, and
(iii) summary of loans for which interest was still being accrued.

Hunter gave evidence that, between July 1988 and May 1989, Johns requested that certain default loans and loans for which interest had been outstanding for one to two months be omitted from the problem loans report. Hunter said he did not regard Johns' request as particularly unusual.
and, given his position with Tricontinental, did not query his decision. He added, "... they were Ian's clients and I am not aware or privy to whatever [actions] he may have ... taken or [whether he was] providing additional information to the board."

(e) Awareness of, and responsibility for, deficiencies in systems

14.182 In his statement to the Commission, Hunter said:

"In relation to securities other than shares, .... cash was lent against the value of the security at that time. There was no provision in the letter of offer for updated valuations (which would be at the client's cost) to be undertaken by [Tricontinental]. Generally speaking, the only time that updated valuations were commissioned was where a client wanted an increased loan against the secured property".

14.183 Hunter said in evidence that, having come from a trading bank, he had been used to manuals. He said, "... I probably found it strange to a certain degree that there were no set guidelines in writing, and as a guidance for new staff members". However, in his statement to the Commission, he said:

"I did not believe there were insufficient securities guidelines upon my initial employment at [Tricontinental] even though I had come from a trading bank .... [Tricontinental] at that stage was comparatively small [and] I believe that one person could cover everything quite adequately, provided they had the knowledge. However, as [Tricontinental] grew and we centralised the securities division, it was obvious we needed some operational guidelines to ensure that each office was running the same as the head office. At the time of the re-structure of the securities division, I spoke to Johns and queried whether he deemed it necessary to have a securities manual and his reply at that stage was that he didn't really like manuals and didn't think it was quite appropriate. I suggested that we do a brief summary of guidelines that would be distributed to each office so that everything was more or less running the same everywhere. Johns agreed with this suggestion."

14.184 Hunter said the guidelines drawn up by him (see para 22.24 of the first report) were meant to be adhered to and, in his view, it was not permissible for an employee to deviate from the stated guidelines. He said
there were occasions when the guidelines were deviated from in respect of minor procedural matters, but otherwise, he believed they were adhered to.

The guidelines written by Hunter did not set out the particular securities to be taken. Hunter said that was a matter for the lending officer to confirm with his client. He said:

"The unwritten laws were that you would always, where possible, take a mortgage debenture over the company's assets and also definitely the guarantees of directors. ... Johns was of the view that if a prospective client's directors were not prepared to give their personal guarantees, we shouldn't lend to them. Therefore, it was a requirement the whole time. However, this requirement was waived in certain instances at Johns' discretion".

In his statement to the Commission, Hunter said:

"There were times when letters of offer were prepared and despatched purely on the basis of a memo from Johns to me wherein he had stated that he had approved under his discretion or, alternatively, he had gained the verbal approval of directors for a particular loan. There were instances where Johns would call in either myself or my assistant, Debbie Wall, and give us details verbally of a submission that he had approved under his discretion, but hadn't had time to have a memo typed".

Hunter could recall only one example of a large amount of funds being drawn down before the execution of the securities. In this instance, he was given a certificate of title to a particular property and an undertaking that the borrower would execute the security documents at the earliest opportunity, and a brief letter in which the borrower acknowledged that the securities held on other facilities would secure the new facility. Hunter said there may have been other instances where small amounts of money were drawn down before the execution of security documents.

Hunter said that, as early as 1985/86, he was instructed by Johns that no auditor was to be given access to any file before Johns approved release of
that file. He could recall only two or three occasions on which Johns refused the auditors access to one of the files they had asked to see.

Hunter made the following comments on the securities department:

"I believe that within the credit, securities and lending operations division, there were pretty good controls in place, particularly on the share monitoring. In respect of freeholds, we had no control over declining property values. I believe that [Tricontinental] had controls in place and knew what their clients were doing.

Whilst there has been some criticism of the securities taken, I am of the view that the security documents themselves have been prudently attended to in their preparation and execution and, on their face, appear readily enforceable. To the extent that this was the task of the securities division, it is my opinion that the securities division undertook its duties thoroughly. Any criticism which is to be levelled at the securities is really a criticism of the securities accepted for the loan transaction in question. .... I do not perceive the approval of certain securities for borrowed funds to be the subject of consideration or determination by the securities division or myself."

Mr Hunter said he was exposed to thousands of credit submissions. He said, "...there would be a lot of submissions that contained all the pertinent information that should be supplied. Then again, there would be submissions that would ... be very brief on information." He said that, for the purposes of preparing the letter of offer, he could always find the necessary information in the credit submission.

Hunter said the thought went through his mind and, he thought, other people's minds quite regularly, that some of Tricontinental's borrowers had sought funds from other sources and had failed, and accordingly, had come to Tricontinental as their last resort. Hunter was asked what procedures were in place to verify the usefulness of personal guarantees given by high net worth individuals where facilities were granted to corporations. He said in response that it was up to the relevant lending officer whether or not an asset and liability statement was obtained from the guarantor. He
said he did not believe there was a desire on the part of the lending officer to elicit that sort of information and that he thought there was a willingness on the part of the lending officers to accept what they were told as being the financial position in respect of a particular individual. Hunter said that, on occasion, lending officers came to securities department and sought assistance about the type of securities which should be obtained for a particular transaction. He added that, in hindsight, perhaps this should have occurred more often.

Hunter said he did not recall the credit procedures manual being made available in the securities department, and it was certainly not provided to new securities officers as they joined Tricontinental. By contrast, he said the securities guidelines written by him were for the benefit of lending officers as well as officers in the securities area. He said the guidelines were made available to every new officer who came into the securities department and should have been made available to any new officer in the lending division. He was personally responsible for the distribution of the guidelines to new staff in the securities area in Melbourne. Regional managers from interstate would receive a copy of the guidelines, the front page of which contained the instruction that each lending officer was to receive a copy.

In addition to the securities audits referred to in paras 14.161-162 above, Hunter also conducted spot audits to ascertain whether reporting covenants were being complied with. In his statement to the Commission, he said, "It was very difficult to monitor covenants restricting the incurring of additional indebtedness by the borrower." He agreed that such a covenant was a significant condition. He said monitoring compliance with such a condition was the function of the account manager, who should have been close enough to his client to know what was happening. Tricontinental would simply rely on an assurance from the borrower at the beginning of the facility that no indebtedness would occur without notice to
Tricontinental. He said that, in this respect, Tricontinental was the same as any other lending institution.

In relation to covenants to supply monthly financial statements, Hunter said that, to his knowledge, such requirements were generally complied with; however he could not comment on the earlier years, when no one was policing this. He said it was the lending officer's job to monitor the loan from drawdown and thus to ensure such a covenant was complied with. It was up to the individual lending officer to implement his own system to monitor compliance with such a covenant. However, Mr Johns said in evidence, "It was the securities division's responsibility to ensure that all covenants were adhered to. Once a letter of offer was accepted by a client, these matters were diarised by securities to follow up." In the face of this conflict of evidence, it must be assumed that Mr Johns spoke of what he thought was happening, and Mr Hunter spoke of what actually happened - or failed to happen.

Hunter said he had some reservations about placing a value on mortgage debentures. He said the reason for his reservation was that, when companies ran into trouble and loans were not repaid, the mortgage debentures turned out to be valueless as the assets had gone. He considered that it wasn't up to him to gauge the extent to which the security met the lending guidelines, but, he "... always shook my head for the 8 or 9 years that I was there, [about] the values that were extended against mortgage debenture lending. That always concerned me because, .... the trading banks never extended a value".

In relation to valuations of property, Hunter said, "We would ensure that .... the valuation had been undertaken on the basis that it was for mortgage purposes." The valuations were always sworn valuations. To his knowledge, no briefing document was provided to valuers. He said, "if the valuer had reservations about the future marketability or saleability of the
property, we would have expected him to highlight it within his valuation.

.... Generally valuers .... know what is required in doing a valuation for .... mortgage purposes, that they must look at it on the basis of a fire sale, if necessary."

In his statement to the Commission, Hunter said:

"I do recall the existence of a 'watch list' in relation to potential problem loans .... the regional manager of each officer would monitor an account closely if he suspected that a client may be in potential financial difficulty or the value of the security was deteriorating. This was a matter to be included in the watch list. .... When a borrower was put on the watch list they would be performing loans, they would not be 'in default' as such as that time".

He said in evidence that this watch list was never provided to the board as the board never requested such material be provided to them, and that he did not consider that the board would have been concerned at a watch list where an actual default had not yet occurred. He said, "I prepared the problem loans report [on the basis of] what I believed the board had requested be supplied to them." He was not aware that the internal audit report dated December 1988 suggested that priority be given to monitoring the potential failure of a client's obligation to Tricontinental, although this was to some extent being provided by the watch list.

The monthly arrears report procedures were dealt with in a memorandum dated 6 May 1985. The memorandum stated:

".... where interest is in arrears, a letter is to be forwarded to client after 7 days with a follow up letter after 14 days seeking payment. [In addition] a personal telephone call would have been made to the client direct, and if payment had not been received after 30 days, notice of demand would be served only subject to the prior approval of [a manager lending]."

Hunter said in evidence said that he could conclusively say that this statement was not followed in practice. As a result of a memorandum
from Johns to Mountford dated 9 November 1987, which was copied to him, he was aware that Johns had instructed various officers that:

"It is essential that all outstanding interest payments are collected as soon as possible and that the extent and level of these arrears, that is $148m, do not appear in board papers. All efforts must be made this week to collect outstanding payments and where officers and/or managers experience any difficulty the matter is to be referred urgently to myself and I will personally make the required phone call."

An Australian Ratings report attached to the January 1988 managing directors report stated:

"Tricontinental's client base includes a number of parties which could have been expected to come under financial pressures as a result of the share market collapse in October 1987. However we understand that to date no major problems have been experienced in this area and all top up calls have been met."

Hunter said in evidence that he did not agree with that statement. He had no role to play in providing information to Australian Ratings.

The process of monitoring the prices of shares held as security was undertaken by the securities department. Hunter said, "We basically relied on the Financial Review or the Reuters screen." He said no effort was made by the securities area to assess the intrinsic worth of the shares. He thought that, if this occurred, it would have been done by a lending officer or the analytical area, but probably only in respect of selected stocks.

Hunter said he did not ever receive a report from the auditors dealing with the securities department. However, he did see a report that went to Mr Stott that contained about two references to the securities department. He added that he never received any document or communication from Mr Johns or any other senior manager informing him of concerns by the auditors as to the way to which the securities area was operating. He said that, to the extent that reports were made by the internal auditors which
covered matters within his area, he would have expected Mr Stott to raise those matters with him.

A draft internal audit report for December 1988 stated:

"There was concern that the ongoing recording of holdings of listed securities is through a record of ins and outs, without there being a regular physical count of the total holdings, and a recommendation that future system up-grades in this area include an integration of the credit exposure system and monitoring of securities required under facility approval. We also recommend that periodical, say, quarterly, counts be conducted of listed securities and that these be reconciled to the underlying accounting records."

Hunter agreed that this was clearly a matter with which his department dealt directly but this issue was never raised with him. Nor did he see it as a problem. He said, "Every time shares may have been received or any released, the share monitoring process would be amended accordingly."

Hunter said it was commonly the case that a formal valuation of property had not been obtained at the time the credit submission was approved. Whatever analysis the credit analyst was doing was essentially based on the client's estimate of the property. Once the formal valuation was received, there was no system of copying it back to the credit analyst, and it would only be provided to the lending officer if that officer had expressed an interest in following up the matter. Accordingly, he said, there was no one at Tricontinental who, as a matter of routine, was undertaking a critical assessment of assumptions underlying the valuation, except perhaps the lending officer if he asked for and read the valuation. However, he said, the securities department would read valuations to ensure they did not contain anything that could affect a potential sale or the value of the property at a later date. He added, "There were occasions we had to go right back to valuers because they hadn't confirmed that it was for mortgagee purposes". Apart from that he could not recall any specific cases where he was dissatisfied with the nature of a valuation received. He said, "There may have been a few occasions that if we weren't happy with
something we would probably refer it back to the lending officer and say to him that maybe he should broach the subject with the valuer."

(f) Responsibility for changes or improvements in systems or practices

14.204 Mr Hunter's job description listed as one of his duties, "instigation and maintenance of internal systems in relation to securities." Hunter drew up the guidelines for the securities division in 1984 or 1985. He said, "My belief is that most officers found the guidelines helpful because there had been no strict guidelines or guidance before and it assisted new staff." He also considered they worked well to establish a consistency between the various interstate offices and had the effect of ensuring a more efficient and standardised response. He was also responsible for implementing or suggesting changes to the guidelines. He said there were no substantial alterations during the period 1985 to May 1989, and any changes made during that time were of a procedural nature.

14.205 Hunter said he did not believe it was his position to comment on whether or not he thought the security on a particular transaction was inadequate. He said, "if the credit committee and board had approved [the securities], I didn't think it would be appropriate that I intervened."

(g) Possible breaches of law or of a duty of care

14.206 On the basis of their analysis of transactions entered into by Tricontinental, counsel assisting have identified several instances in which they submit that Mr Hunter committed a breach of s229(2) of the Code or, at least a breach of a common law duty of care.

Atoll Corporation Pty Ltd (TR 1)

14.207 Mr Hunter's role in the Atoll facilities involved preparing the first letter of offer, taking securities for each facility, arranging the issue of default notices under the first facility, preparing the problem loans reports at
Johns’ direction, and giving instructions for the notice of default in relation to the second facility. In their submission on the Atoll transaction, counsel assisting argue that Hunter was incompetent in that he made no genuine independent checks of information, and totally relied on Johns’ provision of information for passing on to the directors. There is no suggestion that Mr Hunter’s conduct amounted to a breach of s229(2) of the Code.

In their submission on Atoll, Hunter’s counsel say it is true that Johns’ domination meant Hunter did not provide any check or balance. However, in their submission, this contradicts the assertion that he was incompetent, as he was subject to the direction of Johns and was an employee of Tricontinental. They argue that he was required to, and did, adhere to the directions of Johns, which is not an aspect of incompetence but an aspect of complying with directions. These questions are dealt with generally in paras 14.365-367 below.

Direct Acceptance Corporation Ltd (TR 6)

In July 1986, Johns and Ryan approved a $4.3m facility to Amaldela Pty Ltd (‘Amaldela’) - a company within the Rocado group, which had a shareholding in Direct Acceptance Corporation Ltd (‘DAC’). The facility was provided to Amaldela to assist it to acquire a 13.33% interest in Dutch Hotel and Casino Development Corp N V (‘Dutch Co’). Dutch Co was proposing to undertake the redevelopment and refurbishment of a casino on the island of Aruba in the Netherlands Antilles. The facility was to be for a term of six months, and secured by a registered charge over the shares in Dutch Co and an assignment over funds to be raised by the flotation of Churchill Leisure Industries Ltd (‘CLIL’) (another company in the Rocado group), which was expected to raise $6m by mid-October 1986.

The credit submission that was prepared stated that the facility was subject to a precondition to drawdown - that Tricontinental was to receive confirmation of a firm underwriting agreement for the public flotation of
CLIL. Drawdown of the facility occurred on 24 July 1986 for the full amount. The precondition to drawdown was not dealt with until October 1986, and even then the underwriting agreement depended on Tricontinental first receiving firm commitments for the majority of the underwriting exposure.

14.211 It is the submission of counsel assisting that, as Mr Hunter was responsible for the management of the securities department which was an important aspect of Tricontinental’s business, he was responsible for ensuring that no drawdown occurred until such time as the precondition in relation to security had been fully satisfied. They submit that, in failing to meet this responsibility Mr Hunter, as an executive officer of Tricontinental, failed to exercise the degree of care and diligence required by s229(2) of the Code.

14.212 It is submitted by Mr Hunter’s counsel that the person in Tricontinental who played the pivotal role in relation to the transactions and loan facilities to the DAC group was Mr Johns who, since 1985, had been the account manager for the companies that formed the DAC group. They further submit that it was the responsibility of Johns, the account manager for the Amaldela facility, to ensure that the precondition that a firm underwriting agreement be in place before drawdown was satisfied. If the precondition was to be varied, it was for Johns to take it back to the board. Hunter’s counsel submit that, as the Commission did not have the benefit of hearing evidence from Johns, and given the pivotal role played by him in respect of the DAC group, it is not open to the Commission on the evidence to make any findings against the directors and management of Tricontinental, including Mr Hunter.

14.213 The Commission accepts that it is not possible for it to make a clear finding on this issue, particularly as the precondition was not set out in the letter of offer, upon which Mr Hunter based his monitoring. This case will be covered by the general findings in paras 14.365-367 below.
In November 1985, Tricontinental provided a facility to Qintex Limited ('Qintex') for the purpose of financing the acquisition of 19.9% of AWA Limited. The credit submission on its face indicated that Tricontinental was to provide $25m of a $75m syndicated facility, with two other banks contributing $25m each. Approval was given by directors on the condition that Tricontinental's exposure to the Skase group should not exceed $75m. It already stood at $67.7m, according to the credit submission. The letter of offer for the facility, which was signed by Johns and Hunter, was inconsistent with the approved credit submission in that it offered a $75m facility and referred to Tricontinental having the right to syndicate the facility, rather than stating that the provision of funds was conditional upon syndication. By July 1986 the facility was drawn down to $71m. The proposed syndicate was never formed.

AWA Limited shares were initially held as security for the facility, but were released and replaced by shares in Qintex Australia Limited ('QAL'). The security for the facility ultimately consisted entirely of QAL shares, representing 25.2% of the issued ordinary capital in QAL.

Hunter was responsible for the preparation of the letter of offer and signed it with Johns. He gave evidence that the letter was prepared under instructions from Johns, although he could not recall an instruction from Johns to change the amount of the facility to $75m. He also gave evidence that he knew nothing about the circumstances in which the letter of offer was amended, mainly to extend its term from two years to three, but identified the initials opposite the amendment as Johns'. He said he was not given any opportunity to report to the board on securities. It is the submission of counsel assisting that Hunter should have reported to the board any instruction he received from Johns to offer a facility of $75m despite the limited approval given by the board. They submit that, in failing to do so, he failed to exercise a reasonable degree of care and
diligence in the performance of his duties, contrary to s229(2) of the Companies Code. Counsel assisting also submit that Mr Hunter failed to exercise a reasonable degree of care and diligence within the meaning of s229(2) in permitting Tricontinental to accept QAL shares as the sole effective security.

In their submission on Qintex, counsel for Mr Hunter highlight his evidence that the variation of the letter of offer from the terms of the approval would have been done under the specific instruction of Johns. In response to the submission of counsel assisting that Hunter should have reported Johns' instructions to the board, counsel for Hunter submit that it was not his role or responsibility to report to the board, this being the function of Johns. They refer to Hunter's evidence that he was never requested to give continuing advice in evaluating the worth of any security, and that the managing director was always aware of what was held as security. Hunter also said he did not have access to the board at all, and all the information that went to the board would be contained in the credit submission.

Hunter was asked whether, if he had a concern about the value of security of a particular type, he would see it as a part of his duty to report such concern and express a view about it. He replied he would do so to Johns, but not to the board. He added that it may have been too late to tell Johns - if security had already been agreed and approved by the credit committee and the board. Hunter's counsel state that this is wholly consistent with the obligations cast upon him, as an employee of Tricontinental subject to any direction and instruction from the managing director. In response to counsel assisting's submission that Hunter did not exercise a reasonable degree of care and diligence in permitting Tricontinental to accept QAL shares as sole effective security, his counsel argue that it was not the role or duty of Hunter to decide on the adequacy of security taken by Tricontinental. This was a matter for Johns or the
board. They point to Hunter's evidence to the effect that it was not his role to consider the adequacy or otherwise of security or whether it met existing guidelines.

In the opinion of the Commission, it was no part of Mr Hunter's duty to go to the board about the matters in question. He had no knowledge of what may have passed between Mr Johns and other directors, and it was not as though there was any suggestion of corruption or dishonest dealing on Johns' part. All Hunter could see was an apparent variation to a credit submission, conveyed to him by the managing director.

**Qintex Australia Limited (TR 8)**

Qintex Australia Limited ('QAL') was a publicly listed company of which Qintex Limited ('Qintex') gained control in 1981. Tricontinental provided two facilities to QAL: a $27m facility in August 1988 ('facility 1') and a $25m facility in January 1989. Facility 1 was for the purpose of assisting QAL to make an early discounted payment of its debt to the Fairfax group. Its term was to be a maximum of eight weeks. The security was to consist of a guarantee from Qintex, an assignment over all the proceeds of a call on partly paid QAL shares and a letter of acknowledgment that three major shareholders would make payments when the call was made.

Counsel assisting submit that, on the evidence, it is probable that the assignment over the call proceeds was never taken as security by Tricontinental. The call was delayed and the term of the facility extended by one month to 30 November 1988. In November 1988, Mr Skase requested a six year extension of all Skase group facilities. Directors approved a three year extension. At the same time, the security was reduced to a guarantee from Qintex, and there was no requirement for QAL to use the call proceeds for repayment of the facility.
In their submission on QAL, counsel assisting argue that it was Mr Hunter's responsibility as group manager securities to ensure that the security stipulated in letters of offer was taken. Mr Hunter said in evidence that he had no reason to doubt that the security stipulated in the letter of offer for facility 1 was taken. He said that, if it was not taken, the only possible explanation was that the account officer gave instructions not to take the security. However he could not recall such instructions being given. Counsel assisting submit that, as Mr Hunter was the manager of the securities department and responsible for any failure to obtain the designated security, he failed to exercise a reasonable degree of care and diligence as required by s229(2).

On the other hand, counsel for Mr Hunter submit that the security for facility 1 was adequate. They point out that counsel assisting, despite due search and enquiry, have been unable to locate an assignment over the call moneys, and there has been no evidence presented to the Commission to confirm whether or not an assignment ever came into existence and, if it did, why it was not used to ensure repayment of facility 1. Such an assignment should have been obtained by Tricontinental's solicitors and, if it was not, they may have been at fault.

In response to the submission of counsel assisting that Hunter breached s229(2), his counsel submit that, at all times, he had to adhere to the directions and instructions of Johns, the account manager. They point to his evidence that there was no reason to doubt that the security stipulated in the letter of offer for the facility had been taken. They submit that, in the absence of evidence from Johns, it is not possible to say that Hunter was in breach of s229(2). The Commission accepts these submissions of Mr Hunter's counsel.
Kahmea Investments Pty Ltd (TR 9)

The Commission examined three facilities provided by Tricontinental to Kahmea Investments Pty Ltd ('Kahmea'), the private investment company of Mr Christopher Skase. These facilities were for amounts of $9.06m, $39m and $4.5m, respectively. The security for the facilities was almost exclusively in the form of shares or convertible notes in Qintex Limited ('Qintex'), in which Kahmea had a 52% shareholding. Personal guarantees were also given by Mr and Mrs Skase as security for facilities 1 and 3. The credit submission for facility 1 showed that Mr Ryan's approval was subject to a "first mortgage over Dickson Terrace property". A letter dated 12 May 1987, signed by Mr Hunter, stated that the security for facility 1 included a deposit of certificates of title for the Dickson Terrace property - not a mortgage of that property as stipulated in the letter of offer. On the letter of offer for the extension of facility 1, signed on behalf of Kahmea and returned to Tricontinental, there was a hand-written note which read "titles to 26-36 Dickson Terrace in names C C Skase and P N Skase to be returned to C C Skase". The certificates were returned to Mr Skase, under cover of a letter dated 16 January 1989 signed by Mr Gold, an officer of the securities department which was under the control of Hunter. The property was eventually mortgaged to the Australia and New Zealand Bank ('ANZ').

Counsel assisting submit that Mr Hunter failed to exercise the degree of care and diligence required by s229(2) of the Code by agreeing to accept additional shares and the deposit of certificates of title as security in lieu of a property mortgage, without prior approval of the directors. It is further submitted by counsel assisting that Mr Hunter failed to exercise the degree of care and diligence required by s229(2), in permitting the return of certificates of title, which had been held as security, to Mr Skase.

Counsel for Mr Hunter refer to the very special business relationship over a period of seven or eight years between Johns and Skase, and the fact that
Skase conducted delicate negotiations directly with Johns. They submit that, on the evidence, Mr Hunter was merely following the directions of Johns and it cannot be said that as an employee in following a direction of the managing director he failed to exercise the care and diligence required by s229(2) in accepting additional shares and the deposit of certificates of title as security in lieu of a property mortgage. His counsel further submit that he did not fail to exercise the degree of diligence and care required by s229(2) in returning the certificates of title. They argue that, whilst they did not have the opportunity of cross-examining Johns as to the return of the certificates of title, it is probable that the certificates were returned to Skase on the instruction of Johns. In support of this, they refer to Mountford's evidence that, in the first instance, it is the account manager's responsibility to decide if security is to be released. As Johns was the account manager for Kahmea, the release of security was his responsibility. This matter is dealt with in the Commission's general findings in paras 14.366-367 below.

The Goldberg group - Parkston, Entrad and Roxbury Holdings (TR 12)

14.228 Tricontinental lent extensively to the Goldberg group between 1986 and 1989. The Commission examined in detail three facilities to companies within the group to which a total of $82m was provided, namely:

- Parkston Limited ('Parkston') - $50m,
- Entrad Limited ('Entrad') - $10m, and
- Roxbury Holdings Pty Ltd ('Roxbury Holdings') - $22m.

Parkston Limited

14.229 The Parkston facility was provided in April 1987 to finance a takeover by Parkston of Entrad Corporation Limited ('Entrad Corporation'). Half the facility ($25m) was to be repaid within six months. The facility was to be secured by a first registered share mortgage over all the issued share capital of Entrad Corporation (valued at approximately $155m). Ultimately the
security represented half the issued share capital. The facility was fully drawn down on 1 June 1987. $25m was repaid on 16 November 1987.

The full security on the facility (100% of Entrad Corporation shares) as contemplated by the credit submission and required by the letter of offer was never obtained. Mr Johns had directed that, if security was not in order, an equivalent cash deposit was to be lodged by the borrower, but this did not occur.

On 19 May 1989, Parkston repaid the facility balance of $25m, apparently to avoid unnecessary interest payments for the group. However Mr Durlacher, the company secretary, had a discussion with Mr Hunter asking that the facility not be cancelled. Hunter replied by letter of 1 June 1989 confirming that the facility was available and could be drawn down on three days notice. The facility was redrawn on 3 June 1989. The same occurred with the Roxbury Holdings facility of $22m (see para 14.244 below). Mr Durlacher recalled his discussion with Hunter concerning the repayment and it did not include any information for, or inquiry from, Hunter as to the financial position of the group as a whole. Mr Hunter could not recall this discussion. Thus it seems that Hunter allowed these facilities to be redrawn without any discussion as to the group’s financial position and without knowing the purpose for which the moneys would be used.

Despite a Tricontinental board resolution of 30 May 1989, requiring all new lending to be submitted to the SBV credit committee or board for approval, he did not refer the matter to either. He maintained that he did not need approval for the facilities to be redrawn, because they were still current and securities were in order. He said that he was unaware of any deterioration in the borrower’s position.
Mr Carr considered the redrawing to amount to new lending of which the board should have been informed, saying that in his view Hunter should have obtained approval from some executive officer or the credit committee. Mr Ryan took the view that there was no requirement for reference back to the board; however, in the circumstances, any loan being redrawn should have been subjected to close investigation as to the purpose and the securities.

In their submission on the Goldberg transactions, counsel assisting recognise that the period immediately following integration with SBV was one of great urgency and confusion for Tricontinental and SBV directors and management. They concede that this atmosphere may have contributed to the failure of management properly to consider the proposal for a redrawning of the facility. Nevertheless, they submit that, notwithstanding an earlier assurance given to the borrower as to redrawing, Mr Hunter was obliged to refer the matter back to the SBV credit committee or board. In the circumstances then prevailing (including the fact that the related company, Roxbury Holdings, was insolvent) Tricontinental would have been fully justified in refusing to allow the facilities to be redrawn.

Counsel assisting further submit that, as the officer in charge of the securities division, Mr Hunter was negligent in the discharge of his duties in that he failed to ensure that security (as stipulated by the letter of offer) was in place before the original drawdown, and should not have permitted the facility to be redrawn without reference to the SBV credit committee or board.

In relation to the failure to take security cover approved by the directors, counsel for Mr Hunter argue that, whilst he could give no explanation as to why full share cover had not been taken, that was not to say that he was the one responsible for the actual decision. They refer to Mr Hunter’s evidence on a number of occasions that, where Mr Johns was account
manager, any decision of this nature would have been on Mr Johns' instruction.

Concerning Mr Hunter's conduct in allowing the facility to be redrawn without any discussion with Mr Durlacher as to the group's financial position, and without enquiry as to the purpose for which the money was to be used, counsel for Mr Hunter submit that it is difficult to be critical of him, having regard to the circumstances existing in May 1989. They refer to Mr Hunter's evidence that, in his view, this was not new lending and did not come within the Tricontinental board resolution of 30 May 1989. They also argue that Mr Hunter knew nothing, and was not expected to know anything, of the finances of the company.

It was, in the Commission's view, an action on Mr Hunter's part that appears to have been quite out of character. For a man who tended to avoid responsibility, and regard himself rather as a senior clerical officer, it seems strange that he took this decision without reference to higher authority - particularly in the highly-charged atmosphere of integration. But take it he did, perhaps because of a narrow, clerical approach to the fact that the facility was still in existence. It was certainly a grave error of judgment, but even if Mr Hunter should have referred the matter of redrawning the facility to Mr Mountford, or to the SBV credit committee or board, there is no evidence to indicate whether they would have permitted the facility to be redrawn. It seems likely that the renewed loan would have been looked at critically, but the outcome must be considered uncertain. Further, there were no guidelines to cover the particular situation, and Mr Hunter may have believed he was acting in a routine way. Wider issues are dealt with in paras 14.366 and 14.368 below.

Entrad Limited

In September 1987, the directors of Tricontinental approved a $10m facility to Entrad Corporation Limited ('Entrad Corporation'). The purpose of the
facility was to refinance part of the existing $20m facility in favour of Homfray Carpets Pty Ltd, another of the Goldberg group entities. Repayment was to come from either refinancing or cash flow. The facility was to be secured by "debenture stock issued by Entrad Limited to the value of 110% of the facility amount".

The facility was, in fact, provided to Entrad Limited ('Entrad') and different security was substituted, namely, a first registered third party mortgage by Parkston over real property at Five Dock, New South Wales, and first registered share mortgages over shares in publicly listed Australian companies acceptable to Tricontinental. The facility was also subject to a covenant that the market value of shares and/or investment properties constituting security was to provide cover of at least 1.33 times the amount drawn down under the facility.

Full drawdown of the facility occurred on 1 October 1987. The covenant requiring at least 1.33 times cover was seriously breached following the stock market crash. The cover fell from 1.17 times to .28 times. No top-up security was obtained by management until 1 December 1987, when 10 million Entrad Corporation shares (valued at $15m) were substituted.

Counsel assisting submit that it is clear that Mr Hunter played a significant role in communicating with the borrower. He could recall chasing Mr Durlacher for top-up security on a regular basis, until it got to the stage that "the well was empty". Counsel assisting submit that Mr Hunter was negligent in the discharge of his duties as he was responsible for ensuring that security requirements were met, but allowed a serious deficiency in security to continue for a substantial period.

Counsel for Mr Hunter submit that it cannot be found that Mr Hunter was negligent in the discharge of his duties. They contend that it was up to Johns to obtain adequate top-up security or to instruct Hunter to do this (as
Hunter himself said in his evidence), and that just because Hunter may have chased up Durlacher, it cannot be said that he had the prime responsibility. They go on to argue that it is unlikely Johns would have liked Hunter to have contacted a borrower for top-up security without some form of instruction and that, without the evidence of Mr Johns, it cannot be concluded that Mr Hunter was negligent in the discharge of his duties. They further submit that Mr Hunter was not an executive officer within the meaning of s229 and it cannot be assumed that he did not do everything possible to obtain top-up, if and when he was instructed to do so. Having considered these submissions, the Commission is not satisfied that Mr Hunter could have achieved any better result by greater effort.

Roxbury Holdings Pty Ltd

In September 1987 an existing facility to Roxbury Holdings was reduced to $22m. The purpose of this facility was to refinance existing facilities to Roxbury Holdings (and Pochette Nominees Pty Ltd) and to provide an additional $2m for working capital. Security was to be a first registered debenture charge over all the assets and undertakings of Roxbury Holdings, and joint and several guarantees from Mr Abraham Goldberg and his associated companies and trusts (the guarantees were attributed no value for security purposes). The facility was fully drawn down by September 1988. On 19 May 1989 the full facility ($22m) was repaid along with that which had been made available to Parkston ($25). Both facilities were then redrawn on 5 June following integration with SBV.

The primary security over the facility was to be a first registered debenture charge over all the assets and undertakings of Roxbury Holdings. It transpired that this primary security was not achieved. The facility remained unsecured for the whole period of the loan. In September 1987, Tricontinental appointed the firm of solicitors Holding Redlich & Cooper Korbl ('Holding Redlich'), to act on its behalf in obtaining this security. The charge which purportedly constituted the security for the facility was in
fact a second ranking registered charge after one which had been created in 1978, in favour of ANZ, over all the assets and undertakings of Roxbury Holdings. Holding Redlich’s file in respect of this aspect of the transaction indicates that a company search was completed on 2 November 1987. However, the solicitors failed to notify Tricontinental of the results of that search, which, if conducted properly, should have revealed Tricontinental’s second ranking behind ANZ.

14.246 Mr Ryan said in evidence that he would have expected the securities department to confirm, on the basis of an assurance obtained from its solicitors, that Tricontinental had a first registered debenture charge. Mr Hunter said that Tricontinental relied on the solicitors to make searches for securities and depended on their advice that the appropriate security was held. The solicitors in this case provided no advice to Tricontinental that they had registered a first ranking charge. Further, note 18 of Roxbury Holdings 1988 annual accounts stated that the borrower had entered into a guarantee by way of a cross deed of covenant executed in favour of the ANZ banking group to secure loans and advances (worth $62.5m) made to related and associated entities.

14.247 Counsel assisting submit that a careful reading of the accounts, and particularly this note, should have raised questions as to whether this security might rank ahead of the first registered mortgage which Tricontinental supposedly held. Roxbury Holding’s major assets were properties valued, as at April 1990, at $50.6m. These secured loans to ANZ and AFC of $57.8m. Accordingly, Tricontinental has been unable to recover any moneys pursuant to its charge. The guarantees have also proved worthless as they were based on a net worth figure for Mr Goldberg that was very much out of date, and the guarantees were only as strong or as weak as the group itself.
There is evidence that, had Tricontinental been aware of the earlier charge to ANZ, it would have either required different security or sought release of the first ranking security before funds were advanced. Further, Mr Durlacher, the company secretary, indicated that he was not aware of ANZ's first ranking position at the time the facility was obtained from Tricontinental and that, had he realized this was the position, alternative security would have been readily forthcoming.

It is the submission of counsel assisting that, as the officer in charge of the securities department, Mr Hunter was responsible for seeing that security requirements were met. Before drawdown he failed to obtain positive advice from solicitors that the required primary security was in place. Accordingly, counsel submit that he failed to exercise a reasonable degree of care and diligence in the exercise of his powers and discharge of his duties contrary to s229(2) of the Code.

Counsel for Mr Hunter submit that it cannot be found that he breached s229. They contend that there was no evidence that he did other than properly rely upon the fact that the solicitors had carried out their function in obtaining the primary security. They further submit that he was not an executive officer within the meaning of s229 and that, in all the circumstances, it cannot be said that he can be criminally responsible under the provisions of that section. (This last question is dealt with in paras 14.339-345 below.)

The extent to which the responsibility for the failure to obtain security can be apportioned between Mr Hunter and the solicitors is a difficult question. The Commission has received a submission from the solicitors and has heard Mr Hunter's evidence - although he could add nothing of value to the sparse documentary evidence. These are not sufficient to enable the Commission to reach any clear view.
In any event, the debate is sterile because it is almost certain that any other security offered would have been swallowed up in the total collapse of the Goldberg empire, and proved worthless.

(b) Exculpatory factors

In his statement to the Commission, Hunter said:

"The time frame for preparing [securities] documentation differed considerably. There were occasions where to prepare security took weeks or months or more but, generally speaking, the majority of the facilities were prepared and ready for drawdown within 2-3 weeks. There were a number of occasions that things were extremely urgent and we might be looking at a 24 or 48 hour time limit to prepare securities after the receipt of a credit submission."

Hunter said he was aware of Mr Johns desiring an especially quick preparation of documents in cases where he was account manager, and on the majority of occasions, that would occur in practice.

Hunter said documents that had been prepared by solicitors would be sent to the securities department for checking. Sometimes, due to the urgency of the transaction, the original documents may have been forwarded to the client or its solicitors on the basis that they were still subject to Tricontinental's approval. Hunter said in evidence, "I think every facility was treated as urgent, because the lending officer was always anxious for the facility to be drawn down, the clients always wanted their money as soon as they could, so that every facility was basically treated as being urgent." Hunter said he did not consider that this requirement compromised the efficiency of the operation in any way.

Hunter said that before the October 1987 stock market crash he had never considered the possibility that the market was too optimistic and that it might collapse. He said, "... prior to October ... there was complete[ly] adequate security there, and I don't think anybody envisaged that the share market would fall as drastically as it did within that day or two."
Mr Atlas joined Tricontinental in 1982 as a security officer/analyst in Perth. In July 1983 he moved to Melbourne. His first position in the Melbourne office was lending officer. In 1984 he became the senior manager lending. When the project finance division was formed in 1985, he was initially the only member of that division. In 1986 he became group manager project finance division, and in 1987 became assistant general manager of that division, a position he held until leaving Tricontinental on 29 September 1989.

Before joining Tricontinental, Mr Atlas was employed by Arthur Young & Co, chartered accountants in Perth, where he worked in the general accounting and tax divisions. While there, he did not undertake any tasks involving lending or credit activities.

Mr Atlas described the training he first received when he commenced employment with Tricontinental as a securities officer and analyst in Perth as, "... very much on the job training."

Mr Atlas has a Bachelor of Commerce degree from the University of Western Australia and is a member of the Australian Society of Accountants. His commerce degree included one year of studies relating to taxation. He did not obtain further formal qualifications, but attended a number of training courses while employed with Tricontinental.

When asked about his qualifications to head the project finance division, which was essentially involved in packaging tax-effective methods of lending, Mr Atlas said, "...most of the training and the information I learned was [through] interaction with other people in the market place who were doing the same type of things, plus the knowledge that I picked up at conferences."
(b) History at Tricontinental

In his statement to the Commission, Mr Atlas described the establishment and development of the project finance division from 1985. The division was separate from lending but, despite the separation, used the lending department's procedures and staff. From its inception in 1985, the division reported directly to Johns. It was originally set up in response to a massive growth in the use of tax-based unit trusts for real estate development, which Tricontinental was becoming involved in on behalf of its clients. In its early days, the division also did some leveraged lease work. Later, the division became involved in different types of debt structures, using mezzanine debt and off-shore zero coupon bond financing, and in structuring syndicated facilities. Mr Atlas said the major reasons for the establishment of the division were to expand Tricontinental's business, to expand its services to its clients, and in response to a need expressed by clients.

In August 1985, Mr Atlas wrote a paper dealing with the establishment of the project finance division. This paper was presented at the 30 August 1985 board meeting. Atlas was the sole author of this document and said that his research for the paper consisted of speaking "... to a lot of people who were actively doing this thing in the market place." He added that much of the information was obtained through "... meetings with other packagers on transactions that they were discussing, going around seeing the trading banks and the major organisations that had the tax shelter requirements and discussing with them what their parameters were and what type of transactions they were looking at."

When asked how he kept up to date with the complicated changes to taxation statutes, Mr Atlas said, "Once again, through interaction with solicitors and accountants, other packagers, a number of conferences which I attended. I believe that the best way to keep up with those [issues] is to
talk, in discussions and [interact] with other people who are involved in the same type of industries, or who have the expertise."

(c) Functions

In his statement to the Commission, Mr Atlas described the functions he performed in the various positions he held at Tricontinental. As a security officer and analyst he was in charge of preparing all credit submissions, letters of offer and security documentation for all corporate loans undertaken by Tricontinental's Western Australian office. He also undertook all loan administration and office administration for the state and was in charge of credit control and credit reports. As a lending officer in Melbourne, his duties included servicing new business and administration of Tricontinental's "major .... lending portfolio, namely, [the] Jewish community in Melbourne". As senior manager lending, he was in charge of administration of the lending division together with the duties he performed as a lending officer. His new role also involved negotiating lending syndication positions and tax shelter investments.

Mr Atlas was appointed head of the newly established project finance division in July 1985. A job description for his position as manager project finance describes the principal objectives of this position as, "To co-ordinate and direct [Tricontinental's] project finance activities on a national basis with emphasis based in two areas:- 1. tax based structures, and 2. product innovation as an adjunct to existing lending products". The job description goes on to list a number of detailed duties.

In July 1986, as group manager project finance, Mr Atlas said his principal responsibilities included, "management of staff and all administration, marketing of tax-effective finance structures, specialising in property based trusts and leases, both leveraged and equity .... identification of potential products through division creativity." In December 1987, Atlas was appointed assistant general manager and the division's activities were
expanded to include packaging syndicated debt facilities, innovative tax-based structures, non-tax-based innovative structures, packaging and advising on Tricontinental property-based real investments and resource-based products and undertaking an advisory role to clients on financial management and funding.

Mr Atlas was not on the credit committee; however he said that, on a number of occasions, credit committee members would contact him for further information or an explanation of some aspect of a submission. Nor was he a member of the management committee, although he said that Johns, on occasion, informed him of certain issues which were raised at management committee meetings which affected the project finance division.

Credit submissions for the project finance division's simpler transactions were prepared by the credit department. Credit submissions for more complicated transactions were prepared by the project finance division itself. Mr Atlas estimated that approximately 20% of credit submissions would have been prepared by the project finance division as distinct from the credit department. He disagreed with Mr Stott's evidence that the project finance credit submissions were written by the project finance division after the first 6 to 9 months. He said, "With respect to the tax-based facilities I think our division might have prepared more than the credit department. With respect to the lending facilities that project finance controlled, all credit submissions continued to be done by the credit department to the best of my knowledge". Atlas said that, although background information for credit submissions prepared by the project finance division was collected by that division's staff, he vetted the ultimate structure of the submissions.

Mr Atlas had account manager responsibilities for a small number, (approximately five) of project finance division's clients. He estimated that
80% to 90% of the project finance clients were either controlled or initiated by Mr Johns. In most cases where Atlas was account manager, those responsibilities had been delegated to him by Johns. Atlas or his staff looked after the day-to-day running of project finance clients controlled by Johns. In addition to his project finance clients, Atlas also had a number of lending clients that stayed with him after the establishment of the project finance division. He estimated that these lending clients would have taken up approximately 20% of his time. The notes of an interview between Mr Atlas and the internal auditors said that he had 10 to 15 clients. Atlas said this figure included his lending clients and the project finance division clients with whom he had day-to-day interaction. He estimated the value of the loans to those ten to fifteen clients at that time (November 1988) would have been ".... a couple of hundred million dollars in total." The notes of interview with the internal auditors went on to say, "he sees his role as an integrator who interacts with all divisions in structuring specialised financial deals."

Mr Atlas was not charged with the task of preparing internal reviews in relation to the project finance division borrowers. If a review was required of his lending clients, he would obtain the information from the client and provide it to the credit analyst for preparation of the internal review.

Mr Hunter would ask Mr Atlas, on a monthly basis, to provide updates of any of his accounts that were bad and doubtful debts, for the preparation of the problem loans report. Mr Atlas said, "If it was a client of both Mr Johns and I, we would discuss [the] particular client. I think commentary we put in was very much an overview. It didn't set down a blow by blow description of problems that the client had." He was asked if there was any reluctance by Johns to have matters included in the reports which Atlas considered ought to be included. He said, "I didn't give it a lot of thought at the time, but in hindsight I would say yes."
(d) Relationship with Mr Johns

Atlas first met Johns in 1982. At that time Johns was group manager lending. Atlas said, "After discussions between Johns and myself in 1983 about my future at [Tricontinental], Johns arranged for me to be transferred [from Perth] to Melbourne."

After his transfer to Melbourne, Atlas worked closely with Johns. Mr Atlas said that Johns also worked very closely with Stott and Hunter. He said, "... whilst Mr Johns was close in a business and in some degrees a social sense with both Mr Stott, Mr Hunter and myself, Mr Johns tended to ride the people he was closest to the hardest ... and I think the three of us got the long end of the stick [on] most occasions."

In his statement to the Commission, Atlas said:

"[Johns] was aggressive, extremely hard working and to me, as someone who had just started in merchant banking, extremely knowledgable. If I had a problem I could always talk to him about it and he would give me guidance and assistance.

Johns had two features which set him apart from the other staff at [Tricontinental];
(a) his ability to quickly grasp potential lending situations; and
(b) his excellent memory."

Atlas said he learned a lot of his lending skills through Johns and his staff. However, of Johns' knowledge in relation to project financing, Atlas said, "... he picked up the concepts very quickly. However, I do not believe that he had the expertise in terms of the 'nitty-gritty' side of it, if you wish to put it that way."

Mr Atlas said he found Johns to be, "... autocratic, he was hard ... but at times he was very fair." He added:

"I think Mr Johns was extremely efficient. He would review papers etc. that you put forward to him in the minimum possible time that he had available. He had an excellent memory which allowed him to at times to be more au fait with and remember things about your
clients and his clients that you had a day-to-day contact with ... also he was very efficient at following things up."

On the subject of how Johns treated people, Atlas said:

"He was hard. He was pretty intimidating for younger staff members. He certainly didn't pull any punches in what he thought about certain situations and he was a difficult person at times ... [with whom] to have a discussion [involving a] disagreement of principles ... but I think at times, on the other side of that, he was reasonably fair. If a staff member had a problem he would go out of his way to help that staff member with the problem, and I think he really had two sides. Unfortunately, I think junior staff members only really saw the more aggressive side."

Mr Atlas was asked whether it appeared to him that, during Tricontinental's period of increased activity, say 1986 and 1987, Mr Johns became less capable of maintaining such a high degree of detailed involvement in Tricontinental's activities. Mr Atlas' response was:

"I believe Mr Johns was having a problem maintaining his work load. ... [H]is work load increased significantly when he became managing director, plus he also .... had a great love of all parts of banking and took an active interest in all aspects of the company, which obviously increased his work load as well. For people like myself it was frustrating because we had a great difficulty getting to him to discuss, for a lengthy period of time, transactions and situations that existed with clients. I think he just had too much on his plate and couldn't give his full time to areas where he should have if he wanted to maintain the hands-on approach. .... I don't believe that one could have taken on that work load and still produced efficiently and stayed healthy. .... I think Mr Johns had one failing, and that was he found it extremely difficult to say 'no'. He also didn't have the time in which to, I suppose, roll up the shirt sleeves and get stuck into a problem on a file that he directly controlled. He tended to pass it off down to either Mr Mountford ... or to Mr Hunter or to whoever was supposed to be doing it ... but he wouldn't let go the ultimate yes/no situation; so the person who was handling it was really working with one hand tied behind his back when he was in there trying to solve the problems."

Mr Atlas was asked whether, if he had been a position of authority, he would have sought to remove some of the concentration of power which was in Johns' hands. He said, "I think I would have liked to have seen an
increased management base with more, what I call, outside independent management brought in, people who had worked outside in different organisations .... who had experience working with other major organisations, which a lot of us didn’t have."

Although Mr Atlas was not a member of the credit committee, he did observe the functioning of that committee. He said he believed that Johns forced his opinion on the credit committee, although he was not aware of any situation where Johns overruled a credit committee recommendation. He added that transactions which Johns was sponsoring had an "extremely good chance of being approved" by the credit committee.

When asked about the deterioration of the relationship between Johns and Stott, Atlas said, "... I think that Mr Stott was getting to the end of his tether about being, metaphorically speaking, bashed around the head by Mr Johns, him and also his staff." He also said, "I believe Mr Hunter and his staff were placed under a tremendous amount of pressure at times by Mr Johns. Whether they were verbally harangued or, in metaphors bashed around the head I'm not sure. I know Mr Hunter was placed under great pressure by Mr Johns on a lot of occasions." He added, "... whilst treating staff very hard [Johns] was very loyal to his staff."

(e) Awareness of, and responsibility for, deficiencies in systems

Atlas said the project finance division occasionally used outside tax consultants such as Coopers & Lybrand. He said, "We didn't use them particularly often because none of the tax-based financing structures we were utilising were particularly innovative." The division also used a panel of solicitors to structure the legal documentation for the various transactions.

In his statement to the Commission, Atlas said that all project finance division transactions that used the Tricontinental balance sheet were subject
to the lending guidelines. For example: (a) they required a credit submission, (b) they required the same approval process as lending submissions, (c) securities were required, and (d) solicitors were charged with preparing documents and signing off. He added:

"[Project finance division] was designed to look at new styles of lending, new structures and so forth. These structures did not always fit the lending and operational guidelines. Therefore, in some instances, [the division] was forced to implement new guidelines which were established based on [its] knowledge and experience."

Mr Atlas gave further evidence that the lending guidelines were inappropriate for the project finance division. He said:

"The guidelines were looked at, but I don't believe the guidelines were a true reflection of how project finance transactions were done because, by their very nature, project finance transactions were more cash-flow orientated. .... I think one of the issues with the lending guidelines is that they were created well before the project finance division was created and the structures to be put together by the project finance division were contemplated. ... some of the project financing transactions did not fit within the lending guidelines, and sometimes the loan security ratios utilised within the project finance division were higher than what the lending guidelines allowed."

However, the project finance division did not attempt to formulate its own lending guidelines. In the statement quoted in the previous paragraph, Mr Atlas was referring to the establishment of the division's own practices and procedures, particularly its computer systems, not to any formal guidelines.

Mr Atlas said that deviations from the lending guidelines, for example lending 100% of construction costs rather than 70%, occurred on an ad hoc basis depending on the deal being arranged by the project finance division. He was asked whether someone approved these deviations from the guidelines and said, "I believe it would have been decided by the board when they approved the credit submission or the credit committee when they recommended the credit submission." He said, "In the tax-based
financing industry, which involved the unit trusts, it was very common for the transactions to be 100% of the total cost ... which would include the purchase of land, would include all the capital costs and would include the capitalised interest during the construction phase, and that was very much the norm in the mid '80s."

Monitoring of project finance division transactions was undertaken by a number of divisions within Tricontinental. Atlas said, in the case of structured finance transactions which involved lending through foreign exchange, the foreign exchange division advised of roll-over dates. Project finance division kept computer models and a book of receipts on all structured debt financings to enable monitoring of the client's position. A system was set up by the accounts department to pick up all payments made by telegraphic transfer. The accounts department advised project finance division if any payment was overdue. He said defaults could be picked up very quickly and once it was brought to the attention of the project finance division, the client would be contacted. Atlas said, "Project finance division did not have many clients. The department was fully aware of the borrower's position and whether it met the servicing requirements."

In his statement to the Commission, Mr Atlas commented on the internal auditors' report dated 22 December 1988. The report stated that, "The lack of adequate information flow to the accounting department creates uncertainty as to the appropriate treatment of associated transactions." It recommended that a more comprehensive overview of project finance transactions be communicated to the accounting department on a timely basis. Mr Atlas said that the auditor's recommendation was implemented in or about September 1988 by the internal transfer of an officer from the accounting department to the project finance division. In addition, controls were put in place within the accounting department to ensure that all payments were received and recorded. He added, "A part of the problem with the accounting department was that it tended to place a low priority on
the work of project finance division due to its commitment with the work load from treasury, futures and the general operations of [Tricontinental]. This was rectified by [the officer’s] transfer.

The 22 December 1988 internal audit report also stated, "Essentially all project finance work is administered and monitored by Mr Warren Atlas. We consider that this concentration of knowledge with one individual places Tricontinental in a risk position if Mr Atlas was to resign." It recommended that other staff seek greater involvement in the administration and monitoring of project finance deals. In his statement to the Commission, Mr Atlas said:

"This matter was never raised by the auditors with me and I deny that there was such a concentration. In my view, as divisional head, I was in charge of the [division], although the staff which worked with me were aware of most, if not all, transactions in which the division was involved. In addition, the transactions were documented and readily accessible."

In evidence he said that all project finance division staff sat in one room and had a working knowledge of what each other was doing by virtue of the fact that desks were three or four feet apart. He said, "We discussed most transactions and most staff members had working knowledge of all facilities. They might not have had intimate knowledge, but they had a working knowledge of all facilities."

In the draft internal audit report dated 6 November 1986, the auditors raised the issue of billing interest and fees in advance or in arrears. They identified a facility in which no analysis was performed to ascertain whether it would have been more beneficial to use the exchange rate at the beginning of the loan period or that at the end of the loan period. Mr Atlas said, "After the auditors had raised the issue of charging interest and billings, a system was implemented for each new transaction whereby the fees and margins were charged in advance and the interest in arrears."
The draft internal audit report of 6 November 1986 also stated that procedural check lists were not being used by project finance division. The report said that, "Whilst the division is new it is also rapidly expanding, and for this reason we believe that procedural check lists would be valuable for ensuring appropriate conditions and procedures are complied with before drawdown." No management comments were provided in response to this suggestion. The auditors' comment about the lack of procedural check lists was repeated in the internal audit reports of 29 January 1988 and 22 December 1988. In reply to the January 1988 report, Mr Atlas wrote a letter to the auditors, dated 12 February 1988, in which he said that he believed that a procedural check list was unnecessary as solicitors retained to draw security documents for Tricontinental were required to give a legal opinion as to when settlement could occur, which necessarily involved an assessment of whether the securities were in appropriate form. He said in evidence, "... I was firmly of the opinion that the legal sign-off letters were more valid than a procedural check list." Despite this, procedural check lists were established for tax-effective finance transactions shortly after his letter of February 1988. However, the internal audit report of 22 December 1988 revealed that a procedural check list had not been prepared before drawdown of a major facility. Atlas said in evidence that Mr Johns did not agree that the solicitor's sign-off letter system was preferable and eventually procedural check lists of the kind that were used by the lending division were prepared for all of the tax-based transactions.

Mr Atlas said in his statement to the Commission:

"After the management committee was established, there was an improvement of the reporting requirements of [the project finance division. Tricontinental] was divisionalised and each division became separately accountable. Each division had an increased focus on its budget as all expenses, liabilities and so forth were distributed to the different divisions."
Although not a member of the management committee, he said that, from his discussions with Johns, he understood its role was to set the guidelines, subject to the approval of the directors, for the future growth, operations, accounting and budgetary goals and direction of Tricontinental.

In his statement to the Commission, Atlas said that he knew of two credit submissions which by-passed the credit committee and were presented by Johns directly to the board. He believed that there were other occurrences of this nature. He said these credit submissions either involved takeover bids, had timing constraints, or were sensitive situations.

On the impact of the October 1987 stock market crash, Atlas said that, as the project finance division had only a few clients with exposure to equities, it was the division least badly affected by the crash. In addition, as a result of the stock market crash, a lot of money poured into the property market and, according to Atlas, this meant most project finance division clients had a strengthening of their asset position at the time.

In his statement to the Commission, Mr Atlas identified the factors he believed caused Tricontinental's failure. He said:

"The predominant reason was that [Tricontinental's] asset base was too large for its capital base. In addition, [Tricontinental] loaned to predominantly large private companies and small public companies which were amongst those most severely affected by the stock market crash. After the stock market crash the interest rates dropped which allowed a lot of clients to survive financially longer than they perhaps would have as they were initially able to meet their servicing obligations. Although there were some problems with the value of the equity security immediately after the crash, servicing problems didn't arise until there was a massive rise in interest rates in mid 1988.

Prior to the October 1987 crash, Johns had been reasonably successful in trading out of bad debt situations. However, given the fact that security values had diminished so heavily, especially with regards to equity exposures, [Tricontinental] had an enormous problem in trying to turn around some of these bad loans. Johns was reluctant to take write-off where a loan was not performing and
preferred to restructure a loan if there was a reasonable prospect of the borrower trading out of difficulty.

I believe the prolonged high interest rates was a cause of [Tricontinental's] demise. Another cause was the announcement that SBV was looking at selling [Tricontinental] to Australia Bank Limited. The overseas banks started to withdraw credit facilities because [Tricontinental] no longer had its AAA rating and had been classed as a rating watch.

With the loss of credit facilities, [Tricontinental] could not fund itself. .... Eventually, SBV had to provide credit and liquidity support."

During examination, Mr Atlas was asked whether a mechanism was in place for aggregating project finance exposures with other lending exposures. He said:

"The exposures of the project finance department as they pertain to the Tricontinental asset base, were outlined in the loans listing reports, and the credit department could produce an aggregation of a client's exposure, based on the methods that they utilised, plus it was also common to have very close contact with all lending staff. .... When the credit submission was prepared by [project finance division] staff, it was given to the assistant manager credit and his staff to look at, ... in most cases, prior to it going to the credit committee, etc, and they would put on the aggregation at that time if we hadn't put it on."

In response to a question as to whether project finance division clients came to Tricontinental as a last resort, Atlas said:

"Most of the clients that the project finance division had were established clients of Tricontinental, and in a lot of cases Tricontinental was lead financier, and we always asked [whether they had tried their project out on other banks], because it was very important to know that."

He added that, in most cases, the response was that the client had not tried the project on anybody else.

Mr Atlas was aware that Tricontinental had a base of a small number of large borrowing clients who would come back and back to Tricontinental
for further borrowing. He said Tricontinental actively invited a lot of clients to spread their lender base as it was important for major clients to have more than one financier. At the time he heard in the marketplace that Tricontinental was a last resort lender, but he did not believe it.

In his statement to the Commission, Mr Atlas indicated that the use of outside tax consultants such as Coopers & Lybrand was a fairly rare occurrence. During examination he was asked whether other outside consultants were involved in the setting up and assessing of the viability and feasibility of packages. He said:

"In the case of property-based finances there was always an independent valuation undertaken. That is probably the most common case in which an outside consultant was used. … where buildings were under construction, it was common for an outside quantity surveyor to be utilised to ensure that cost estimates were inside the designated guidelines within the credit submission."

He said that the project finance division did not have a hands-on role, it was very rare that they ever visited sites. Their continuing role was restricted to an accounting or computerisation exercise and the hands-on management was undertaken by the independent quantity surveyor.

The project finance division reported directly to Mr Johns, and there was never any real involvement by the general managers of lending. Mr Atlas said there was intended to be a significant exchange of information between lending and project finance divisions.

As to the size of transactions entered into by the project finance division, Mr Atlas said, of Tricontinental’s exposure:

*I think that [of the] transactions that I was involved in, the most in one particular transaction was about $70m, and a group series of transactions would have probably been about the same amount. There [were] never transactions which approached $100m or over.*
He said he was not conscious of there being any ceiling in relation to an exposure which could be agreed to by the project finance division. He said, "... my view was that the ceiling was really a limit set by the board or the managing director in regard to a particular client." He was not conscious of there being a ceiling tied to the capital base of SBV.

14.301 Mr Atlas could not recall specifically when the project finance division first started to have occasion to make reports for inclusion on the problem loans report, although he could recall a number of occasions where clients were put on the watch list. He said that, by late 1988 or early 1989, the division was regularly making reports of problem loans and defaults.

14.302 Mr Atlas said he would have disagreements with Mr Johns over the structure of transactions. When this occurred, they would sit down and reach a consensus about the structure. He could also recall a disagreement with Johns about information being sought from a client who was in arrears on some payments. He thought Tricontinental was represented on the board of this client and had a 20% shareholding. He could not recall the outcome of this situation.

14.303 There was a computer expert in the project finance division. Monthly and quarterly computer-generated client reports were produced, reporting all the accounting aspects of project finance division transactions. These reports were essentially prepared for the purposes of the division. They were provided to any outside lenders who were involved, and given to the accounting department. They were never provided to clients. The notes of an interview between Mr Atlas and the internal auditors in November 1988 stated, "No reports are produced from [Atlas'] department for management. All are done by other departments." However, Atlas did have the responsibility for reporting to Johns for the purposes of the managing director's report.
Mr Atlas agreed that, in tax-effective financing, the borrower's ability to repay is not the most critical feature, as the project is expected to finance itself out of its cash flow. He said:

"In private companies full guarantees were taken from ... directors together with inter-company guarantees of the group. .... In cases where the clients were new clients, assets and liability statements were taken. In cases where the clients were existing clients, it was usual that we had up-to-date information. .... In some of the cases the asset and liability statements would be signed by the accountant. In other cases they would just be signed by the directors. When we look at the project finance division, most of the clients were known to us in some way, shape or form over a number of years, so despite having their asset and liability statement we had a pretty good idea what they were involved in and their worth."

He also agreed that there was a tendency to accept at face value that these clients were high net worth individuals who were known to Tricontinental and now wanted to do project financing.

Mr Atlas said the major economic influences he looked at were interest rates and currency rates. He did not pay much attention to property values. He would have informal discussions with Mr Peter Osborne, Tricontinental's in-house economist, about where interest rates were going and where currency prices or currency exchange rates were going and the market in general.

In his statement to the Commission, Mr Atlas discussed a major transaction involving the restructuring of Tricontinental's exposure to a mining group. According to Mr Atlas, this transaction aroused the attention of the press, and there was an inquiry by the National Companies and Securities Commission. The restructure resulted in a gold mine carrying a debt burden which exceeded the level which normally would have been carried on a transaction of this type. Mr Atlas said no members of the board queried him in relation to this credit submission. Tricontinental did not obtain independent legal advice about the propriety of this transaction. He
14.307 Mr Atlas said he did not discuss project finance division activities with directors other than Mr Ryan. Ryan would query him in relation to specific credit submissions on an informal basis.

14.308 Asked whether he was ever concerned about the lack of internal reviews in relation to project finance transactions, Mr Atlas said:

"A lot of the project finance clients were state government ... so that wasn't a major problem. With our lending clients, a few of them were publicly listed companies so it wasn't difficult to get the information, and a number of them were private companies which did not release details of their full private financial affairs, which was a worry - but on the whole we managed to get most of the information from our clients. .... The majority of it was not audited. .... The best way to control your clients was the constant contact that you had with them, which I think was more meaningful than the accounts of private companies which are not audited and which are done for tax purposes."

14.309 (f) Possible breaches of law or of a duty of care

On the basis of their analysis of transactions entered into by Tricontinental, counsel assisting have identified two instances in which they submit that Mr Atlas committed a breach of law or duty of care. However they have made no submissions in relation to possible breaches by Mr Atlas of the Companies Code. It has been submitted that his involvement in the Quatro group transaction amounted to negligence, and thus he breached his duty of care to his employer. A submission has also been made in respect of the Long Corporation Limited transaction that he aided and abetted any breach by Jacy Investments Australia Limited of s15 of the Companies (Acquisition of Shares) Code ('CASC').
Long Corporation Limited ('Long Corp') was a residential property developer which appointed Tricontinental Securities Ltd ('TSL') to assist it in a Part B defence of a cash takeover offer announced by Barina Corporation Limited on 14 April 1986. TSL was briefed to find an alternative bidder. Jack Chia (Australia) Limited ('JCAL') was a publicly listed property developer, owned 80% by companies associated with Jack Chia. Johns introduced Mr Tim Hewison (managing director of JCAL) to the idea of JCAL making a takeover offer for Long Corp. JCAL purchased its initial shareholding in Long Corp (14.96%) in April 1986. This initial purchase was fully funded by Tricontinental. After this purchase JCAL issued a successful 2 for 1 share offer for Long Corp.

A number of 'friends' of Tricontinental held shares in Long Corp and accepted JCAL's 2 for 1 offer. After the share swap offer was accepted by these parties, JCAL shares held by Tricontinental in the names of Camsan, TCL - Muron, Tricontinental Nominees Limited and Tricontinental Corporation Limited were sold to Jacy Investments Australia Limited ('Jacy'), another company within the Jack Chia group, in March 1987. Although the transactions with Jacy were completed in March 1987 and moneys for the shares had been paid to the relevant parties, Tricontinental agreed to transfer the shares to Jacy in two separate transactions six months apart, presumably to avoid breaching s15 of the CASC.

Mr Atlas had the running of this part of the transaction and, in particular, calculated the payout figures required for Jacy to acquire the various share parcels held by Tricontinental on behalf of its 'friends'. To avoid breaching the 3% 'creep' provisions in s15 of the CASC, Tricontinental Nominees Limited agreed to hold 2,570,196 JACL shares on behalf of Jacy, which were then released over time. Atlas was involved in arranging for the balance of shares to be transferred gradually after the ceiling for the creep provisions had been reached.
Counsel assisting submit that Jacy may have breached s15 of the CASC. However, they accept that it would be necessary to inquire further into the contractual arrangements to determine whether or not such a breach occurred. It is the submission of counsel assisting that the evidence suggests Mr Atlas may have aided and abetted any breach by Jacy of s15. While they concede that the evidence is insufficient, in terms of completeness and admissibility, for the Commission to make findings of criminal conduct against any of the persons involved, they argue that it is sufficient to warrant matters identified being referred to the Australian Securities Commission ('ASC') for further investigation.

Counsel for Mr Atlas submit that his involvement in the Long Corp/Jacy transaction did not include any knowledge of the transactions other than carrying out mechanical tasks and implementing what had already been agreed. They submit it cannot be found that he had any involvement beyond this. In their submission, Mr Atlas cannot be said to have aided and abetted unless he can be said to have been "involved" in the transaction, as distinct from merely acting in an administrative capacity. They contend that it is clear he had no involvement of the type which would constitute illegal activity. Mr Atlas' counsel further submit that, in view of the evidence and position of Mr Atlas, no recommendation to refer this matter to the ASC should be made. They argue that Atlas has been subjected to a searching inquiry as to his behaviour and, as there was no illegal or improper activity, there is no basis to refer the matter of his involvement to the ASC.

For reasons set out more fully in TR 14 in volume 3, the Commission accepts the submissions of counsel for Mr Atlas on this issue.
Quatro Group (TR 2)

14.316 Tricontinental provided financial assistance to three companies within the Quatro group; Quatro Limited (‘Quatro’), Discronics Limited (‘Discronics’) and Pro-image Limited (‘Pro-image’). Mr Atlas had responsibility for the Quatro group accounts from January 1986 until June 1988.

Quatro Ltd

14.317 From January 1986, Tricontinental provided a number of facilities to Quatro, three of which have been examined in detail by the Commission. The first facility (‘facility 1’), for $4m, was approved in January 1986 to finance the restructuring of the Quatro group - in particular, the acquisition of shares in Pro-image and the provision of working capital. The second facility (‘facility 2’) was approved in February 1987 for $15m, to finance the acquisition of shares in public companies or allow the group to undertake a takeover of a listed or private company. The third facility was approved in March 1989, after Mr Atlas had ceased to have responsibility for the Quatro accounts.

14.318 In their submission on Quatro, counsel assisting contend that the evidence revealed a number of deficiencies in the credit submissions prepared. In particular, they say that the credit submission for facility 1, prepared by Mr Venner in January 1986, on instructions from Mr Atlas, was deficient in that it did not include information Mr Atlas had as to the financial position of Pro-image and Discronics as well as Quatro.

14.319 The credit submission for facility 2 was prepared in February 1987. The financial information included in it was seven months out of date, and no cash flow projections were supplied. Mr Atlas acknowledged that it would have been preferable to include more up-to-date information if it had been available. The submission also failed to provide full details of borrowings and how these had increased, or whether additional assets had been
acquired with those funds. Again, Mr Atlas accepted that the credit submission was defective in this respect.

14.320 Facility I was extended in June 1988. The credit submission for the extension, again prepared at Mr Atlas’ direction, did not undertake any analysis of Quatro’s ability to service or repay the facility; nor did it disclose various management agreements which would have affected Quatro’s ability to service the loans. Mr Atlas acknowledged that these were relevant matters that should have been included.

14.321 In response to the comments of counsel assisting on the credit submission of January 1986, counsel for Mr Atlas refer to his evidence that Pro-image, the principal subsidiary of Quatro, was a borrower of Tricontinental at the time, and Tricontinental had intimate knowledge of its performance and, as a result, its ability to generate cash on behalf of its parent, Quatro. In the circumstances, they submit, there was no relevant omission on the part of the analyst who prepared the credit submission, to extract Quatro’s cash flow projections.

14.322 In relation to counsel assisting’s contention that the credit submission of February 1987 contained outdated information, namely financial information as at 30 June 1986, counsel for Mr Atlas submit that there is in fact reference to the financial statements of Quatro as at 31 December 1986. They point out that after-tax profits for the half-year ended 31 December 1986 are set out, together with the interest cover and level of Tricontinental’s current commitment to Quatro. They say that one does not expect directors to be given (or them to ask for) all supporting data. Counsel for Atlas further submit that the most recent and best financial information was used by Tricontinental’s officers.

14.323 In relation to the allegation concerning the failure to give cash flow projections, Atlas' counsel refer to his evidence that it would have been
misleading to give projections when Tricontinental had no knowledge of the shares being acquired by Quatro. As no intention had been expressed as to the use of the $15m facility, they submit that he was correct in asserting that it was not possible to provide meaningful cash flow projections.

As to counsel assisting’s arguments on the credit submission of June 1988, counsel for Atlas reply that there was little fresh analysis in this credit submission because financial statements of the borrower for the period ending 30 June 1988 were not available. They refer to Mr Moyle’s evidence that, whilst there may have been an increase in Quatro’s debt during the financial year ended 30 June 1988, this may not have been detectable by a credit analyst. He said an analyst, in preparing a credit submission, could only check the last accounts provided to Tricontinental, and inquire from the borrower about any material changes. Accordingly, counsel for Atlas submit there is no basis for making any adverse finding against any Tricontinental officer, including Atlas, in respect of this credit submission.

Counsel assisting also contend that the Quatro facilities raise a number of issues in relation to the adequacy of Tricontinental’s monitoring procedures. In particular, the stated purpose of facility 2 was the purchase of shares in publicly listed companies or the takeover of a listed or private company. Mr Atlas acknowledged that the funds were actually used to take up rights issues in Pro-image. This, however, does not appear to raise monitoring questions. The share purchases had to be "acceptable" to the managing director. It was Mr Johns who authorised the apparent departure, if departure it was, from the terms of the credit submission.

In response to the more general submissions about monitoring, counsel for Atlas make a number of points. They refer to the evidence of Mr Atlas that he was aware of the declining performance of Quatro, because of the decreased value of its shares. He attributed the declining performance to
Quatro's write-down of the value of its assets. He said, however, that Quatro continued to appear to be performing satisfactorily, and to service its loans and provide adequate security cover. On this basis counsel submit there is ample evidence that Atlas adequately monitored the Quatro facilities during the period he was the account manager. They also refer to Atlas' evidence that, in addition to attending a number of board meetings of companies within the Quatro group, he had frequent meetings and "constant discussions" with Quatro and its various officers.

As a general submission, Atlas' counsel maintain that, whilst Tricontinental's officers may have had some input into the Quatro facilities in terms of their day-to-day operation, there is no evidence that Tricontinental's officers, other than Johns, had any participation in the approval or variation of facilities to Quatro. They submit that, based on the evidence, it is clear that Johns controlled, and made the major decisions concerning, Tricontinental's facilities to Quatro.

Disctronics Ltd

On 14 April 1987, a credit submission was prepared for a $33m facility to be provided to Disctronics. The credit submission was prepared by Mr Maddison on instructions from Mr Atlas. Counsel assisting submit that the credit submission was deficient in a number of respects. Mr Atlas gave evidence that he was particularly taken with what he saw as a unique opportunity for Disctronics within Australia. He added that the facility did not give any cause for concern in all the time he was involved with it, and that he thought it was a good, solid manufacturing business in a very solid industry. During his examination before the Commission, Mr Atlas acknowledged that, with hindsight, unless Disctronics succeeded, the entire Quatro group was likely to fail.

Counsel assisting submit that the analysis presented in the Disctronics credit submission was optimistic. They give as an example Mr Atlas'
statement that, as the sole manufacturer of compact discs in Australia, Disctronics would have no competitors. This failed to take into account competition from low-priced imports, or the possibility of other competitors setting up in Australia. In addition, if, as noted on the credit submission, 85% of Disctronics' production was to be exported, the issue was not one of competition within Australia, but of competition within those overseas markets. Similarly, the credit submission analyses Disctronics' repayment and servicing capacity based on projected sales. Of these, only one third were subject to firm contracts.

14.330 In reply, counsel for Mr Atlas point to the four factors which were, in their opinion, sufficient to reduce significantly the risks of extending a facility to Disctronics; namely exclusivity, competitors, sponsors and expertise. They add that there is considerable evidence concerning the analysis undertaken by Tricontinental. In this respect they refer to Mr Maddison reviewing the contract and letters of intention, and performing an independent verification on the basis of projected earnings produced by Disctronics' management, and Atlas' recollection that a feasibility study other than the Price Waterhouse valuation was sighted (this document has not been discovered by the officers assisting the Commission).

14.331 As in the case of the Quatro facilities, the Disctronics facility is said to raise issues regarding the adequacy of Tricontinental's monitoring procedures. The facility was mainly secured by a debenture charge over all the assets and undertakings of Disctronics. Disctronics shipped to the US and UK, in May/June 1988, equipment which was subject to the charge. Mr Atlas gave evidence that it was not until long after his involvement with the facility had ceased that it was discovered that the equipment had been moved overseas. Counsel assisting submit that, in the absence of a provision requiring the proceeds of a float of Disctronics to be used to repay the Tricontinental facilities, Tricontinental's dependence upon its monitoring was increased. Monitoring also took on added importance
because, as Mr Atlas conceded, the entire Quatro group could fail if Disctronics was not successful. It is the submission of counsel assisting that it is open to the Commission to find that Mr Atlas, as account manager, was negligent and inattentive to the monitoring of the Disctronics facility in the period before mid-1988.

On this issue, Atlas' counsel refer to his evidence that he received monthly schedules from Disctronics. They submit that the documents disclosed in the transaction report are incomplete, and Atlas' recollection of receiving monthly schedules ought to be accepted. In their submission, any broad allegation of negligence against Atlas cannot be sustained, since he gave clear evidence about his monitoring by reviewing monthly financial statements of Disctronics, attending board meetings of Disctronics and conducting regular discussions with Disctronics' directors and officers. They go on to argue that, as Atlas was not the account manager after June 1988, he cannot be held responsible for alleged deficiencies in credit analysis or monitoring after this time, and that criticisms by counsel assisting in relation to the internal review are not relevant to Atlas as the review was prepared in August 1988. His counsel therefore submit that there can be no finding of negligence against him in respect of monitoring the Disctronics facility, and particularly the monitoring of financial statements.

In relation to the removal of assets subject to a debenture charge to the US and to the UK, Atlas' counsel submit that there is clear evidence of constant monitoring by Atlas. They point to the evidence that Atlas attended Disctronics' plant on three occasions, once during the construction phase, again at about the time of opening, and finally sometime after the opening. They submit that Tricontinental received statements of Disctronics' inventories (which have not been produced to the Commission) and attended the plant sufficiently frequently for the purpose of monitoring its progress. They further submit that it is unreasonable to expect
Tricontinental's account officer to conduct spot audits and, similarly, it is unreasonable to expect that Tricontinental's officers will detect missing equipment if a borrower seeks unlawfully to remove it to another place.

Counsel assisting submit that the evidence relating to the Quatro group as a whole establishes a failure of attention to duty by Mr Atlas in the period before mid-1988, amounting to negligence. They argue that his actions, although usually within his ostensible authority as assistant general manager, were not those of a reasonable person in the circumstances, particularly regarding the information available to him which he failed to communicate, either to the board or to Mr Johns as his superior. Nor did he provide the level of supervision of his subordinates that would be expected of a reasonable person in his position. It is submitted by counsel assisting that, by reason of these matters, Mr Atlas breached his duty of care to his employer. These matters are dealt with in paras 14.369-371 below.

(g) Exculpatory factors

14.335 Mr Atlas said in evidence that 80% to 90% of the project finance division's clients were either introduced or controlled by Mr Johns. However, Atlas was responsible for ten to fifteen project finance and lending clients with facilities having a value of "... a couple of hundred million dollars in total".

14.336 When the project finance division was established, it was intended that the division market its products to attract new clients. In fact, most of its clients came from within the existing Tricontinental base. Mr Atlas said this was due to a strongly competitive environment that existed until the stock market crash in October 1987, and was then sustained by the strong property market until the high interest rate regime hit in early to mid-1988, which led to a decline in property values and a change in attitude of domestic lenders and off-shore financial institutions. He said:
"... after deregulation ... the trading banks pushed very heavily into the areas which were traditionally the domain of the merchant banks and the merchant banks were forced to become either more competitive via rates or more competitive via innovation to really survive and continue to have a place."

He added that:

"... in 1988 ... the tax laws changed, which significantly diminished the amount of property-based tax-based financing that could be done by financial institutions and [the project finance division] changed tack ... to continue with our business of structured debt financing and syndications."

He said if the project finance division could have expanded its market it would have done so, but the market prevented this from occurring.

In relation to the pressure placed on staff at Tricontinental, Mr Atlas said:

"... I would think that either a merchant bank or a trading bank which had the amount of clients that Tricontinental had [would] probably have a lot more staff with which to control those clients. There were pressures on staff members, particularly income-earning staff members or fee-earning staff members, to number one, market and number two, control their client base, which meant that if you were spending 50% of your time marketing you needed to spend another 100% of your time monitoring. If you put that into some sort of calculation, most staff members were working probably ten to twelve hours a day."

He added:

"... most of us who worked [at Tricontinental] saw ourselves as reasonably lucky to be working within an organization that gave young people a very good chance to move up through the ranks, and also gave people the opportunity to explore new types and new avenues of ... funding ..."

Mr Atlas said:

"I think you were always under pressure, because in the mid '80s everybody seemed to want everything done yesterday and there were opportunities constantly opening up for borrowers, but we certainly weren't under the same time constraints with tax-based financings as you would have been with a takeover financing, for example. Nowhere near the time constraints."
G. Conclusions and Findings

14.339 It is convenient to deal first with general considerations of the liability of executive officers under the Companies Code. The Code defines an 'executive officer', for present purposes, as "... any person ... who is concerned, or takes part, in the management of the corporation."

14.340 Ormiston J in Commissioner for Corporate Affairs (Victoria) v Bracht [1989] VR 821 was called upon to construe the expression "... concerned in or take part in the management of a corporation ...". He said, at 828-31:

"It may be difficult to draw the line in particular cases, but in my opinion the concept of 'management' for present purposes comprehends activities which involve policy and decision-making, related to the business affairs of a corporation, affecting the corporation as a whole or a substantial part of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs. ... thus, although the decisions of a branch manager, subject to predetermined restrictions, may not be comprehended, there are those involved in large, discrete parts of a corporation's business, who, although not participating in the central administration of that corporation, nevertheless are involved in its management to the extent that their policies and decisions have a significant bearing on the business and its overall financial health."

14.341 It could be argued that, since the section Ormiston J was concerned with was not a penal section, a more restrictive emphasis should be given to the expression 'executive officer' in relation to s229 of the Code than to the section with which Ormiston J was concerned.

14.342 In view of the recommendations which the Commission proposes, it is not necessary for it to reach any concluded view on the matter. However, the tentative view which the Commission has reached is that Mr Mountford was an executive officer within the meaning of the Code, and Mr Atlas was also an executive officer, at least for certain purposes. On the other hand,
the Commission believes that it was unlikely that Mr Stott was an executive officer and it is confident that Mr Hunter was not.

14.343 These conclusions are based not upon any formal duty statement which may have applied to the respective offices of the managers concerned, but rather on the true nature of their duties and responsibilities as disclosed in evidence. That evidence makes clear that Mr Johns exercised a high degree of control in the areas of Tricontinental with which we are here concerned, and that, as a result, Mr Stott and Mr Hunter were left with very few real decisions to make. They had rules or practices to follow and, if in doubt, were expected to seek guidance from the managing director. They would not normally have taken it upon themselves to make decisions which could have had "some significant bearing on the financial standing of the corporation or the conduct of its affairs."

14.344 Mountford and Atlas, on the other hand, did from time to time make such decisions, although not as often as one might expect in an organisation of the size and complexity of Tricontinental.

14.345 Even executive officers, of course, can only be held liable, under s229, for their own acts and decisions. If they are simply carrying out the lawful instructions of the managing director, and have no reason to doubt that he has the express or implied authority of the board of directors for his actions, then they can hardly be held responsible for any lack of care or diligence on his part.

14.346 So much for the offences created by s229 carrying, as they do, penalties of up to $5000 (or heavier penalties in the case of fraudulent conduct). It is noted, in passing, that sub-s(7) of s229 provides for the recovery by a corporation of losses which it may have incurred, from any officer responsible for those losses. This section cannot be used against a director of Tricontinental because of the provisions of s49 of The State Bank Act 1988 and s38 of The State Bank (Succession of Commonwealth Bank) Act 1991. However, executive officers (other than directors) of Tricontinental
do not receive the same protection. But it would be extremely unjust if proceedings were taken against a manager of the company, such as Mr Mountford, for recovery of damages for negligence, when a similar action could not be brought against Mr Johns or any other director. The Commission has paid no attention to this possibility, but notes in passing the extreme difficulties of proof that would attend any attempt to prove that a particular act of individual negligence produced a particular quantifiable loss.

Apart from any questions of even-handedness, or problems of proof, there would be no advantage to the Victorian taxpayer in bankrupting any of Tricontinental’s managers in the hope of recovering some small amount greater than the costs of the recovery action itself. For these reasons the Commission recommends strongly against the taking of any civil action against any managers.

Leaving aside questions of legal liability, the Commission has to reach conclusions about the conduct of senior managers, for the other reasons set out at the beginning of this chapter. In doing so, it is necessary once again to emphasise the pervasive influence of the managing director in the whole of the lending process.

It was not just that he set policies and established practices which led to the speedy granting of large and inherently risky loans after inadequate inquiry and analysis. In addition, he was directly involved in the great majority of the loans which, in time, became the source of heavy losses to Tricontinental. His own consideration of the ability of those borrowers to service and repay their loans was frequently very superficial, and he allowed no time for anyone else to carry out the task more thoroughly. He put his faith in forms of security which, if called upon, were likely to prove illusory.
Mr Ken Mountford

14.350

Johns' attitude to lending was bound to rub off on his immediate subordinates and, indeed, to affect all staff. Certainly it seems to have had an affect on Mr Mountford, who came from lending in a major trading bank, and apparently took a year or more to adapt to Tricontinental's very different philosophy and procedures. However, having done so, he loyally followed the managing director's lead. In the first year Johns told him what to do and, after that, when he was left to make his own decisions, he seems to have asked himself, consciously or unconsciously, 'What would Ian Johns want me to do?'

14.351

Mr Mountford was very open in his evidence to the Commission. He always seemed to be doing his best to remember the circumstances about which he was asked, and he was frank in admitting past errors, now that he is able to see them in perspective. The Commission believes it should be careful not to penalise Mr Mountford for his openness. It is against this background that the Commission makes findings in those cases where Mr Mountford appears to have been, arguably, most at fault.

Tibham Pty Ltd

14.352

The urgent credit memorandum prepared by Mr Mountford in this matter was certainly not one of which he could be proud; see paras 14.43-44 above. It had a number of major flaws, which could only be partly explained by his lack of familiarity with the project and the limited time given to him by Mr Johns.

14.353

In the Commission's view, the dominant role of Mr Johns in this proceeding cannot entirely excuse Mr Mountford. He owed a duty of care to the other directors of Tricontinental and to the company itself. He should not have put forward a credit memorandum which contained glaring omissions; see para 14.44. If he needed more time to make clear that the mortgage representing the chief security was not over freehold land but over leasehold airspace, or that development approval could not be expected for some time, then he should have taken the extra time required.
The other major omission from the memorandum, namely the identification of the Ariadne shares, is excusable on the grounds of confidentiality. The directors, if they had cared, could easily have asked what shares were involved, and Mr Mountford was entitled to assume Mr Johns would identify the shares to his fellow directors.

**Mainsel Investments Pty Ltd**

In this case also, the main criticism of Mr Mountford relates to the contents of the original credit submission. The ignoring of a precondition is also important. The defect in this submission was that it spoke of security being obtained through a first registered mortgage over the site concerned. The difficulty about this was that a number of preconditions had to be met, including the substantial construction of the building, before the borrower could legally give Tricontinental a mortgage over the bulk of the land. The credit submission made no mention of this problem.

The second important feature was that only limited drawdowns would be permitted, according to the credit submission, until development approval for the project had been obtained. After discussion with Mr Johns, Mr Mountford decided to ignore this precondition to drawdown. The Commission accepts Mr Mountford's evidence that he initially resisted unauthorised drawdowns, but Mr Johns instructed him to go ahead; see paras 14.53 and 14.56.

Although it is asking a lot of anyone in Mr Mountford's position to stand up to his managing director over an issue such as this, the Commission believes that a person of his seniority and experience should have done so. He has not suggested in his evidence that he tried to reason with Mr Johns, or persuade him to a different point of view. He should, at least, have done that - pointing to the need to inform other directors of the proposed major departure from the scheme which they had approved. With regard to the other major criticism of Mr Mountford in this transaction - the failure to explain to directors the difficulty in obtaining a mortgage - the Commission is disposed to accept the arguments of his counsel, who say
that, had all the detailed preconditions laid down in the credit submission been observed, this would not have been a major problem. However, the acceptance of this argument only serves to highlight the seriousness of the step that was taken when preconditions were ignored.

Markland House Limited

14.357 It must be said at the outset that this transaction was put together in great haste, under considerable pressure from the client, and at a time when Mr Mountford himself was working very long hours and under considerable strain. Tricontinental was only a few weeks away from its demise. The Commission accepts that in this, as in all other transactions which it has considered, Mr Mountford was doing what he thought was best for Tricontinental. On the other hand it is a good example of the difficulty which both he and Mr Johns seemed to have had in denying a loan to any major borrower, even a new client. Mr Mountford conceded in his evidence that this was always a high risk transaction, but he believed he had properly calculated what he called the ‘downside risk strategy’, and so Tricontinental would not lose, even if things went badly.

14.358 It is now clear that the proposal was, from the outset, very seriously flawed; see paras 14.76 and 14.79. The put option was a vital part of the security, but Tricontinental was only able to obtain Essington’s agreement to participate on the understanding that it would provide the necessary funds, if the option was exercised within twelve months. In effect, Tricontinental was agreeing to fund its own security. The other defect in the put option was that it was compromised by the existence of a shareholders’ agreement, which gave another party first call on the shares which were the subject of the put.

14.359 It seems reasonable to assume that neither of these defects would have been explained to the directors who were asked to approve the transaction. The evidence points to the probability that directors were asked to approve on the basis of an oral description of the proposal by Mr Mountford. They would have had to take his word for the quality of the security being taken.
In fact the security, including the charge over Markland House's assets, and the guarantees from its various subsidiaries, proved to be of no value; see para 14.76 above.

14.360 When a formal credit submission was prepared some days later, it was seriously defective because it contained no reference to the undertaking by Tricontinental to fund the put option, nor did it refer to the shareholders' agreement which also detracted from the effectiveness of the option. Perhaps even worse was the fact that the submission falsely stated that $3.42 million of one facility was required for working capital, when in fact those funds were required to purchase certain non-performing mortgages from Tricontinental. Because the credit submission was little more than a note for file, these serious defects were reduced in significance. They could not, in the Commission's view, found an action under s229(1) of the Code. They do, however, indicate an attitude of mind in which the whole truth ceases to be important.

14.361 This very complex deal, involving a number of parties, was put together in a matter of a few hectic hours. Mr Johns did have a hand in it, and was kept informed by Mountford. However, the main responsibility for putting it together must lie, on this occasion, with Mr Mountford himself. It is clear now that a hectic day's work was not a good day's work.

Mr Lynton Stott

14.362 As discussed above in paras 14.98-101, there was a question mark at Tricontinental about Mr Stott's capacity to carry out his role as head of the credit and securities division. Having observed him in the witness box over a number of quite lengthy periods, the Commission can understand those reservations. He does not give the impression of a very confident person, capable of giving strong leadership. On the other hand, the Commission believes that Mr Stott did his best to be helpful to the inquiry, answering questions carefully and to the best of his ability. It is easy to understand that his rather cautious style did not sit comfortably with the innovative and daring image which Johns was keen to project.
The result was that he played little part in the decision-making processes of Tricontinental. He carried out his formal duties, no doubt conscientiously, at least until he began to resent the way he was being treated and to lose motivation - probably in late 1988 and certainly early in 1989.

In the result, the Commission finds that it does not need to say much about Mr Stott. He and his department never provided the checks and balances which could have made all the difference to Tricontinental's performance. But that was not his fault. He did what was asked and expected of him by his managing director and other senior managers. It would be quite unfair to blame an officer of his level for the faults which were endemic to the whole Tricontinental credit risk management system.

Mr Neil Hunter

The Commission was not much assisted by Mr Hunter's evidence. He made no attempt to test the limits of his memory, confined himself as far as possible to generalities, and volunteered very little.

However it must be said, in fairness, that this seems always to have been his style. The impression given by documentary evidence and the evidence of other witnesses, is of a person who carried out a largely mechanical series of responsibilities in a generally careful and thorough fashion. But he was also a person who showed no great initiative and tried to avoid responsibility. He supported his managing director loyally and tried to perform satisfactorily all the tasks which Mr Johns gave him, until he was asked to take major responsibility for the pursuit of problem loans. In this, as in other areas, he was always willing to carry out instructions, but did not want to have to decide for himself what steps to take.

Mr Hunter had direct access to Johns and, in the absence of evidence from Johns, it would not be safe to assume that Hunter took any action of significance without consultation. This is true, for example, of the return of the certificates of title in the Kahmea case; see paras 14.225-227 above.
As indicated in paragraph 14.238 above, Mr Hunter's action in permitting very large sums to be redrawn by the Goldberg group in June 1989, was quite out of character. The departure of Mr Johns from the management scene, although he may still have been on the premises, left Mr Hunter without his usual source of direction. However, one would have thought that he would be even more cautious than usual in the early days of integration. Although he may have been acting within the strict letter of his authority - and even that is doubtful - his thought processes at the time must remain something of a mystery. It was certainly, at least, a very serious error of judgment not to refer the matter to a higher authority.

Mr Warren Atlas

Mr Atlas gave his evidence clearly and appeared to be forthright and doing his best to be helpful to the Commission. He had a number of perceptive insights into the way in which Tricontinental functioned. Paragraph 14.278 above provides a good example of this.

Like Mr Mountford, Mr Atlas accepted the leadership of Mr Johns and, no doubt, pursued business with the enthusiasm that was expected of him. The only transactions in which he was closely involved, which were examined by the Commission, were those relating to the Quatro group. Although these resulted in quite heavy losses for Tricontinental, this was not because of any inherent weakness in the ventures which Tricontinental was supporting. Both Pro-image and, particularly, Disctronics, represented projects which seemed to have good chances of success and were worth supporting. Problems arose because the managers of Quatro and its subsidiaries over-reached themselves in overseas aspects of their activities.

It is true, as explained in paras 14.317-334 above, that there were a number of points on which credit submissions, for which Mr Atlas took responsibility, can be criticised. The faults were very much the same as those which pervaded most Tricontinental credit submissions - inadequate financial information and analysis in particular. Deficiencies of monitoring are also alleged, but these are not so clear-cut. Having considered the
transaction as a whole, the Commission is not disposed to make any adverse findings relating particularly to Mr Atlas. The weaknesses shown up by the review of these transactions are those which apply generally to all Tricontinental’s lending operations.

All managers

After considering all the material set out in this chapter, the Commission has reached a firm view that no action for penalties should be taken against Mr Mountford, or any of the other managers of Tricontinental junior to him. They have, in varying degrees, been guilty at times of poor performance - sometimes amounting to negligence. In a few instances, apart from very considerable difficulties of proof, it would seem that actions under s229(2) of the Code could theoretically be brought.

However, there are a number of matters to be borne in mind. In the first place, these managers were acting at all times under the close supervision, and often under the instructions, of the managing director, and they always believed that what they were doing was in the best interests of Tricontinental.

Mr Mountford, who of all the managers is most at risk of prosecution, spent many trying days in the witness box and, so far as the Commission can tell, gave his evidence fully and frankly.

In the view of the Commission its criticisms, set out in this public report, represent a sufficient penalty for such defaults on the part of these managers as may have occurred. The public interest would not be served by the expense of further proceedings against them.