CHAPTER 17

THE PART PLAYED BY THE RESERVE BANK OF AUSTRALIA

A. Role of Reserve Bank Generally

17.1 The statutory responsibility of the Reserve Bank of Australia (‘RBA’) for the banking system was described in some detail in chapter 23 of the Commission’s first report. It should be borne in mind that the RBA’s statutory power did not extend to state banks. The supervisory role exercised by the RBA over SBV stemmed from a voluntary agreement entered into in 1986 as part of a move by SBV to establish offices overseas (see section C of chapter 23).

17.2 Under that voluntary agreement, SBV undertook to observe the RBA’s prudential guidelines and to provide information on management systems used to control exposures and limit risk, to provide statistical data and to consult on prudential and other matters. The voluntary agreement was extended in August 1986 to provide that special reports from auditors would go to the RBA.

17.3 The supervisory role of the RBA did not extend to ‘non-bank financial intermediaries’ (‘NBFIs’), even if they were subsidiaries of banks, and so did not focus directly on Tricontinental. The RBA relied on assurances from SBV that the business of its merchant bank subsidiary was being properly controlled.

17.4 Prudential statements issued by the RBA from time to time were designed to provide management guidelines to banks which would, among other things, govern their relationships with their non-bank financial subsidiaries. The RBA clearly recognised that these subsidiaries represented a potential
threat to the financial stability of their parent banks and it was therefore essential that they be prudentially managed. The guidelines were designed to reduce any such dangers.

17.5 In discussing the issue of bank supervision, the RBA in its annual report for the year ended 30 June 1991 emphasised that its supervisory role:

"... has three primary objectives, namely:
- preservation of confidence in the banking system as a whole;
- the stability and integrity of the banking system and of the domestic and international payments systems; and
- the protection of bank deposits."

The report emphasised that:

"Prudential supervision does not have as an objective the immunisation of banks from the risk of loss, the economic cycle, or from the mistakes of their managers. Managers and shareholders should factor the inevitability of the economic cycle into their decision-making, and they must pay the price for errors of judgment and carelessness."

17.6 Evidence given to the Commission by officers of the RBA emphasised this approach to the bank's supervisory role, and indeed Mr Graeme Thompson, Assistant Governor (Financial Institutions) of the RBA said, "... a good deal of our supervision of banks and therefore of their subsidiaries is based on the assumption that we can rely on the competence of senior management of banks."

17.7 In order to provide further reassurance, the RBA entered into arrangements with the external auditors of banks to provide separate reports to the RBA. These reports related to the parent bank and did not cover subsidiaries - apart from the RBA limitation on the bank's exposure to its subsidiaries.

17.8 It is clear from the evidence that the RBA in fact relied heavily on the competence and integrity of senior management of banks, as well as their external auditors, in ensuring that its prudential guidelines were being adhered to. This gives rise to the question, considered later in this chapter,
whether the RBA was justified in its reliance on these sources or whether other steps should have been taken to supplement and confirm assurances about particular situations.

B. Different Perceptions of RBA Role

17.9 The Assistant Director-General (Finance) at the Department of Management and Budget, Mr Bruce Rasmussen, gave evidence that he was aware that Tricontinental itself, as an entity, was not subject to direct RBA supervision and that it was supervised only to the extent that it represented a large exposure for SBV.

17.10 Mr Rasmussen’s understanding of the role played by the RBA in supervising the activities of Tricontinental was not shared by his superiors.

17.11 The most senior public servant with responsibility for treasury was Dr Peter Sheehan, who held the position of Director-General of the Department of Management and Budget. Dr Sheehan said in evidence that he was not aware that the RBA distinguished in its supervisory arrangements between banks and the subsidiaries of banks.

17.12 The State Treasurer, Mr Rob Jolly, said in his statement to the Commission that he regarded supervision by the RBA as very important and that he "gained considerable comfort from the fact that the State Bank had agreed to comply with the prudential principles laid down by the Reserve Bank".

17.13 The Victorian Premier, Mr John Cain, in his evidence said that he believed that the RBA would keep an eye on the State Bank. He believed it had an obligation to "maintain the integrity of the banking system." He believed the RBA’s role extended to SBV and, as Tricontinental was a part of SBV, it covered Tricontinental also.
17.14 During his examination before the Commission, Mr Graeme Thompson of the RBA was asked whether anyone within the RBA understood the importance which the State Government placed upon the RBA's role. In responding he said, "I can't say I am specifically aware of evidence to that effect. It doesn't surprise me."

C. Limitation of Authority Over State Banks

17.15 The absence of direct statutory authority over SBV appears to have resulted in the RBA's supervision of SBV being less forceful than it would have been in respect of a licensed bank subject to the Banking Act. Although in his evidence Mr Thompson said that the absence of any direct statutory powers did not mean that the RBA's supervision of SBV was any less effective than its supervision of the major trading banks, he did concede that:

*We attempted to treat the state banks on the same basis as we treated the other banks, but I think at the back of the minds of those in the position at the time was the knowledge that the arrangement with the State Bank was a voluntary one*.

Elsewhere he said:

*I think, to some extent, particularly early on, we felt somewhat constrained in cracking the whip in the case of a state bank whose compliance with our requirement was voluntary ....*.

17.16 The implications of the status of state banks were dealt with by the House of Representatives Standing Committee on Finance and Public Administration ("the Martin Committee"); see paras 13.85-96 of its report. The Committee's recommendations 27 and 28 were directed towards ensuring that the supervision of the state banks should be greatly improved, both at state government level and, more particularly, by state governments formally referring powers over state banking to the Commonwealth Government "so that state banks can be regulated and supervised in the same manner as private banks".
D. Absence of Direct Control Over Non-Bank Financial Intermediaries

17.17 The approach of the RBA to the supervision of NBFIs reflects the fact that, while an NBFI subsidiary can create financial risks for a parent bank, the RBA has direct supervisory responsibility only for the licensed trading banks, and not for NBFIs. This approach is encapsulated in Prudential Statement G1. It was recognised by the RBA that the activities of an NBFI subsidiary had the potential to affect seriously the financial strength of its trading bank parent. Prudential Statement G1 seeks to deal with this risk in three ways:

(i) By providing that a trading bank parent must not provide a general guarantee of the subsidiary's liabilities, and must not create the impression that the licensed bank parent will "stand behind" the subsidiary to the extent of honouring the subsidiary's liabilities.

(ii) By providing that where a bank feels "implicit responsibility" for a subsidiary, it should exercise that responsibility by ensuring that the NBFI is prudently managed, so that it has "undoubted viability" within the limits of its own capital resources.

(iii) By providing that a bank should ensure that its NBFI subsidiary "does not become unduly large relative to the bank itself".

17.18 The first of these requirements fails to take adequate account of the commercial reality that the parent bank would find it virtually impossible to "walk away" from a subsidiary experiencing financial difficulty, unless the RBA forced it to do so because of a risk to depositors' funds. In evidence Mr Thompson agreed that, in practical terms, it would have been impossible for SBV to walk away from Tricontinental. In view of this commercial reality, this first requirement had little real meaning.
With regard to the third requirement, Mr Thompson explained that the RBA's guideline was that the balance sheets of a bank's various subsidiaries should, in aggregate, not exceed 30% of that of the parent bank itself. This guideline is one step removed from the heart of the matter, which is the size of the subsidiaries' liabilities which the parent bank may be called upon to support, relative to the capital resources of the parent from which it would do so. The RBA's guideline left open the possibility that a subsidiary's liabilities could greatly exceed the parent bank's capital base. In fairness to the RBA, it could hardly be expected to draw the guideline in anticipation that a subsidiary's losses would be so extensive as to result in its unsupported liabilities exceeding the entire capital base of the parent - particularly if the parent were to observe faithfully the second of the three prudential requirements of Prudential Statement G1.

In reality then, the key aspect of Prudential Statement G1 was the second of the three requirements. In the view of the Commission, the approach of the RBA to the issue of NBFI subsidiaries of the trading banks was deficient in that this requirement - that the subsidiaries be prudently managed to ensure "undoubted viability" within the terms of their own capital resources - was, at least in the case of SBV and Tricontinental, not supervised by the RBA. The RBA did not take sufficient steps to check that Tricontinental had in place effective management systems and prudent lending policies, or that Tricontinental's major exposures were limited to a prudent proportion of Tricontinental's own capital base. In this connection it should be noted that Prudential Statement H1, concerning the reporting by a bank's auditors on its management systems which limit risks to prudent levels, does not extend to reports in relation to the management systems of an NBFI subsidiary. Prudential Statement E1, regarding the reporting of a bank's large loan exposures, similarly did not at the time extend to the exposures of an NBFI subsidiary.
17.21 The commercial reality of parent support for a subsidiary is of particular significance where the parent bank is a State bank. In that case, the reality of support for the NBFI subsidiary extends to the provision of financial support by the State government. In evidence, the former Victorian Premier, Mr John Cain, said that it was never an option for the Government not to back an organisation which was a 100% owned subsidiary of SBV.

17.22 The deficiencies in the monitoring or enforcement of Prudential Statement G1 meant that the benefits of RBA supervision were, in respect of the risks associated with NBFI subsidiaries, largely illusory. Effective supervision by the RBA of banks having NBFI subsidiaries required that the RBA be satisfied that the bank was ensuring that the NBFI was prudently managed, with effective internal operating systems, and that it operated within the constraints of its own capital base. A review of Tricontinental on that basis would have disclosed that Tricontinental’s loan exposures were considerably in excess of any prudent proportion of its own capital base.

17.23 While it is true that the RBA does not have direct statutory responsibility for the NBFI subsidiaries of trading banks, it was nevertheless acknowledged by the RBA in evidence to the Martin Committee, dated November 1991, that the RBA has a "responsibility for ... the integrity of the payments system and overall stability of the financial system". The Martin Committee noted that:

"This is not directly stated in the legislation although 'prudential matters' in the above clause is defined to include a bank not conducting its affairs in a way that would cause instability in the financial system. It would also come within the rubric of 'the economic prosperity and welfare of the people of Australia'" (para 12.13).

17.24 This matter is considered in the Report of the Martin Committee (paras 14.32-39) which concluded that:
"The fact that banks do not provide formal guarantees to their subsidiaries is not sufficient to prevent the subsidiaries having the potential to damage the standing of the banks. As a consequence banks will be under pressure to prop up subsidiaries which will weaken the position of banks."

The Committee therefore recommended that "banks with Australian subsidiaries whose principal business is raising deposits and making loans be required to wind them back into the parent bank within three years" (para 14.39, recommendation 36).

E. RBA Concerns about Tricontinental

17.25 The principal concerns which the RBA had about Tricontinental are canvassed in chapter 23 of the Commission's first report. Some of these concerns arose from the period shortly after SBV acquired one hundred percent of Tricontinental and, continuing after that, persistently featured in the regular prudential consultations held by the RBA with SBV executives. An example was a concern about the effect of Tricontinental's growth rate on the capital adequacy of SBV - this arose early in 1986, within a few months of the acquisition. And in June 1987 Mr Ziebell told an RBA officer that Tricontinental was "lending flat out".

17.26 Other concerns arose from time to time, but were not regarded as being of sufficient weight to cause the RBA to take action beyond seeking the assurance of SBV directors that all was well.

17.27 It is important to note here the point made in paragraph 23.28 of the Commission's first report that, although the RBA was aware that SBV would have to stand behind Tricontinental in a crisis, it did not attempt to intervene directly to "rein in" the liability of SBV to Tricontinental or to control it.
That the RBA acknowledged that it had certain wider responsibilities is evident from a file note of 15 March 1988 of a meeting between Mr Moyle and the RBA officer in charge of the supervision unit, Mr Brady, which indicates that Mr Brady expressed his concern at the "very strong growth which had been recorded by both the bank and Tricontinental during the past couple of years - growth which had outstripped that which could be supported prudently by the bank's capital base...", and went on to record Mr Brady as recognising that, "we have responsibilities both to overseas authorities and to the Australian public to whom we have given assurances about state banks' observance of our prudential requirements." For Mr Moyle's response to Mr Brady's concerns, see para 23.16 of the Commission's first report.

As reported in paras 23.63 and 23.67 of the first report, the RBA was aware as early as March 1988 that Tricontinental's large exposures were looked at on a group basis and that "compared to TCL's capital, loan exposures to individual clients would be well in excess of normal standards". This was confirmed by Mr Johns in August 1988 when he told officers of the RBA that, "... in some cases exposures are about 100% of shareholders' funds", and that Tricontinental was "highly geared with capital about 2½% of total assets".

The manner in which the RBA supervised SBV was not markedly different from the approach it took to its statutory obligation of supervising the trading banks. Because the role it played with SBV arose out of a voluntary agreement, it tended to take a somewhat softer approach to its charge. However there is no evidence to suggest that the results achieved were markedly different.
17.31 As already mentioned, the RBA's role was primarily directed to protecting the banking system, it was certainly not designed to protect banks from poor commercial decisions. Indeed it did not have, or profess to have, competence in this area of banking activity.

17.32 In a paper presented to an RBA conference held in June 1991, Mr Graeme Thompson, in dealing with the question as to whether supervision could reasonably have been expected to have achieved more during the period from 1985 onwards, made the following points among others:

(i) "There is no firm basis for the view that supervisors are better than bankers at picking the good from the bad propositions."

(ii) "What was not accurately predicted by the prudential supervisors was the extent of the additional risk that banks would acquire and, more importantly, the failure of the banks themselves to factor this correctly into their pricing."

(iii) "Events suggest that prudential supervision will need to be more "assertive" in some respects and might, in particular, need to discriminate more among banks according to their perceived risk characteristics."

17.33 In a further observation in the same paper Mr Thompson said, in relation to merchant banks and finance company subsidiaries of banks:

"These subsidiaries are not subject to the [RBA's] supervision although some prudential requirements (capital adequacy and large exposures reporting) now extend to consolidated groups. The main objective of the [RBA's] prudential statement dealing with non-bank subsidiaries of banks is to reduce the risk of contagion by emphasising the separateness of the entities. .... We therefore advise banks that, to the extent they feel implicit responsibility for an associate, they should ensure that it is managed soundly and prudently within the bounds of its own capital resources.

Experience suggests deficiencies in some banks' capacity to observe this advice. The Bank is reviewing its policy in this area."

17.34 There can be no doubt that the RBA could have done more to pursue its concerns about Tricontinental, both with SBV management and, if that
proved unsatisfactory, with the shareholder of SBV, the Government of Victoria.

17.35 Some officers of the RBA were concerned about certain aspects of Tricontinental's business as early as 1986. A hand-written comment on an internal RBA file note, dated 2 December 1986, referring to Tricontinental's "strong asset growth" noted particularly Tricontinental's strategy of "taking on board a higher degree of riskier business", and said that such a strategy was "yet to stand the test of time".

17.36 As noted by Mr Thompson in his evidence, the RBA sought assurances from the senior management of SBV that it was in control of Tricontinental, and "that problems were not likely to develop in the subsidiary which would come back and cause severe problems for the bank itself, and we received those assurances whenever the matter was raised".

17.37 The matter had been raised as early as April 1986, when an RBA officer rang the chief executive officer of SBV, Mr Bill Moyle, to discuss the impact on SBV's capital adequacy of the growth in Tricontinental's assets. The RBA file note records Mr Moyle as telling the RBA officer that the "matter had been raised at a meeting of his board this morning", and that "the size of Tricontinental's balance sheet would level off as maturing facilities were run off ... Mr Moyle said that it had struck him also as being very large but that the matter was under control" (first report para 10.15).

17.38 It is apparent however that the discussions with SBV management did not involve any detailed review of SBV's relationship with Tricontinental in terms of Prudential Statement G1. The RBA was then unaware that Tricontinental determined maximum group exposures by reference to SBV's capital base. Mr Thompson said that he regarded this as a breach
of Prudential Standard G1. However Mr Moyle did not; he said that he believed that SBV was "fully complying" with the standards.

17.39 The extent of the RBA's knowledge of Tricontinental's operations is described at Section E of Chapter 23 of the First Report. Significantly, the RBA was aware both of the high-risk nature of the strategy undertaken by Tricontinental, and (through its supervision of SBV's capital adequacy) of the under-capitalised status of the SBV group (comprising SBV and Tricontinental together) from 1986. These factors, when combined with the acknowledged commercial reality that SBV (and therefore the Victorian Government) could not refuse to honour Tricontinental's liabilities, should have caused the RBA to take action to satisfy itself that Tricontinental's activities did not constitute a financial risk to SBV, and to the State Government of Victoria.

17.40 Mr Thompson gave evidence that, if the RBA had had any perception that the problems in Tricontinental were of the magnitude later disclosed, it would have spoken with the Government of Victoria directly. In fact, there were no communications between the RBA and the State Government before May 1989, when the business of Tricontinental was integrated with SBV, and SBV had provided guarantees in relation to Tricontinental's liabilities. The RBA was sufficiently concerned, however, to raise the matter of Tricontinental's activities with SBV management from time to time. It accepted oral assurances; see first report, paras 23.28-31.

17.41 In his evidence, Mr Cain said that he saw the RBA as "the guru of the banking system", with an obligation to maintain the integrity of that system. Mr Cain believed that the RBA was undertaking an appropriate supervisory role over the entire SBV group (including Tricontinental). Mr Thompson responded to Mr Cain's observations by noting that Mr Cain had not distinguished clearly between the RBA supervision of banks,
and the fact that the RBA did not directly, in any way, supervise NBFI subsidiaries of banks. Nevertheless, the government was entitled to take comfort from the fact that the RBA was exercising some prudential supervision over the SBV group as a whole.

17.42 It may be noted that the Martin Committee concluded in its report:

- "...it appears that due to the voluntary nature of the supervision [of state banks the RBA] has adopted a different role with respect to state banking than it applies to private banks. The Committee is not satisfied with the vigilance of [the RBA] in regard to state banks" (para 12.44).
- "The Committee believes much of the problem reflects a misinterpretation by State governments of the extent to which the task of protecting the interests of their taxpayers could be left to [the RBA]" (para 12.45).

G. Conclusions and Findings

17.43 The RBA should have been aware that its supervision of SBV was regarded by overseas authorities as well as the State Government and Australian financial circles as of real importance in providing reassurance that its prudential requirements were being observed. The fact that the arrangement with SBV was voluntary did not diminish the need to ensure that prudential standards were being maintained. The absence of constitutional authority may explain a diffident approach by RBA to its responsibilities, but it does not excuse it. Having accepted the supervisory task by arrangement with the state government, the RBA should have carried it through.

17.44 Given the extent of the RBA's knowledge of, and concerns about, Tricontinental's activities, it was not enough to raise those concerns with SBV executives and simply accept oral reassurances. The RBA should have sought the necessary information to satisfy itself that its guidelines about an NBFI operating within the limits of its own capital resources were being observed. Knowing that Tricontinental had rapidly grown to
be the largest (or close to the largest) merchant bank in Australia, the RBA should also have asked whether its growth was so rapid as to be beyond that which could be prudently managed. The rate of growth, in a highly competitive environment, was itself a clear indication of low credit standards.

17.45 It is not clear that the mere provision of more information about the size of Tricontinental's loans would have led to a firm stand by the RBA and so prevented the collapse of Tricontinental, but it would certainly have led to significant brakes being applied to its activities. That this is so is evident from paragraph 23.51 of the first report of the Commission, where Mr Thompson of the RBA is reported as indicating that:

"...if Tricontinental from July 1986 had set its exposure limits by reference to a percentage of [SBV's] capital base, the RBA would have expected to have been made aware of that decision. Had the RBA been told about Tricontinental's exposure limits, it would not have condoned them. The RBA would have suggested to SBV that the policy be changed or, alternatively, if SBV wished to persist with the arrangement, the RBA would have expected SBV to have a close involvement in the lending decisions of Tricontinental - as if those decisions had been made within the bank itself."

There is no evidence that the RBA asked how SBV's subsidiary's exposures were controlled or restricted.

The collapse of Tricontinental and its flow-on effect through SBV did serious damage to the financial fabric of the State of Victoria. That this was possible without the RBA being aware of the potential danger, in itself suggests grounds for criticism of the body charged with the responsibility for supervising the Australian banking system.

17.47 It is no doubt true that, in order for the RBA to have become fully aware of the potential dangers inherent in the Tricontinental loan portfolio, it would have been necessary for it to carry out on-site inspections of the systems and records of the merchant bank. The RBA was not organised to operate in this intrusive manner and did not possess staff with the
competence to carry out such work. Despite this, the question remains as to whether the RBA could properly satisfy itself that all was well with SBV in the absence of basic relevant information about Tricontinental's exposures.

17.48 The Commission has concluded that although the RBA acted responsibly in constantly questioning SBV executives about Tricontinental it should, at the very least, have insisted on more information being provided about the merchant bank's activities. In particular, the reporting of exposures on a group basis which was introduced as an RBA requirement in August 1989 should have been introduced much earlier. In addition, the arrangements between the RBA and external auditors of banks should have clearly extended to the provision of relevant information about significant non-bank financial subsidiaries as well.

17.49 In the final analysis, while having sympathy for the RBA's difficult passage through the troubled and uncharted waters of deregulation, the Commission believes the RBA must accept some share of responsibility for the events leading up to the forced sale of SBV. Its responsibility is secondary rather than primary, and considerably less than that of the managers and directors of Tricontinental, or of those directors of SBV who were also directors of Tricontinental. It is there nonetheless.
CHAPTER 18
THE ROLE OF AUDITORS, VALUERS, AND ADVISERS
- TERM OF REFERENCE 4

18.1 This term of reference asks, in effect, if any professional firms on which Tricontinental relied for advice were negligent, or in breach of the terms of their contracts, in the carrying out of their functions. The term of reference also asks about any false or misleading statements or information from such firms.

18.2 It seemed at first that an inquiry into the role of Tricontinental’s auditors, KPMG Peat Marwick, would take up a large amount of the Commission’s time. The circumstances in which it was determined that that should not occur are set out in paras 3.10 to 3.18 above.

18.3 Chapter 12 above outlines the relevant information which was in fact passed by KPMG Peat Marwick to management and to the board of Tricontinental. It does not attempt to determine what other information, if any, should have been passed.

18.4 Accordingly the Commission, with the concurrence of the Victorian Government, does not attempt to answer this term of reference so far as the auditors are concerned.

18.5 With regard to valuers, the Commission has been alert for any suggestion in the evidence that Tricontinental has been poorly served by any of the property valuers it employed. There has been no such suggestion and, although the Commission has had to consider a number of specific valuations, there has been no evidence that any of them has been deficient within its own boundaries.
18.6 What has emerged, in several cases, has been that Tricontinental's management has knowingly used a valuation given for one purpose, and on an appropriate basis, for a different purpose where the basis was no longer appropriate.

18.7 In other cases, past valuations have been relied on when a fresh valuation would have seemed desirable.

18.8 In ways such as these valuations have, on occasions, given false comfort to directors. But this has not been the fault of the valuers. No instance of property valuation which appeared as if it could fall within term of reference 4 has come to the notice of the Commission.

18.9 There were several instances referred to in the first report in which a firm of accountants was called upon to value Tricontinental; see first report paras 12.17, 14.34-35, 15.13-14 and 15.45-54. In the last case the valuation was impliedly criticised by officers of the Reserve Bank of Australia as not amounting to a complete due diligence review; see first report paras 15.55 and 23.93. But in that case, the accountants had not been instructed to undertake a due diligence review of Tricontinental, but rather to value the company based on information provided by Tricontinental. Indeed, each of the valuations was expressly based upon information supplied by Tricontinental itself, and the firm disclaimed any independent testing of that information. In the view of the Commission, the accountants did what they were asked to do and could not be said to have been in breach of any duty when they placed a higher value on Tricontinental than is now known to have been justified. The fault lay in the figures supplied by Tricontinental's management.

18.10 The only other advisers who have come to notice have been the various firms of solicitors which handled Tricontinental's legal affairs. Two instances of possible negligence have been suggested, but there is no
evidence to support one (see TR 8, paras 30 and 76, in vol 3), and the other is not clear-cut. In particular, it would seem difficult to establish what damage was done in this second case, even if a negligent act could be proved; see TR 12, paras 184-195 and 209-10.
CHAPTER 19

THE LEGAL OBLIGATIONS OF DIRECTORS
AND OTHER OFFICERS

A. Introduction

19.1 As noted in chapter 9, the two most important questions that the Commission has to answer are:

- What caused Tricontinental's losses? and
- Who, or what, were to blame?

19.2 The bulk of this report has been directed to giving a factual explanation of what happened, and why. Causation, and responsibility, have been approached in that context.

19.3 The original terms of reference (Appendix 1), however, also ask or give rise to questions about legal responsibility. Specifically, in relation to Tricontinental:

- Whether any person has contravened the provisions of the companies legislation or the criminal law? (Term 1)
- Whether any Tricontinental director or other officer has engaged in illegal, corrupt or improper activities or conduct, or has acted in breach of any duty owed to Tricontinental? (Term 2)
- Whether any auditor, valuer or adviser acted in breach of any duty owed to Tricontinental, or gave false or misleading statements or information? (Terms 4)
- Whether the affairs of Tricontinental were properly supervised by the directors and other officers of Tricontinental, and the directors and employees of SBV? (Term 5)
19.4 Much of this is dealt with in other chapters of the report. This chapter refers mostly to the underlying general law (encompassing equitable and common law duties), and the relevant companies legislation, from which the legal obligations of directors and other corporate officers arise.

19.5 The applicable companies legislation is that in force up to May 1989. As the present Corporations Law did not come into operation until 1 January 1991, the relevant provisions are those contained in the Companies (Victoria) Code 1981 (‘the Code’).

B. Sources of Legal Obligations

19.6 The legal obligations of directors and other officers arise from a number of sources, including:

• The fiduciary relationship which exists between a director and the corporation: this relationship has its origins in equity.

• A relationship in contract: this will arise from the express or implied terms of a contract of employment between the corporation and an executive director or manager.

• The operation of the law of torts, or civil wrongs, under which a duty of care may arise, breach of which constitutes negligence.

• The companies legislation.

• The Crimes Act 1958 (Vic).

C. Fiduciary Duties and the Companies Code

19.7 The most relevant obligations for consideration in the present context, especially in the case of non-executive directors, are the fiduciary duties, and their counterparts in the companies legislation.

19.8 A director has two broad fiduciary duties:

• To act in good faith.
To act with reasonable care and diligence.

These fiduciary duties have their counterparts in the provisions of s229 of the Code. The requirement in s229(1) that an officer of a corporation shall at all times act "honestly" in the exercise of his powers, reflects the requirement to act in good faith. The requirement in s229(2) for an officer to exercise a reasonable degree of care and diligence, embodies the second equitable duty.

D. The Companies (Victoria) Code 1981
(a) Section 229 - general provisions

Section 229 places a number of obligations upon an "officer" of a corporation. For the purpose of that section, the expression "officer" is defined in s229(5). It includes "a director, secretary or executive officer of the corporation". A significant point is that there is no reference to "employee". This is in contrast to the definition of "officer" in s5(1), for the wider purposes of the Act.

Thus the duties in ss229(1) and 229(2) apply only to an "officer" as defined in s229(5), and not to an employee who is not a director, secretary or executive officer. (In contrast, the duties in ss229(3) and 229(4) are expressed to apply to an officer or employee). The meaning of "executive officer" is defined in s5(1), and is discussed later in this chapter.

Of course, each executive is subject to the possibly more stringent express or implied obligations of his contract of service, but then there is no exposure to the criminal sanctions contained in s229 of the Code.

Section 229 is not intended to replace any obligations that might otherwise exist. Section 229(10) provides that the statutory duties imposed by s229 have effect in addition to, and not in derogation of, any other rule of law.
relating to the duty or liability of a person by reason of his office or employment in relation to a corporation.

(b) Section 229(1) - "act honestly"

Section 229(1) provides:

"An officer of a corporation shall at all times act honestly in the exercise of his powers and the discharge of the duties of his office. Penalty -

(a) in a case to which paragraph (b) does not apply - $5,000; or
(b) where the offence was committed with intent to deceive or defraud the company, members or creditors of the company or creditors of any other person or for any other fraudulent purpose - $20,000 or imprisonment for 5 years, or both."

The concept of "acting honestly" comprehends the notion of "acting bona fide in the interests of the company", which is one aspect of the fiduciary duty of good faith. (Another is the avoidance of a conflict between personal interests and the interests of the company.)

Under s124(1) of the Uniform Companies Act 1961 (a forerunner of s229(1)) it was held that proof of a mental element was necessary - a consciousness that what being done was not in the interests of the company, and deliberate conduct in disregard of that knowledge - Marchesi v Barnes [1970] VR 434 at 438 per Gowans J; followed in CAC v Papoulias (1990) 20 NSWLR 503, Flavel v Roget (1989) 15 ACLR 741, (1990) 8 ACLC 237; and Morgan v Flavel (1983) 1 ACLC 831. A broader view of failing to "act honestly" was expressed in Australian Growth Resources Corporation Pty Ltd v van Reesema (1988) 6 ACLC 529 at 539. In relation to the differently expressed provisions of s229(1), compared to the earlier s124(1), it was said by King CJ (with Cox J concurring):

"The section .... embodies a concept analogous to constructive fraud, a species of dishonesty which does not involve moral turpitude. I have no doubt that a director who exercises his powers for a purpose which the law deems to be improper, infringes this provision notwithstanding that according to his own lights he may be acting honestly."
This approach by a Full Court of the Supreme Court of South Australia was followed, with apparent reluctance, by a differently constituted Full Court of that State in Southern Resources Ltd v Residues Treatment and Trading Co Ltd (1990) 3 ACSR 207 at 226-7, 8 ACLC 1151 at 1167.

(c) Section 229(2) - "care and diligence"

Section 229(2) provides:

"An officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and the discharge of his duties.

Penalty: $5,000."

Thus it is not enough for directors to act honestly - they also have a statutory duty of care and diligence.

This section may be compared with its predecessors, s107(1) of the Companies Act (Vic) 1958 and s124(1) of the Uniform Companies Act 1961. Each of these sections provided that:

"a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office."

It is to be noticed that these earlier sections combined elements of what later became ss229(1) and 229(2), but omitted any reference to "care".

The successor to s229(2) is s232(4) of the Corporations Law 1991, which is in terms identical to s229(2).

(d) Section 229(3) - "use of information"

Section 229(3) reflects the general law rule that a director cannot make improper use of information obtained by virtue of the office.

Section 229(3) provides:

"An officer or employee of a corporation, or a former officer or employee of a corporation, shall not make improper use of information acquired by virtue of his position as such an officer or employee to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Penalty: $20,000 or imprisonment for 5 years, or both."
19.20 In *Chew v R* [1991] 5 ACSR 473 at 500 Malcolm CJ recognised that s229(3) reflected the general law rule against secret profits. On the other hand, s229(3) appears to be wider than the general law, in that it applies to any officer or employee, and the remedy against the officer or employee under s229(7) includes recovery of a profit made by a third party - see *Grove v Flavel* [1986] 43 SASR 410, confirmed in *McNamara v Flavel* [1988] 13 ACLR 619.

(e) **Section 229(4) - "use of position"

19.21 Section 229(4) reflects the general law rule that a director cannot make improper use of the position of director to obtain a personal advantage or to benefit another without the authority of the corporation.

19.22 Section 229(4) provides:

"An officer or employee of a corporation shall not make improper use of his position as such an officer or employee, to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Penalty: $20,000 or imprisonment for 5 years, or both."

19.23 In *Chew v R* [1991] 5 ACSR 473 Malcolm CJ at 507 considered the mental element required for this offence. He said:

"... what is required by way of mens rea under s229(4) is a deliberate act or combination of acts by a director as such, with knowledge that what is being done is not for the purpose of furthering any interest of the company, but [of] achieving a collateral purpose which will gain an advantage for himself or another, or cause a detriment to the company. This is of course, less than a specific intent, which requires an intention to bring about a specific result. The gaining of the advantage or the causing of the detriment are respectively elements of the offence."

19.24 On appeal to the High Court (reported in (1992) 10 ACLC 816) a majority (Mason CJ, Brennan, Gaudron and McHugh JJ at 819) disagreed with this last statement of Malcolm CJ. They did not regard the accrual of an
advantage or the suffering of a detriment as an element of the offence. An officer who makes improper use of his or her office in order to gain an advantage is guilty of an offence, even if his or her purpose was thwarted. The majority of the High Court appears to have decided that the mental element in s229(4) is that the accused must have the purpose of gaining an advantage or causing a detriment and must believe that the intended result would be an advantage for himself or herself or for some other person or a detriment to the corporation.

(f) Section 229(5) - "executive officer"

It has already been noted that ss229(1) and 229(2) apply only to an "officer" of the corporation, and for that purpose s229(5) defines "officer" as including a "director, secretary or executive officer" of the corporation, thus excluding an employee who is not within one of the other categories.

Section 5(1) of the Code defines "executive officer" as meaning:

"... any person, by whatever name called and whether or not he is a director of the corporation, who is concerned, or takes part, in the management of the corporation".

The meaning of being concerned or taking part in the management of a corporation has been considered in the context of s227(1) of the Code by Ormiston J in Commissioner of Corporate Affairs (Vic) v Bracht [1989] VR 821 at 828-833.

On the issue of what constitutes "management" for the purposes of that section, his Honour concluded that:

"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."

19.29 There is scope for uncertainty about the level and nature of involvement required to constitute being "concerned" or "taking part" in management for the purposes of ss229(1) and 229(2). The meanings attributed to similar expressions in other contexts, which serve different purposes, are not necessarily a sure guide.

19.30 This uncertainty is amply illustrated by reference to cases such as Cullen v Corporate Affairs Commission (NSW) (1988) 14 A CLR 789 at 793-4 per Young J; Re Ansett (1991) 9 ALCR 277 at 285 per Brooking J; Re C & J Hazell Holdings Pty Ltd (1991) 9 ALCR 802 at 805 per Cox J; and Holpitt Pty Ltd v Swaab (1992) 10 ALCR 64 per Burchett J. In all of those cases reference was made to Bracht, with differing degrees of approval or application.

19.31 It by no means follows that every employee of Tricontinental who was described as a manager, group manager, or assistant general manager was necessarily an "executive officer", and thus an "officer", for the purposes of ss229(1) and 229(2) of the Code. No doubt the prospects of qualification were greater as "decision-makers" than "policy-makers", but even so, the decision-making must have occurred at a level and in areas of the corporation's activities where significant discretions were exercised.

19.32 In the light of the conclusions reached by the Commission about the roles and responsibilities of Tricontinental's executives, other than Mr Johns, for the losses suffered by Tricontinental, the Commission has not found it necessary to reach any precise conclusions about whether they qualified as "officers" for the purposes of s229.
E. **Reasonable Care and Diligence - Section 229(2)**

(a) **The fiduciary standard**

19.33 In *Byrne v Baker* [1964] VR 443 the Full Court of the Supreme Court of Victoria considered s107(1) of the Companies Act 1958. The Court accepted that the language of s107(1) reflected the statement of the general law contained in the often quoted judgment of Romer J in *Re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407.

19.34 Romer J (at 427-8) summarised the general law fiduciary obligations of a director in the following way:

- A director must act honestly; but he must also exercise some degree of skill and diligence.
- The care that a director is bound to take is "reasonable care", which is to be measured by "the care an ordinary man might be expected to take in the circumstances on his own behalf."

19.35 The following important qualifications were then added (at 428-9) by Romer J:

- "A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience."
- "A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature ..."
- "In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

19.36 In *Byrne v Baker* at 450 the court noted that s107(1) referred only to "reasonable diligence", and not "reasonable care". In s229(2), however, the statutory provision was changed to include the need for reasonable care as well as reasonable diligence. Applying the dictum of Romer J, it follows that the skill that a person actually possesses is an element to be taken into
account in determining what constitutes a reasonable exercise of care in the circumstances.

19.37 The position as to what is now s232(4) of the Corporations Law 1991 has been summed up as follows:

"In the light of the common law formulations it is arguable that s232(4), a penal provision, does not contemplate some model, reasonably competent, non-executive director and that it does no more, in the case of a non-executive director, than require the director to exercise what, objectively, would be a reasonable degree whatever skills the director may have that are relevant" (Ford and Austin, Ford's Principles of Corporations Law 6th ed at para 1527).

19.38 In AWA Limited v Daniels and ors (1992) 10 ACLC 993 at 1015 the Chief Justice of the Commercial Division of the Supreme Court of New South Wales, Mr Justice Rogers, speaking of the duties of non-executive directors, said:

"Notwithstanding a small number of professional company directors, there is no objective standard of the reasonably competent company director to which they may aspire. The very diversity of companies and the variety of business endeavours do not allow of a uniform standard."

19.39 Although a non-executive director is not required to bring any particular skills to the board table, if he does happen to possess some special knowledge or experience (skill), he will be expected to make reasonable use of it - Re Brazilian Rubber Plantations and Estates Ltd [1911] 1 Ch 425. A more recent illustration of this appears in National Mutual Life Nominees v Worn (1990) 5 NZCLC, 66,384, at 66,406, in the High Court of New Zealand, in which the following comments were made by Henry J:

"The standard of care to be exercised by a director has been said as being to exhibit the degree of skill reasonably to be expected from a person of his knowledge and experience (eg Re City Equitable Fire Insurance Co Ltd [1925] Ch 407). I would add that the standard is to be assessed by also having regard to the circumstances pertaining and to the responsibilities which the directors have undertaken. I have some reservations as to whether the subjective qualities of the particular director are appropriate factors to apply in determining
the yardstick in today's business world, but that does not require further consideration in this present case when regard is had to the background and experience of each of the directors of AICS. They were all knowledgeable and experienced business people, sufficiently versed in the general ramifications of the AICS operations."

19.40 To sum up the law as it is presently applied in Australia, the fiduciary standard of care required of a director is partly objective in nature, and partly subjective. There must be an objectively reasonable use of such skills as the particular director actually possesses.

(b) The content of directors' duties

19.41 The requirements of the objective element in the fiduciary standard of care owed by a director are not fixed in content. This is because the "care" which it might be "reasonable" to ask of Romer J's "ordinary man" will depend upon the particular circumstances. (It is emphasized that here the Commission is not referring to the obligations owed by an executive - whether director or manager - who is also governed by the express or implied terms of a contract of service.)

19.42 In City Equitable at 426-7 Romer J described the scope of directors' duties in the following terms:

"It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ from those of a director of another. In one company, for instance, matters may normally be attended to by the manager or other members of the staff that in another company are attended to by the directors themselves. The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff. The manner in which the work of the company is to be distributed between the board of directors and the staff is in truth a business matter to be decided on business lines. ..."
In order, therefore, to ascertain the duties that a person appointed to the board of an established company undertakes to perform, it is necessary to consider not only the nature of the company's business, but also the manner in which the work of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the circumstances, and is not inconsistent with any express provisions of the articles of association.

19.43 There is a question as to whether, with the passage of time, more has been expected of the "ordinary man", even in the same circumstances. Back in 1959 Sir Douglas Menzies made a telling forecast:

"Directors ... are not now appointed on the premise that a directorship is a sinecure in which reasonable competence is a desirable but not a necessary qualification and ... what is in general expected of directors will tend to become the measure of what is required of them" (33 ALJ 156 at 163-164).

He added (at 163):

"It is not to be thought ... that honest and diligent muddling will not give rise to liability."

19.44 The need for a flexible approach to the content of a director's duties was underlined more recently by Tadgell J, in Commonwealth Bank of Australia v Friedrich & ors (1990-1) 5 ACSR 115 at 125. His Honour paraphrased a passage from Byrne v Baker (which in turn had been derived from the judgment of Romer J) in the following terms:

"What constitutes the proper performance of the duties of a director of a particular company will be dictated by a host of circumstances, including no doubt the type of company, the size and nature of its enterprise, the provisions of its articles of association, the composition of its board and the distribution of work between the board and other officers."

19.45 Business conditions, and expectations demanded of company directors, have changed over the years. Corporations are larger, shareholders are more numerous, and business more complex. This has been recognised in the Explanatory Paper for the Public Exposure Draft of the Corporate Law Reform Bill 1992 (Cth) at para 96:
"The Government considers that, since the decision in Byrne v Baker and the tabling of the Committee Report in 1989, the courts, in their assessment of what is reasonable, have tended to raise the standard of care and diligence required of directors. It notes observations of Tadgell J in Commonwealth Bank of Australia v Friedrich, (1991) 9 ALC 946 at 956: 'As the complexity of commerce has gradually intensified ... the community has of necessity come to expect more than formerly from directors ... In response, the parliament and the courts have found it necessary in legislation and litigation to refer to the demands made on directors in more exacting terms.'"

19.46 The duties of directors have arisen for consideration by the courts in a variety of contexts in recent years. These include cases concerning the disqualification of directors, applications to act as a director despite bankruptcy, and companies trading while insolvent. In the latter type of proceeding, under s556 of the Code (now s592 of the Corporations Law) the courts have imposed upon directors a duty to enquire and obtain relevant information, and a duty to understand it, once acquired. These proceedings have led to a more general consideration of the duties of directors.

19.47 In Commonwealth Bank v Friedrich at 124, 128-9, Tadgell J considered that a plaintiff making a claim against a non-executive director under s556(1) must prove facts which, immediately before the time when the company incurred the relevant debt, gave a person "seeking properly to perform the duties of a non-executive director of that company" grounds to say: "I expect that the company will not be able to pay all its debts as and when they become due". When considering what were the duties of a non-executive director, his Honour agreed with the approach taken in Statewide Tobacco Services Ltd v Morley (1990) 2 ASCR 405 at 431 by Ormiston J, who said:

"In the light of the various duties now imposed upon the directors, it would not appear unreasonable that they should apply their minds to the overall position of the company. In other words, a defendant is not entitled to say that he or she was told a minimal number of facts about the company's financial affairs but chose to ignore the
possibility of other facts, or at least failed to inquire further as to other relevant facts.

What is reasonable, therefore, is related in part to the extent of the inquiries that the director has made and should have made about the company's solvency. A director should not in those circumstances be entitled to hide behind ignorance of the company's affairs which is of his own making or, if not entirely of his own making, has been contributed to by his own failure to make further necessary inquiries. On the other hand directors are not required to have omniscience. It is not yet assumed that directors shall apply themselves full-time to the company's business. There is still a place for part-time and advisory directors. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company."

19.48 The imposition of civil liability on the basis that the defendant ought to have known facts is well established. There is a view that a court ought not impose criminal liability on the basis of facts which a person ought to have known but did not, unless there is a clear and unambiguous legislative direction to do so.

19.49 However, Ormiston J's decision was upheld by the Full Court of the Supreme Court of Victoria on 24 July 1992. The Full Court found (at page 15 of the original judgment) that if the director in question had applied herself to her duties as a director with "a reasonable degree of care and diligence" as is required by s229(2) of the Companies Code she would have known "... that the company was unable to pay its debts as they fell due". The court distinguished the test formulated by the High Court in Shapowloff v Dunn (1981) 148 CLR 72 at 85. The Full Court agreed (at 28) that the days of the sleeping or passive director are well and truly over, and it emphasised that the test of reasonable grounds to expect that the corporation will not be able to pay all of its debts (s556) is not to be
treated in isolation from other provisions of the Code. Particular weight was given to s229(2).

19.50 In Commonwealth Bank v Friedrich at 184 Tadgell J observed:

"It is of the essence of the responsibilities of the directors of a company such as the National Safety Council Victorian Division that they should take reasonable steps to place themselves in a position to guide and monitor the management of the company by reference to information appropriate for the purpose."

19.51 In particular, when a director agrees to a corporation entering into a transaction, there is a duty to understand what it is that he or she is agreeing to be done:

"In my view, a director who is entrusted to commit his company to large payments (as was the case) has a duty to understand the nature of any transaction to which he or she puts a signature."


19.52 Articles of association normally empower directors to undertake primary responsibility for the management of a corporation, and for the directors to appoint a managing director for such period and on such terms as they think fit: see regulations 66 and 79 in Table A of the Code. The corporations in the Tricontinental group had articles to that effect.

19.53 Cases such as those referred to above, lead the Commission to anticipate that in proceedings brought under the corporations legislation in the future, the courts are likely to examine critically any failure by directors to be sufficiently well informed about matters affecting the financial performance and health of their corporations, even if they are non-executive directors.

19.54 Given these developments, it is disturbing to note the circumstances described by Rogers CJ, in AWA at 988, concerning the present day activities of non-executive directors of major corporations:
"... many companies today are too big to be supervised and administered by a Board of Directors except in relation to matters of high policy. The true oversight of the activities of such companies resides with the corporate bureaucracy. Senior management and, in the case of mammoth corporations, even persons lower down the corporate ladder exercise substantial control over the activities of such corporations involving important decisions and much money. It is something of an anachronism to expect non-executive directors, meeting once a month, to contribute anything much more than decisions on questions of policy and, in the case of really large corporations, only major policy. This necessarily means that, in the execution of policy, senior management is in the true sense of the word exercising the powers of decision and of management which in less complex days used to be reserved for the Board of Directors."

19.55 If this is an accurate assessment of what is really happening, then the boards of the largest corporations have been relegated to a peripheral role, except for major policy decisions.

19.56 The evidence in this inquiry has brought home to the Commission how vital it is, as a matter of legal responsibility and as a matter of sound commercial practice, that a board should ensure that it retains effective control over management, whatever the size of the corporation. To do that, there must be workable systems which result in the board monitoring accurately the operations of the corporation. It is not enough merely to pronounce upon policy. There is the need to be satisfied properly that policy is being implemented fully and efficiently. To put the matter at its simplest, the board needs to know what is really going on, and that requires more than formal reports from a chief executive officer. It would be absolutely wrong, in a major public corporation, for the board to permit the chief executive officer to be a 'one-man band'. The board must retain effective control, but with that, of course, comes corresponding responsibility and accountability.

19.57 Further, there are strong reasons why non-executive directors should be encouraged to play a substantial part in the activities of the board of a
major public corporation. They can bring to a board a wide range of relevant skills and experience, beyond those of the executive members. They are also capable of exercising an independence and objectivity of judgment that may be difficult for executive directors to achieve or maintain.

(c) Reliance upon other persons

19.58 The second and third qualifications by Romer J, listed in para 19.35 above, emphasise that a director is entitled to rely on other persons - fellow directors, managers and employees - to perform their tasks properly, in the absence of grounds for suspicion.

19.59 The extent to which a non-executive director may rely upon an executive director, or other executive, depends upon what an "ordinary person" would reasonably do in the circumstances, subject to taking into account any particular skills which the non-executive director happens to possess for evaluating what comes before him.

19.60 In City Equitable at 426-7, Romer J said:

"The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff. The manner in which the work of the company is to be distributed between the board of directors and the staff is in truth a business matter to be decided on business lines."

Any consideration of delegations should include consideration of whether the limits of delegations are sufficiently precise to allow management to understand the limits of their authority.

19.61 Each executive, by his or her service contract, may be taken to have promised the company that he or she has the skills of a reasonably competent person in his or her category of appointment, and that he or she will act with reasonable care, diligence and skill:
"Alleged breaches will be tested by reference to an objective body of knowledge and expertise possessed by persons in the same recognized calling" (Ford and Austin, para 1527).

19.62 In broad terms a non-executive director is entitled to rely on information, reports or statements, including financial statements, prepared and presented by an executive, when the non-executive director reasonably believes that the executive has skills relevant to the matters presented, and is reliable.

19.63 The practical necessity for reliance on others was described in Southern Resources (1990) 3 ACSR 207 at 225:

"It is a commonplace of commercial experience that directors contribute different skills, especially in large and complex corporations; issues will often arise for decision in which a director will necessarily have to rely to a large extent on the knowledge and experience of others; and when it is said that directors must exercise an independent judgment, that means no more than that, having listened to and assessed what their colleagues have to say, they must bring their own mind to bear on the issues using such skill and judgment as they may possess."

19.64 Rogers CJ took up this issue in AWA at 1015. He said:

"A director is justified in trusting officers of the corporation to perform all the duties that, having regard to the exigencies of business, the intelligent devolution of labour and the articles of association, may properly be left to such officers ... A director is entitled to rely without verification on the judgment, information and advice of the officers so entrusted. A director is also entitled to rely on management to go carefully through relevant financial and other information of the corporation and draw to the board's attention any matter requiring the board's consideration. The business of a corporation could not go on if directors could not trust those who are put in a position of trust for the express purpose of attending to details of management (American Law Institute 'Principles of Corporate Governance, Analysis and Recommendations' pp 175,176). Reliance would only be unreasonable where the director was aware of circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgment information and advice of the officers" (Re City
In the above passage Rogers CJ cited City Equitable in support of the proposition that reliance on others becomes unreasonable only where the known circumstances are "of such a character, so plain, so manifest and so simple of appreciation" that no-one could rely upon them. That language was in turn derived from Overend & Gurney Company v Gibb (1872) LR 5 HL 480 at 486.

It seems to the Commission, from what it has observed in this inquiry, that so relaxed an approach is not appropriate in the modern context. Even in City Equitable, at 429, Romer J went on to express the test rather more cautiously:

"In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

Plainly there is an issue as to the seriousness and cogency of the grounds for suspicion that need to be established before a reaction is required from a non-executive director. This issue goes to the heart of Tricontinental's problems. If it appears to a non-executive director that an executive director, or some other officer, or an employee, lacks the expected skills, or is not exercising them, then continuing reliance without further enquiry is likely to be unreasonable, even for the "ordinary man", let alone a non-executive director who does in fact possess some relevant skills which should assist him to form a judgment.

Should such a director be entitled to ignore suspicious signs of a substantial problem, take comfort in bland assurances from senior executives, seek no
further information, and do nothing else unless and until struck by uncontroversible proof of a disaster? Some recent cases have already been mentioned in which judges have emphasised the need for directors to be of an enquiring mind. Without pausing to draw fine distinctions between various situations, an elementary concept of "care" would suggest that a director should be moved to enquiry, by a matter giving rise to suspicion, well short of something that was so "plain, manifest and simple" that it could not be ignored.

F. Obligations in Particular Circumstances

19.69 In this section consideration is given to the fiduciary and statutory obligations of directors and executive officers in particular circumstances.

(a) Responsibilities of the board

19.70 Attention has been focussed principally upon the fiduciary obligations of directors individually, under both the general law and the Code. There is a related issue of the functions and responsibilities of the directors as a whole, acting as the board.

19.71 In AWA at 1013, Rogers CJ noted that a board's functions, apart from statutory ones, were said to be fourfold:

• To set goals for the corporation.
• To appoint the corporation's chief executive.
• To oversee the plans of managers for the acquisition and organization of financial and human resources towards the attainment of the corporation's goals.
• To review, at reasonable intervals, the corporation's progress towards attaining its goals.

19.72 The functions of a board are put to the Commission in broadly similar terms by counsel assisting, who submit that, according to accepted writings on corporate organisation, it is the responsibility of a board to:
• Formulate strategy.
• Set policies.
• Supervise executive management.
• Provide accountability.

19.73 Counsel for the directors are content to accept that formulation for present purposes, and submit that the directors for whom they act met their responsibilities under each of those headings.

19.74 Counsel for Mr Renard and Dr Ironmonger approach the matter from the perspective of the responsibilities of their clients as members of the SBV board (not also being members of the Tricontinental board):
• They accept, for present purposes, that the SBV board was under an obligation to supervise the activities of the Tricontinental board.
• They also accept that the SBV board had to monitor the performance of the subsidiary corporation.
• They submit, however, that it was not part of the functions of the SBV board to duplicate the proper functions of the Tricontinental board, or otherwise supervise the activities of Tricontinental’s executives so as to ensure that they were duly performing their tasks.

19.75 In relation to collective board decisions, it is recognised by the courts that directors will bring their individual skills (such as they might be) to board meetings and make individual contributions which may affect, in varying ways, the decisions ultimately made by the board. Let it be assumed that the directors individually exercise reasonable care and diligence in the process. If it appears that the board makes a decision in good faith and not for irrelevant purposes, and the decision is one that is open to a reasonable board, then it will not be reviewed by a court. That is, a court will not act as some kind of "supervisory board" - Howard Smith Ltd v Ampol Petroleum Ltd [1974] A.C. 821 at 832. Neither the conduct of the
individual directors, nor the decision by the board, will be reviewed by a court on the basis of a mere error of judgment.

19.76 Under term of reference 3, the Commission is required to inquire into and report upon the matters and events which have caused or contributed to the financial losses of Tricontinental. This obliges the Commission to examine the merits of certain business judgments made by the individual directors, and boards, both of Tricontinental and of SBV with respect to Tricontinental, even though these may well include issues that a court would decline to examine.

(b) Functions of the chairman

19.77 The particular duties of a board chairman are to:

(a) chair meetings of directors;
(b) chair general meetings of the members; and
(c) act as a spokesperson for the corporation.

A board with appropriate authority in the articles could delegate particular board powers to a chairman, but in the absence of a valid delegation by the board to the chairman, he has no implied authority merely by reason of his appointment: Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549 at 560, 584, 586. In the performance of functions as an individual director, a chairman is subject to the same fiduciary duty of care and diligence as all other directors. A chairman who is not also the chief executive officer will normally have a closer relationship, involving more frequent meetings, with the chief executive officer. In such circumstances he will tend to have more information about the corporation than other non-executive directors, and that will be a relevant consideration when applying the standard of reasonable care and diligence to him. Obviously, length of time in office will be a relevant factor in this connexion; and other circumstances will affect each individual case.
(c) Functions of the chief executive officer

A chief executive officer who is also a board member (usually called the managing director) has dual responsibilities. He has the responsibilities of fiduciary care and diligence, as do the other directors, and also the responsibilities of an executive who is subject to a service contract. For most purposes, the objective contractual standard of skill and care would outweigh the subjective fiduciary standard of duty.

In AWA at 1014, Rogers CJ observed:

"Generally a chief executive is a director to whom the board of directors has delegated its powers of management of the corporation's business. Usually he is employed under a contract of service which will either include an express term or, in the absence of an express term, an implied term, that the chief executive will exercise the care and skill to be expected of a person in that position. The degree of skill required of an executive director is measured objectively."

This passage would appear to have been based upon the judgment in Lister v Romford Ice and Cold Storage Co Ltd [1957] AC 555 at 572-3; 586; 592 and 598.

(d) Functions of the corporate secretary

The secretary, as such, is not a member of the board, but is an independent officer with particular duties and responsibilities: Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics [1971] 2 QB 711. He has a limited implied power to commit the corporation to contracts connected with the administrative side of the corporation's affairs, such as contracts of employment of office staff. The secretary has no implied general power to manage the corporation or to conduct its business operations: Club Flotilla (Pacific Palms) Ltd v Isherwood (1987) 12 ACLR 387; Northside Developments Pty Ltd v Registrar-General (1990) 93 ALR 385 at 425 per Dawson J; Holpitt Pty Ltd v Swaab (1992) 10 ALC 64. A secretary has certain duties imposed by the corporations legislation which relate mainly to the corporation's responsibilities to report, and the secretary is required
to ensure that the documents are in order, registers are maintained, and appropriate returns are filed. The secretary is responsible for affixing the seal of the corporation.

(e) Performance of executive tasks by non-executive directors

19.81 Non-executive directors who assume tasks which are otherwise performed by management, will be exposed to assessment on the basis that they will be assumed to have the relevant skills required for the tasks of management which they undertake, and will be judged accordingly. Management tasks predicate a specific calling and are able to be judged by reference to a reasonable standard within such a calling.

19.82 Further, non-executive directors who have particular skills will be expected to exercise those skills whether acting in a non-executive or executive capacity. For example, in Dorchester Finance Co Ltd v Stebbings (1989) BCLC 498, two non-executive directors who were qualified as accountants signed blank cheques. They were held liable for breaches of duty leading to losses occasioned by the use made by the executive directors of those cheques.

19.83 This is an illustration of the old principle that, if a director brings particular skills to a corporation, he must give the benefit of those skills to the corporation, irrespective of any contractual duty to do so:

"A director's duty has been laid down as requiring him to act with such care as is reasonably to be expected from him, having regard to his knowledge and experience. He is, I think not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance: while if he is acquainted with the rubber business he must give the company the advantage of his knowledge when transacting the company's business" (per Neville J in Brazilian Rubber Plantations and Estates Ltd [1911] 1 Ch 425 at 437).
(f) Responsibility of parent board for subsidiary corporation

19.84 In broad terms, a parent board has powers and responsibilities of oversight of a subsidiary corporation. A parent corporation, as shareholder, has the power to appoint the directors of a subsidiary. The strength of the subsidiary's board as a whole, taking into account the individual skills and knowledge of each of the directors, is a responsibility of the parent board.

19.85 If the directors appointed by a parent board fail to exercise reasonable care and diligence, the directors of the parent board would not, by that alone, be liable for those failures. However, directors of a parent board are expected to perform their duties with reasonable care and diligence, when considering the results of the operations of the subsidiary corporation.

19.86 It is open to a parent board to operate a subsidiary as though it were in fact a division of the parent corporation. Alternatively, it is open to allow the subsidiary to be run autonomously. Under the first model, the directors of a subsidiary may be common directors or executives employed by a parent and hence will often be amenable to direction by the parent board. This may not cause any practical problems, although a director exposed to dictation from an outsider runs the risk of technical breaches of duty under the Code. Further, if the board of a parent corporation dictates to the directors of a subsidiary, the parent directors may fall within the definition of "director" in s5(1) of the Code, in relation to the subsidiary.

19.87 In summary, the board of a parent corporation collectively, and the directors individually, are under no legal duty to act as if they were the board of the subsidiary or the directors of it. They do have obligations to the parent corporation to exercise reasonable care and diligence in choosing the board of the subsidiary, and in monitoring its activities.
Guidelines promulgated by the Reserve Bank of Australia deal with the relationship between a parent bank and a subsidiary company, whether it be a bank or a non-bank subsidiary:

"A bank should not give a general guarantee of the repayment of liabilities issued by its non-bank associates and should ensure that an associate does not, in an attempt to up-grade the status of its liabilities, seek to give the impression that the bank's financial resources stand generally behind, or (could be) called upon to stand behind its operations" (Reserve Bank Prudential Statement G1).

If failure to comply with the guidelines could cause prejudice to the parent bank, a failure by the directors of the parent to use whatever powers they have in relation to the subsidiary could conceivably amount to a failure to exercise a reasonable degree of care and diligence within the meaning of s229(2).

(g) Common directors

Three of the directors of Tricontinental were also directors of SBV (Mr Smith, Mr Morton and Mr Moyle.) It is not unusual to have common directors on the board of a parent corporation and its subsidiary corporation, and generally this is seen to be of benefit to the parent, by providing it with ready access to information about the performance of the subsidiary. There are also obvious benefits to the subsidiary.

A common director will owe duties to both the parent corporation and the subsidiary corporation, and will be obliged to act in the interests of the parent when acting as a director of the parent, and in the interests of the subsidiary when acting as a director of the subsidiary. If the interests of creditors of the subsidiary corporation become material, there may be a conflict of interest. The common director is obliged to act in the interests of the creditors, and at the same time is obliged to act in the interest of a shareholder, being the parent corporation.
(h) Nominee directors

Not all directors of Tricontinental were also directors of SBV. Some were executives of Tricontinental (Mr Johns and Mr Ziebell). Some were executives of SBV (Mr Moyle until appointment as director of SBV, Mr Rawlins until resignation in April 1988, Mr Carr upon appointment in April 1988). Mr Ryan was an executive of SBV when first appointed to the board of Tricontinental, then retired from SBV in July 1985. All were nominated and appointed to the Tricontinental board by the SBV board.

19.93 It is accepted that the customary role of a director nominated by a parent corporation to the board of its subsidiary is to act in the interests of the parent in protection of the parent's investment, so far as it is permissible in law for a director of the subsidiary to act in the interest of someone other than the subsidiary. It is essential, once appointed, for the nominee to recognise a primary legal duty to act honestly in what he believes to be the interests of the subsidiary corporation: Scottish Co-Operative Wholesale Society v Meyer [1959] A.C. 324. As already noted above, the interests of creditors may lead to a position of conflict.

19.94 The law in Australia recognises the dual loyalties of a nominee director, but it is not, as a matter of principle, open to a nominee director to accept dictation from the nominating corporation at the expense of the interests of the subsidiary.

G. Enforcement of the Code

(a) Section 535 - relief from breach

19.95 Section 535(1) of the Code provides as follows:

"If, in any civil proceedings against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity by virtue of which he is such a person, it appears to the court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default or breach but that he has acted honestly and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default or breach, the court may relieve him either wholly or partly
from his liability on such terms as the court thinks fit."

19.96 Under s535 the court has the power to relieve a director or other officer of the company from liability for negligence, default, breach of trust or breach of duty. However, the court will only grant relief if the application relates to a civil proceeding against the person, and if it appears to the court that the officer has acted honestly, and further, that having regard to all the circumstances of the case the officer ought to be excused. Section 535 does not empower the court to grant relief from criminal liability. The section recognizes the need to take into account the fact that a particular director may have been appointed for a special purpose. Being limited to civil liability, the section does not allow relief from prosecution under s229.

19.97 (b) Criminal offences under the Code

Section 229 creates offences. The penalty for breach of s229(1)(b) includes imprisonment for up to five years. The penalties for breach of ss229(1)(a) or 229(2) are monetary only.

19.98 Section 35 of the Companies and Securities (Interpretation and Miscellaneous Provisions) (Vic) Code 1981 categorises offences as summary or indictable, according to whether or not an offence is punishable by imprisonment for a period exceeding six months (subject to an election by the prosecutor to proceed summarily). Thus an alleged breach of s229(2) would be tried summarily.

19.99 The standard of proof required under s229 is the criminal standard - proof beyond reasonable doubt. An allegation of breach of duty made under the general law needs to be proved only on the civil standard - proof on the balance of probabilities.
(c) No immunity from prosecution

Chapter 20 discusses the immunity of the former directors and other officers of SBV, and the directors (but not other officers) of Tricontinental, from civil proceedings, as a result of the provisions of the State Bank Act 1988 and the State Bank (Succession of Commonwealth Bank) Act 1990. This immunity includes civil proceedings under ss229(6), 229(7) and 542 of the Code for compensation or damages.

However, for the reasons discussed below, the immunity provisions do not provide any of those persons with a defence to a criminal prosecution, such as proceedings under ss229(1) to 229(4) of the Code. Basically, this is because the legislation does not shift criminal liability from the directors and other officers and impose it upon the State.

(i) State Bank Act 1988 (Vic) section 49

Section 49 of the State Bank Act 1988 (Vic) is set out in full in chapter 20. It provides that no liability attaches to a director or officer of SBV, or a director of a related corporation, for any act or omission done or made in good faith, in carrying out his or her duties. The section goes on to state that any liability that would, but for the section, attach to a director or officer of SBV, shall attach instead to SBV.

Whilst it is possible to construe s49(1) as transferring civil liability from a director or officer to the State Bank, there are obstacles to construing s49(1) as transferring criminal liability.

One obstacle lies in s6 of the State Bank Act, which makes it clear that the bank is to be under the shield of the Crown. Section 6 provides:

"(1) The Bank represents and shall be taken to be part of the Crown.
(2) The Bank holds its property for and on behalf of the Crown.
(3) Sub-sections (1) and (2) do not:-(a) limit the right of the Bank to sue or be sued in its own name;
Apart from express inroads into Crown privilege contained in s6(3)(c), the bank is left with the legal rights peculiar to the Crown, one of which is immunity from all criminal process: Halsbury’s Laws of England 4th ed. Vol.11(1) at para. 38. The High Court considered Crown immunity from criminal proceedings in Cain v Doyle (1946) 72 CLR 409 at 424 per Dixon J:

"There is, I think, the strongest presumption against attaching to a statutory provision a meaning which would amount to an attempt to impose upon the Crown a liability of a criminal nature. It is opposed to all our conceptions, constitutional, legal and historical. Conceptions of this nature are, of course, not immutable and we should beware of giving effect to the strong presumption in their favour in the face of some clear expression of a valid intention to infringe upon them. But we should at least look for quite certain indications that the legislature had adverted to the matter and had advisedly resolved upon so important and serious a course".

The principle has been considered more recently in Bropho v Western Australia (1990-91) 171 CLR 1 at 23. The High Court in that case confirmed that for displacement of the presumption of Crown immunity to criminal proceedings, it was necessary that an intention to bind the Crown should be plain from the terms of the statute.

Section 6 of the State Bank Act provides an express indication of the extent to which SBV is to be deprived of Crown immunity from civil proceedings, insofar as the section qualifies the bank’s position, but contains no express language indicating that the legislature adverted to the immunity from criminal liability. Furthermore, there does not seem to be any indication elsewhere in the State Bank Act that the legislature intended to deprive SBV of immunity from criminal liability by transferring such liability to the bank.
Given the recent confirmation that the presumption still exists against a statute imposing criminal liability on the Crown, and noting that there is no indication in the State Bank Act that the presumption has been rebutted, and that such inroads into Crown immunity as are made by the statute are express, it appears consistent with s6 to construe s49(1) as relieving directors and officers of civil liability only, and attaching that liability to SBV under s49(2).

This view is reinforced by the terms of s16 of the State Bank Act. It specifically imposes criminal liability on directors who fail to disclose an interest in a matter being considered by SBV's board. If s49 had been intended to extend to criminal liability, one would have expected it to except the provisions of s16.

Another aspect is that a legislative intention to transfer liability under criminal law, from an agent to a principal, needs clear expression. In contrast, vicarious civil liability is commonplace, and a legislative intention that the principal should be liable, even if the agent is to be relieved, is more likely to be found in such a case.

(ii) State Bank (Succession of Commonwealth Bank) Act 1990 (Vic)

Sections 20 and 38 of the Act are set out and dealt with in chapter 20 at paras 20.4 and 20.7-16.

Crown immunity will extend to servants of the crown where the application of the statute to the servant would prejudice the Crown: Bank voor Handel v Administrator of Hungarian Property [1954] AC 584; Cooper v Hawkins [1904] 2 KB 164. The mere fact that a Crown employee is acting in the course of employment will not entitle the employee to the Crown's immunity. Although non-executive directors are not employees of the corporation they are treated as agents. Executive officers would, of course, be employees. In order for the directors and executive officers to
share in the Crown immunity enjoyed by SBV it would be necessary to find that breach of s229 of the Code was an unavoidable necessity in order to pursue an important bank purpose. There is nothing to support this proposition.

(d) Protection from self-incrimination

(i) Evidence Act 1958 (Vic), Section 30

Section 30 of the Evidence Act provides that except in the case of a charge for perjury committed in making a statement, no statement made by a person in answer to any question before any board or commission empowered under the Act to summon witnesses shall be admissible in evidence in any civil or criminal proceedings against that person, nor be made the ground of any prosecution or action or suit against him.

(ii) Australian Securities Commission Act, Section 68(3)

A number of persons were examined by ASC officers who were seconded to the Royal Commission to assist with its inquiries: see paras 3.22 and following. These examinations were conducted pursuant to powers delegated to those officers by the ASC. Accordingly, s68(3) of the ASC Act applies to the statements made by those persons.

During the course of the inquiry, the section provided that no statement or "any information, document or other thing obtained as a direct or indirect consequence of the person making this statement ... is admissible in evidence against the person" in a criminal proceeding or a proceeding for the imposition of a penalty.

Major changes to this law came into effect on 14 May 1992:

- Derivative information is no longer inadmissible.
- The fact that a person has produced a particular book to the ASC is no longer inadmissible.
The privilege against self-incrimination is no longer available to corporations in proceedings under the Corporations Law.

(e) Sections 229(6), 229(7), 542 - compensation under the Code

19.117 Section 229(6) provides that:

"Where-
(a) a person is convicted of an offence under this section; and
(b) the court is satisfied that the corporation has suffered loss or damage as a result of the act or omission that constituted the offence,

the court by which he is convicted may, in addition to imposing a penalty, order the convicted person to pay compensation to the corporation of such amount as the court specifies, and any such order may be enforced as if it were a judgment of that court."

19.118 Section 229(7) provides that:

"Where a person contravenes or fails to comply with a provision of this section in relation to a corporation, the corporation may, whether or not the person has been convicted of an offence under this section in relation to that contravention or failure to comply, recover from the person as a debt due to the corporation by action in any court of competent jurisdiction-
(a) if that person or any other person made a profit as a result of the contravention or failure - an amount equal to that profit; and
(b) if the corporation has suffered loss or damage as a result of the contravention or failure - an amount equal to that loss or damage."

This sub-section would enable a corporation to recover from a director or executive any profit made by that person, or any loss or damage suffered by the corporation, as a result of a breach of s229, whether or not that person has been convicted.

19.119 Section 542 of the Code provides for a summary procedure. The Securities Commission or an authorised person may apply to the court for an order that a person who has been guilty of fraud, negligence, default, breach of trust or breach of duty in relation to a corporation, must transfer property to the corporation or pay compensation to it.
Unlike predecessor provisions such as s367B in the 1961 legislation, s542 of the Code is independent of the provision for examination in s541. S542 would embrace a claim for compensation based on a breach of s229(2). In Kimberley Mineral Holdings Ltd v Triguboff [1978] 1 NSWLR 364 at 369, Needham J noted that the negligence referred to in s367B (ie, the predecessor to s542) was not common law negligence but rather a failure to fulfil a duty toward the company to exercise care, skill and diligence in the performance of an office. He so decided on the basis that the powers conferred on the Court were powers to grant typical equitable relief.

However, as discussed in chapter 20, in the case of the directors and officers of SBV, and directors of Tricontinental, there is a statutory immunity from civil proceedings under ss229(6), 229(7) and 542, except where there has been a lack of good faith.

H. Companies (Acquisition of Shares) (Victoria) Code 1981

This legislation (‘CASA’) regulated share acquisitions and company takeovers during the period under consideration from 1985 to 1989. CASA prohibits the acquisition of shares in a company beyond a threshold of 20% (s11) except by a formal offer under a Part A or Part C takeover bid, acquisition of no more than 3% every six months (s15), or acquisition in circumstances otherwise excepted or permitted.

CASA s11 is concerned with persons who "acquire" shares (as defined in s7(1)) in such a way as to affect the percentage of voting shares to which any person is "entitled" in relation to a prescribed threshold percentage. Section 7(3) provides that the shares to which a person is entitled include (apart from certain exceptions) shares in which that person's "associate"
has a "relevant interest". Section 7(4) defines "associate". The circumstances in which a person has a "relevant interest" are laid down in s9.

I. Crimes Act 1958 (Vic)

19.124 In addition to the specific provisions in the Code which prohibit the improper use of information (s229(3)) and the improper use of position (s229(4)), both of which are punishable as indictable offences, the directors, other officers, and employees of a corporation are also subject to the provisions of the Crimes Act 1958 (Vic).

19.125 The receipt or solicitation of a secret commission by an agent is an indictable offence, prohibited by s176. Further, the obtaining of a secret commission for advice is prohibited by s179.

19.126 The penalties under these Crimes Act sections are much greater than those for breach of ss229(3) and 229(4).

J. Breaches of Obligations

19.127 As noted at the beginning of this chapter, the terms of reference ask whether any person has been in breach of various obligations imposed by law.

19.128 The causes of Tricontinental's losses, and the responsibility for them, are explained in detail in this report in terms of economic, commercial and human failings. When the Commission considers legal responsibility, however, the enquiry becomes much more narrowly focussed.

19.129 There is little to be gained from considering the liability of directors and other officers under the non-criminal law. Even if the former directors of
Tricontinental, or the former directors and other officers and employees of SBV were otherwise liable, they have the benefit of the statutory immunity discussed in chapter 20, by which any non-criminal liability is transferred to SBV (or now, the State of Victoria), except where there was disqualifying lack of good faith. In broad terms, this rules out any proceedings based on general law duties arising from fiduciary obligations, contract or tort.

That immunity does not extend to the former officers and other employees of Tricontinental, but in the circumstances found by the Commission, it would be anomalous in the extreme to pursue them, when their managing director and other directors are statutorily immune.

Proceedings remain open for breaches of the criminal law. This means not only the Crimes Act, but also those provisions of the Code which constitute offences. In particular, these include ss229(1) to 229(4). In this way, fiduciary concepts enshrined in ss229(1) and 229(2) remain relevant.

Any proceeding for a breach of the criminal law would attract a number of factors that are built into the criminal process, for the protection of an accused person. Some of these are:

(i) Evidence given to the Commission cannot be used against the person who gave it.

(ii) Any alleged offence would need to be proved beyond reasonable doubt.

(iii) Any attempt to categorise a general course of conduct as a breach of duty - for example, an alleged failure to ensure the operation of a proper system for the analysis and approval of credit proposals - would have to be tested by reference to its operation in relation to a specific transaction.

This point was established by a long accepted decision of a very strong Full Court of the Supreme Court of Victoria (Herring CJ,
Smith and Adam JJ in *Byrne v Baker* [1964] VR 443 at 453. The court considered s107(1) of the Companies Act 1958, a forerunner of s229 of the Code. In a joint judgment, the court said:

"The language used is appropriate and was designed, we think, to introduce one aspect of the concept of negligence, as known and acted upon for many years by the courts ... and this concept of negligence has reference to identifiable acts or omissions, not to any general characterisation of the conduct of a director over a selected period".

This decision stands in the way of any attempt to find either the board of Tricontinental as a whole, or an individual director or officer, criminally responsible, in some global fashion, for the collapse of Tricontinental. There are strong reasons, based on both justice and practicality, why this should continue to be the law, at least in the case of criminal offences.

(iv) Examination of the individual transaction reports in volume 3 of this report shows that in many cases there are considerable practical difficulties in establishing by admissible evidence, on the criminal standard of proof, that an individual director or officer has failed to exercise a reasonable degree of care and diligence, as required by s229 of the Code. At first blush this might seem surprising, but close analysis shows that in many cases there is room for reasonable doubt about the conduct of any specific person. This is due to inadequate record keeping, the multiplicity of persons involved in the chain of assessment, approval and management of a transaction, vast lapses of memory, great scope for alternative explanations designed to shift blame to someone else, and most significantly, the limitations on proof imposed by the criminal trial process.

A Royal Commission, and other forms of inquisitorial proceedings, are useful devices for finding out what happened, and why, in matters of public importance, without being totally subjected to the full range of legal safeguards that are designed to protect the liberty and livelihood of individual persons. A court of law serves different objectives in the public
interest, and of necessity must act only on information that has been rigorously screened for relevance, probative value, and fairness in the information gathering process.

19.134 This distinction underlies the provision in the terms of reference directing that any finding by the Commission that a person appears to have engaged in conduct amounting to a criminal offence be made only on evidence admissible in a court of law, sufficient to place that person on trial for that offence.

19.135 The Commission would go further. It considers that it is not in the public interest to recommend criminal proceedings in cases where, on admissible evidence, conviction is a possibility, but not likely. It has been fortified in this approach by reference to the prosecution policy guidelines published by the Commonwealth Director of Public Prosecutions, a publicly available document which was tendered in evidence. If the Commission be mistaken in this view, then of course it is still open to prosecuting authorities to review the material gathered by the Commission, and take such proceedings as they may think appropriate.

19.136 Further, there are some persons against whom proceedings may be open, in a technical sense, but in respect of whom there are strong reasons of basic fairness why proceedings ought not be taken. These matters are referred to in the concluding remarks in chapter 23.

19.137 Having said that, the Commission now returns to its finding at the conclusion of chapter 15, that some of Tricontinental's investment banking transactions gave rise to deep suspicions of warehousing, insider trading, and failure to disclose relevant interests in substantial shareholdings.

19.138 Much of this is now beyond further examination, due to the paucity of records, and limited recollections of events which took place some years
ago. Nor did these transactions contribute greatly to Tricontinental's losses, in relative terms, although they were symptomatic of the way in which Tricontinental's business was conducted.

However, some of those transactions do merit further investigation and, if then thought appropriate, prosecution.

Having regard to considerations concerning the potentially prejudicial effect of publishing the details of possible criminal proceedings, the Commission has included further information and recommendations about these matters in the confidential volume 4 of this report.
CHAPTER 20

APPARENT LIABILITY TO MAKE RESTITUTION -
TERM OF REFERENCE 6

20.1 The Terms of Reference (para 6) require the Commission to report:

"Whether any person appears liable to make restitution or pay compensation for loss or damage to [Tricontinental or the State Bank of Victoria]."

20.2 There seem to be several groups of people whom the draftsman of this term of reference may have had in mind. They are -

• the directors and managers of Tricontinental and SBV
• advisers and consultants engaged by Tricontinental
• borrowers and guarantors of borrowers from Tricontinental.

A. Directors and Managers of Tricontinental and SBV

20.3 Section 49 of the State Bank Act 1988 provides:

"(1) No liability attaches to a director or officer of the bank, or a director of a related corporation who is nominated or appointed to the office by the bank, for any act or omission done or made, in good faith, and in carrying out, or purporting to carry out, the duties of his or her office.

(2) Any liability that would, but for sub-section (1), attach to a director or officer of the bank shall attach instead to the bank."

There is no doubt that Tricontinental was 'a related corporation' within the meaning of this section until the end of 1990.

20.4 Section 20 of the State Bank (Succession of Commonwealth Bank) Act 1990 provides:

"(1) No liability attaches to a person who -
(a) was a director or officer of the State Bank; or
(b) was a director of a related corporation who was nominated or appointed to the office by the State Bank
There would be no question, but for the enactment of sub-s49(1) of the State Bank Act 1988 and sub-s20(1) of the State Bank (Succession of Commonwealth Bank) Act 1990 ("the immunity sections"), that any former director of Tricontinental convicted of an offence under s229 of the Companies (Victoria) Code ("the Code") would be liable to pay compensation to Tricontinental, of such amount as a court might determine, to compensate it for any loss or damage suffered as a result of the act or omission that constituted the offence. It would also, but for the enactment of the immunity sections, be open to Tricontinental to commence a proceeding in a court of competent jurisdiction to recover any loss or damage incurred by it, as a result of a contravention of s229 of the Code, whether or not the former director had been convicted of an offence under that section.

For the reasons set out in chapter 19, the immunity sections would not provide a former director of Tricontinental with a defence to a criminal prosecution brought against him for an offence against s229 of the Code. However they would provide him with a complete defence to a civil claim for compensation or damages brought under sub-ss229(6) and (7) of the Code, provided that the former director was not guilty of bad faith in performing the act or making the omission that constituted the offence. The immunity sections would not, for example, provide a defence to a civil claim for compensation brought under s229(6) where the former director had been convicted of an offence under s229(1)(b) of the Code, it being an essential ingredient of that offence that the former director had acted fraudulently.
20.7 Section 38 of the State Bank (Succession of Commonwealth Bank) Act 1990 provides:

*(1)* No liability attaches to a person who is or was a director or officer of Tricontinental for any act or omission done or made, in good faith, and in carrying out, or purporting to carry out, the duties of his or her office as such a director or officer after the commencement of this section.

*(2)* Any liability that, but for sub-section (1), would attach to a director or officer of Tricontinental shall attach instead to Tricontinental Holdings Limited.

20.8 Sub-section 38(1) refers to "a person who is or was a director or officer of Tricontinental". To this extent it is wider than the immunity sections, which are confined to "a director of a related corporation" of SBV - there is no reference to officers. This raises a question as to whether sub-s38(1) has any effect on the civil immunity conferred on former directors of Tricontinental by the immunity sections, and also whether sub-s38(1) confers on former managers of Tricontinental a civil immunity of a similar kind to that conferred on former directors of Tricontinental for acts or omissions done or made before the commencement of s38.

20.9 Sub-section 38(1) appears in Part 4 of the State Bank (Succession of Commonwealth Bank) Act 1990, which provides for the continuation of certain rights of SBV (s28(1)) and the vesting of those rights in the State of Victoria (s29). For the purposes of sub-s28(1) "officer" is defined as including a director, secretary, executive officer or employee (s28(2)).

20.10 In the Commission's view, sub-s38(1) was clearly intended by the legislature to have a prospective operation and, on its proper construction, it confers a civil immunity on a person who is or was a director or officer of Tricontinental for his acts or omissions after the commencement of s38.
It therefore confers no civil immunity on such persons in respect of their acts or omissions before the commencement of s38.

20.11 The scheme of the legislation is clear enough. First, it carries forward the protections previously given by the State Bank Act, merely transferring the ultimate liability referred to from the bank (now the property of the Commonwealth Bank, which was not intended to shoulder any additional burden) to the State of Victoria.

20.12 Secondly, it deals with the situation of those persons who became the directors of Tricontinental (no longer a related corporation of SBV) after the sale of SBV. It gives them the same immunity as their predecessors had enjoyed as directors of 'a related corporation'.

20.13 Finally, it gives the ‘officers’ of the new Tricontinental the same immunity which had previously been enjoyed by officers of SBV, but not by officers of Tricontinental. This is appropriate because they are not officers of a commercially operating merchant bank, but of a Government entity concerned to save what it can from the wreck of Tricontinental, for the benefit of the Government and people of Victoria. Those officers are having to make or recommend difficult decisions in the pursuit or settlement of potential litigation; so their case for personal immunity is strong.

20.14 The scope of the operation of s38(1) was the subject of debate during the course of the Second Reading of the State Bank (Succession of Commonwealth Bank) Bill in the Legislative Assembly and Legislative Council. At least two members of the Legislative Assembly expressed their concern that the Bill might have the effect of conferring a wider immunity than had been provided by s49(1) of the State Bank Act 1988.
The intention of the Parliament was made clear when s38 was amended in response to these concerns. The Honourable David White MLC (Minister for Industry and Economic Planning) said, in relation to his motion to amend clause 38 of the Bill by inserting after "officer" the words "after the commencement of this section":

"This amendment deals with Clause 38, which provides for the immunity of directors and officers of Tricontinental in certain circumstances and takes up a matter raised by Mr Hallam during the second reading debate. The amendment is intended to limit the immunity of directors and officers to those appointed after the commencement of the application of this clause, which means after the time the proposed section comes into effect, which presumably will be on or about 1 January 1991."

For these reasons we consider that the former officers of Tricontinental (other than former directors) as defined by s229(5) of the Code have no civil immunity by reason of s38(1). The immunity sections do, however, confer a civil immunity on former directors of Tricontinental provided that they have acted in good faith in the discharge of their duties.

However the Commission takes the view, expressed in paras 14.342-347 above, that it would be most unjust to bring civil proceedings against, say, Mr Mountford, for any alleged negligence in the exercise of his office, when Mr Johns and the other directors enjoyed immunity. There are also practical considerations pointing strongly against such action.

B. Advisers and Consultants Employed by Tricontinental

This subject is dealt with in chapter 18. For reasons set out there and in chapter 3, the Commission did not consider the question of auditors' liability; and it found no sufficient evidence of negligence by other advisers or consultants which would lead it to recommend action to recover compensation.
C. **Borrowers and Guarantors of Borrowers**

20.19 As explained elsewhere (para 3.3) the Commission has, so far as possible, acceded to the request of the present management of Tricontinental that it should avoid opening up contentious areas where litigation is pending or anticipated, or where delicate negotiations with former borrowers or guarantors are in hand.

20.20 This applies also to any actions which might be available against directors of borrowers who permitted their company to borrow while it was insolvent. The Commission has not investigated the total business affairs of any borrower in such detail as to enable it to offer an opinion on this possibility. See also para 8.66 above.

20.21 Since the Commission has no power to resolve such issues, and could succeed in making more difficult the task of the competent people responsible for recovering what they can of Tricontinental’s losses, the Commission believes this has been the right approach. Accordingly it offers no positive answers to this term of reference.
CHAPTER 21
RECOMMENDATIONS REGARDING CHANGES TO THE LAW -
TERM OF REFERENCE 7

A. Introduction

21.1 The Commission is required by the seventh paragraph of its terms of reference to report:

*Whether changes to the laws applicable to corporations or securities in Victoria or in any State or Territory should be made as a result of any of the matters ascertained in the course of the investigation into the affairs of and the transactions engaged in by corporations in the Tricontinental Group*.

21.2 The Commission has not identified any omission from, or defect in, corporations or securities laws which in any way contributed to or permitted the collapse of Tricontinental or the forced sale of SBV. Accordingly, the Commission does not wish to make any positive recommendations about corporation or securities law reform.

21.3 On the other hand, the Commission hopes that its report will provide a detailed case history against which some proposals for changes in relevant laws, particularly those relating to the responsibility and liability of directors, can be tested. It is in this context that the comments in the following section B are offered.

21.4 In addition to these, the Commission has been confronted with a number of procedural problems, outlined in chapter 4, in areas where it believes there is a need for reasonably urgent consideration of amendments to laws. Although these do not fall strictly within term of reference 7, the Commission believes that it should record its views about them. These are set out in sections C and D below.
B. **Corporations Law**

21.5 Section 232(4) of the Corporations Law 1991 is the successor to s229(2) of the Companies (Victoria) Code (‘the Code’), and it is in substantially the same terms.

21.6 At the present time there are proposals to amend the section. Such a proposal was put forward in an Exposure Draft of a Corporate Law Reform Bill 1992 (‘the Exposure Draft’). This has been replaced since by a more recent proposal agreed to by the Commonwealth Attorney-General on 8 August 1992.

21.7 The proceedings before the Commission have led to a close examination of the meaning and application of s229(2) of the Code. These matters are discussed in detail in paras 19.16-17 and 19.33-68, particularly the requirement for a "reasonable degree of care and diligence" in the discharge of an officer's duties. The same requirement exists in s232(4), which is now under review.

21.8 The Commission does not seek to participate fully in the debate on the law reform proposals, but the evidence which it has gathered does emphasise the significance of some of the issues under review, and it is appropriate to draw attention to them here.

21.9 One of the proposals is that s232(4) should no longer be a criminal offence. Instead, a breach of the section should attract civil proceedings, and a "civil penalty" order. This would result in the application of the civil standard of proof - the balance of probabilities. (Part IV of the Trade Practices Act 1974 (Cth) is a model for this type of approach.) Even so, a court would still not be lightly satisfied, given the serious nature of the matter, including the potential consequences for the defendant.

21.10 On the basis of the evidence set out in this report, the Commission would encourage the adoption of such a change for two main reasons:
Directors and other officers ought not be branded criminals merely because they are incompetent or inattentive. That does not happen in other walks of life. There is a vast difference between the type of behaviour encompassed by s232(4) and, for example, s232(3)(a), which deals with fraud or deception by a director. The latter truly deserves the criminal sanctions of financial penalty or imprisonment or both.

It could be very difficult to establish a breach of s232(4) according to the criminal standard of proof, because of the very nature of the duty imposed. The reasons for this are discussed in paras 19.132-135. Complex transactions, deficient records, dim memories and abstract criteria all create substantial problems, on the criminal standard of proof. The recommendations of the Commission concerning proceedings arising out of Tricontinental's transactions could well have been different in some cases, had the civil standard of proof applied to s229(2).

Another of the proposals relates to the search for a fully objective standard of care. In the Exposure Draft, there is reference to the degree of care and diligence that a "reasonable person" would exercise "in the corporation's circumstances". This draft recognizes that the circumstances of different corporations will differ from each other, but there is no recognition that the circumstances of directors within the one corporation may also differ from each other. The Explanatory Paper, at para 101, states that no distinction was made between an executive director and a non-executive director.

The more recent proposal, to which the Attorney-General has agreed, refers to "the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances".

The addition of the words "in a like position" is said to have been inspired by the American Law Institute's publication, "The Principles of Corporate
Governance”, which, incidentally, was a source of reference used by Rogers CJ in AWA Limited v Daniels & Ors. That publication is quoted as saying that the phrase "recognizes that the nature and extent of the functions to be performed by a director or officer will vary with the tasks that have been imposed or voluntarily assumed ... in general, inside directors and other full-time officers will be expected to know more about corporate affairs than outside directors”.

21.14 The more recent proposal goes to the heart of some of the matters canvassed in evidence before the Commission, and gives rise to the comments which follow.

21.15 The Commission would encourage the adoption of a proposal, such as this more recent one, which facilitates, or at least does not actively discourage, the participation of non-executive directors on the boards of major public companies. Such a director should be free to bring particular skills or his or her background to a board, which may well fill a gap in the knowledge, experience or ‘culture’ of the executive directors and their senior managers. It is especially valuable if an outside director can bring to the board a well-balanced, enquiring mind, backed up by the qualities of independence and integrity. A cautionary note arises, however, from Tricontinental’s experience. A board made up of directors with diverse skills must act in collegiate fashion, so that all of the necessary skills are brought to bear upon any particular matter. It is a mistake for a director, with particular skills, to become individually responsible for tasks for which he is not qualified.

21.16 There is a compelling need for non-executive directors to receive complete, accurate and timely information from management. The Exposure Draft contains a list of matters which a director is required to take into account, and in that list there is heavy emphasis upon the proper consideration of relevant information, before the making of decisions. Implicit in the proposal is the need for proper reporting systems. It is understood, however, that the list has been discarded from the more recent proposal.
The Commission expresses no view about whether it would or would not be desirable to incorporate, in some way, a statutory obligation upon directors to take particular matters into account, such as those set out in the list. It does, however, point out that one of the causes of difficulty at Tricontinental was the absence of an accurate and timely flow of information on a number of important operational matters, in management reports to the Tricontinental board, and in the lending submissions put before directors for their approval. There was also an inadequacy in the information about Tricontinental placed before the directors of SBV, more than half of whom were not directors of Tricontinental. Those non-common directors were left in the dark on some vital aspects of Tricontinental’s activities.

If an appropriate statutory provision were enacted that underlined the need for all directors to be adequately informed, it could have the effect of compelling them to ensure that they were provided with adequate information, and in appropriate cases, could assist them to penetrate beyond the bland assurances of a chief executive officer.

It is noted that both the Exposure Draft and the later proposal are silent on the question of the degree of skill required of an officer. Having canvassed the present state of the law on this issue in paras 19.33-40, the Commission does not wish to add anything here to what is clearly a difficult topic, except to say that if a new s232(4) were intended to be a comprehensive and readily available guide to directors and other officers, this is a surprising omission.

C. Privilege Against Self-Incrimination

The Commission has set out the difficulties it encountered over Mr Johns’ rather late invocation of the privilege against self-incrimination; see paras 3.23-31 above.

It has also expressed its views on the need to amend the Evidence Act or, perhaps more appropriately, introduce a Royal Commissions Act into
Victorian statutes; see paras 4.11-13 above. The only other option would be to pass special legislation defining the powers of each Royal Commission established.

21.22 Whichever course is followed, there is a clear need to legislate if Royal Commissions are ever again to be used to inquire into matters which could become the subject of criminal proceedings. This could apply to allegations as varied as, for example, corruption, fraud, manslaughter (arising from such events as a train disaster or bridge collapse) or offences under local government legislation.

21.23 The existing powers to compel evidence under the Evidence Act may usefully be contrasted with the powers available to Royal Commissions constituted under the laws of the Commonwealth and New South Wales.

21.24 Section 6A of the Royal Commissions Act (1902) (Cth)('the Commonwealth Act') provides that:

"(1) It is not a reasonable excuse for the purposes of sub-section 3(2) for a person to refuse or fail to produce a document or other thing that he was required to produce at a hearing before a Commission that the production of the document or other thing might tend to incriminate him.

(2) A person is not entitled to refuse or fail to answer a question that he is required to answer by a member of a Commission on the ground that the answer to the question might tend to incriminate him.

(3) This section does not apply where the offence in respect of which the production of a document or other thing or the answer to a question might tend to incriminate a person is an offence with which the person has been charged and the charge has not been finally dealt with by a court or otherwise disposed of."

In Sorby's case the High Court held that when the Commonwealth Parliament enacted s6A (in 1982) it clearly manifested its intention to abrogate the privilege against self-incrimination (Gibbs CJ at 296, Mason, Wilson and Dawson JJ at 305 and Murphy J at 313).
Section 6DD of the Commonwealth Act provides that:

"A statement or disclosure made by any witness in the course of giving evidence before a Commission is not (except in proceedings for an offence against this Act) admissible in evidence against that witness in any civil or criminal proceedings in any court of the Commonwealth, of a State or of a Territory."

Section 17 of the Royal Commissions Act 1923 (NSW)('the NSW Act') states:

"(1) A witness summoned to attend or appearing before the commission shall not be excused from answering any question or producing any document or other thing on the ground that the answer or production may criminate or tend to criminate him, or on the ground of privilege or on any other ground.

(2) An answer made, or document or other thing produced by a witness to or before the commission shall not, except as otherwise provided in this section, be admissible in evidence against that person in any civil or criminal proceedings.

(3) Nothing in this section shall be deemed to render inadmissible:

(a) any answer, document or other thing in proceedings for an offence against this Act;
(b) any answer, document or other thing in any civil or criminal proceedings if the witness was willing to give the answer or produce the document or other thing irrespective of the provisions of subsection (1);
(c) any book, document, or writing in civil proceedings for or in respect of any right or liability conferred or imposed by the document or other thing.

(4) This section shall not have effect unless in the letters patent by which the commission is issued, or in other letters patent under the Public Seal, the Governor declares that the section shall apply to and with respect to the inquiry.

(5) A declaration under section 15 that the provisions of this Division are to have effect is not sufficient to apply this section unless the declaration specifically states that this section shall apply to and with respect to the inquiry."

The function of a Royal Commission is fundamentally one of inquiry and investigation. It is a creature of the executive, having a specific purpose governed by its terms of reference. It has a limited life span and, following its report, it ceases to exist. It seeks to discover the whole truth and, in that
pursuit, it is not bound by the normal rules of evidence applying in actions between parties (although it is bound to accord natural justice). In addition, a Commission may serve the vital function of calming public anxieties and informing the community as to the circumstances of a major catastrophe (as in the present case). It is not a court of law and, although it can make adverse findings as to the conduct of individuals and corporations, it does not determine rights between parties or convict individuals or corporations of criminal offences. Its function is to make the fullest possible investigation of the relevant facts and to make findings and recommendations in its report. These findings and recommendations may touch on matters of grave public concern, including issues leading to the determination of civil and criminal liability in the courts, and questions of law reform. To carry out its task fully, a Royal Commission requires access to all relevant evidence available to it.

21.28 The Commission notes in passing that the gist of the views expressed in this section was set out in the final address of counsel assisting, and was generally supported by counsel for the directors and staff of Tricontinental and SBV.

21.29 If this recommendation is taken up, it is suggested that a number of other issues, in addition to that of self-incrimination, be considered at the same time. These should include the following:

(i) The power of any Royal Commissioner to issue summonses. At present ss14 and 17 of the Evidence Act empower only the chairman to perform this function.

(ii) The power for summonses to be left with a responsible person at the usual place of abode or place of work of the proposed witness, or with legal representatives of the witness (substituted service). Presently ss14 and 17 only permit a summons to be delivered personally or by leaving it at the witness’ usual place of abode. In practice the Commission’s staff often served copies on solicitors (who gave undertakings on behalf of their clients) and, by arrangement, served the original on the witness when he or she arrived at the Commission.
However this can only work with the co-operation of solicitors and witnesses.

(iii) The provision of conduct money. At present none is provided for, although the Commission notes that the recent Evidence (Commissions and Boards of Inquiry) Regulations 1992 (SR No 51/1992, 14 April 1992) amend the provision relating to accommodation and meals allowances in the Principal Regulations. An ancillary question is that of witness' costs (s6G of the Commonwealth Act).

(iv) The obtaining of documents and other materials before formal commencement of Commission's sittings. The present s17 suggests that documents can only be produced at a Commission hearing (because the production is linked to the giving of evidence), whereas an investigative search for information may require early production of documents (particularly where there is a need for confidentiality or to ascertain precise documents which should be sought). One cannot always rely on the co-operation of parties, particularly where they may respond only because of a legal obligation to do so (as in the case, for example, of a banker required to disclose information about a client). Some form of preliminary discovery of documents at the behest of the Commission would be very useful.

(v) The obtaining of documents in response to a summons without the need for a formal appearance. This is provided for in some rules of court. The Commission adopted this practice for the convenience of those concerned, but it had no legislative basis.

(vi) The need to be able to issue a summons to produce, in addition to documents, "... other things" (see s2(1) of the Commonwealth Act). Currently a Commission in Victoria is only entitled to call for "any document" (s17), as defined in s3 of the Evidence Act.

(vii) The power to seek a search warrant for "things of a particular kind connected with a matter into which the relevant Commission is enquiring" (s4(1)(a) of the Commonwealth Act), or for the arrest of persons suspected of fleeing or avoiding the jurisdiction.
(viii) The power to issue a gaol order - currently the order can only be made by a Judge of the Supreme Court or a Magistrate (s12 of the Evidence Act).

(ix) The desirability of establishing specified hearing procedures, for example the power to sit in closed session or prohibit publication of certain evidence (s6D of the Commonwealth Act). Other procedural matters which might be spelled out include the right of appearance, the principle that the Commission is not bound by the strict rules of evidence, and the duty to accord procedural fairness.

(x) The Commission's power to pass information and documents to other State and Commonwealth agencies.

(Note: A number of these issues are considered in Dr L.A. Hallett's "Royal Commissions and Boards of Inquiry", Law Book Co, 1982.)

D. Service and Execution of Process Act

21.30 Part 3A was inserted in the Service and Execution of Process Act 1901 ('the Act') by s5 of the Service and Execution of Process Amendment Act 1991, which came into effect on 23 August 1991. It made specific provision for investigative tribunals constituted under the laws of a State to serve subpoenas and warrants out of the jurisdiction. The Commonwealth Attorney-General's Second Reading speech made it clear that the category of investigative tribunal was devised particularly with Royal Commissions in mind, although the definition included other types of Boards of Inquiry.

21.31 This amendment to the Act was a reflection of the desire on the part of the Commonwealth Government to extend the Act to enable Royal Commissions and other investigative tribunals to serve subpoenas on persons interstate, and to provide for interstate enforcement of subpoenas to give evidence. However, s19ZH of the Act, expressed to be a "stand alone" provision, suggests that certain constitutional questions, as to whether the Commonwealth actually has power to legislate to provide for the service and execution of process of state tribunals, remain unresolved.
21.32 Usually, in Victoria, when a Royal Commission is established, the Governor issues Letters Patent commissioning the person or persons appointed. There have been occasions when special Acts were passed providing for the appointment of Commissions. One example was the Westgate Bridge Royal Commission Act 1970. Apart from such legislation, in Victoria, the powers of a Royal Commission to subpoena witnesses to attend the Commission, or to give evidence, or to produce any document, are found in Division 5 of Part I of the Evidence Act (Vic) 1958 ("the Evidence Act").

21.33 Section 18 of the Evidence Act gives any Commissioner the power to administer an oath to and examine upon oath any person summoned or who happens to be present before the Commission. Section 19D(2) of Part 3A of the Act provides that, for the purposes of the definition of "investigative tribunal", a body is taken to be authorised by or under a law of a State to take evidence on oath or affirmation if a member of the body is so authorised to take evidence on oath or affirmation. In Victoria, in the absence of any special Act, this power is given by s15 of the Evidence Act.

21.34 Because Part 3A of the Act was passed specifically so as to benefit Royal Commissions in progress in Victoria, Western Australia, South Australia and Tasmania, it was enacted in advance of the Service and Execution of Process Bill 1992, which is intended in due course to repeal and replace the Act. Division 4 of Part 4 of the Bill contains provisions similar to Part 3A of the Act.

21.35 Although intended to assist this Royal Commission, Part 3A of the Act was not used by the Commission in its inquiries into the affairs of Tricontinental. This is because of the complicated nature of the process of applying for leave to serve a subpoena outside the jurisdiction.

21.36 It is necessary, under the provisions of Part 3A, for the Commission to obtain leave from the Supreme Court of Victoria to serve a subpoena outside Victoria pursuant to the Act. The Supreme Court, however, is constrained by s19J
from giving leave for a subpoena to be served unless it is satisfied of the following three matters:

(i) That the evidence likely to be given by the person to whom the subpoena is addressed, or a document or thing specified in the subpoena, is relevant to the matter that is to be inquired into or reported on by the Commission;

(ii) That the evidence, document or thing concerned could not reasonably be obtained from a person in Victoria. An exception to this matter is made where it concerns an expert witness; and

(iii) If the evidence, document or thing concerned may constitute or contain evidence that relates to "matters of state", that the public interest in having the evidence, document or thing made available outweighs the public interest in preserving the secrecy or confidentiality of the evidence, document or thing.

21.37 Evidence relating to "matters of state" is defined in s19D as:

"Evidence, the adducing of which would:

(a) prejudice the security, defence or international relations of Australia; or

(b) damage relations between the Commonwealth and a State or relations between two or more States; or

(c) prejudice the prevention, investigation or prosecution of offences; or

(d) prejudice:
   (i) the prevention or investigation of; or
   (ii) the conduct of proceedings for recovery of civil penalties brought with respect to;

other contraventions of the law; or

(e) disclose, or enable the person to ascertain, the existence or identity of a confidential source of information in relation to the enforcement or administration of a law, whether written or unwritten, of the Commonwealth or of a State; or

(f) prejudice the proper functioning of the government of the Commonwealth or a State; or

(g) be contrary to the public interest for any other reason that could form the basis for a claim in judicial proceedings that the evidence should not be disclosed."

21.38 Where a court is satisfied that the evidence likely to be given by the person to whom the subpoena is addressed or a document or thing specified in the
subpoena may constitute or contain evidence relating to "matters of state", it is constrained from granting leave under s19M of the Act unless the application for leave has given at least 14 days' notice of the proceedings, and the issue of the subpoena to all of the following persons:

(i) the Attorney-General for the Commonwealth;
(ii) the Attorney-General for the State in which the investigative tribunal is established; and
(iii) the Attorney-General for the State in which is located the person to whom the subpoena is addressed.

21.39 While the legislative intentions behind Part 3A of the Act are laudable1, the new procedure devised as a result is not practical where an investigation is in progress and it is necessary to have a subpoena issued and served quickly while the evidence is to the point. The provisions of Part 3A appear so complex that there is a real risk that they might give rise to protracted legal wrangles, hindering the fulfilling of the Commission's function. Finally, there is the doubtful constitutional status of Part 3A, which could always provoke a challenge by an unwilling witness.

21.40 In their current form, the provisions in Part 3A of the Act are, for most purposes, impractical. Considerable simplification of the procedure for obtaining leave for serving process outside a jurisdiction is necessary before such provisions become options realistically available to Royal Commissions and other investigative tribunals. It should be possible to simplify the

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1Note the comments in the Australian Law Reform Commission Published Report No 40, Service and Execution of Process, at 301: "Linked with this potential for overreaching of legitimate investigative exercises is the possibility that a tribunal may be given an investigative task that, while clothed with legality, is in fact an attempt by the government of one State to pursue an exercise with political motives against, or designed to embarrass, the government of another State. Alternatively, while a particular investigative task may not have this ostensible aim, it may have such an effect. Disagreement between the States is not unknown. If those disagreements were to be facilitated by enabling interstate service of process whose object is to compel the giving of information by persons, particularly public servants or government officers of a State, great harm would be done to the fabric of the federation. At its lowest level, embarrassment to or interference with the government of a State by a tribunal established in another State is something which federal legislation should not countenance or facilitate."
procedures, while still allowing for consideration of "matters of state" in instances where they are truly present. A possible alternative would be to dispense with the requirement for leave, while providing for a challenge to any subpoena, to be brought perhaps in the Federal Court of Australia, on grounds of irrelevance, oppressiveness, or balance of public interest.
CHAPTER 22

FINDINGS AND RECOMMENDATIONS

CHAPTER 6 - TRICONTINENTAL’S LOSSES AND FINANCIAL POSITION

- Tricontinental's losses reported between 1 July 1988 and 31 December 1990 totalled $2,516.5m.

- The elements of the losses actually suffered to 31 December 1990 (rounded to $1m) were:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad and doubtful debts</td>
<td>$2,045m</td>
</tr>
<tr>
<td>Excess of interest expenses over interest income</td>
<td>$ 338m</td>
</tr>
<tr>
<td>Loss on sale, or diminution of value, of investments</td>
<td>$ 156m</td>
</tr>
<tr>
<td>Tax expense recognised</td>
<td>$  13m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,552m</strong></td>
</tr>
</tbody>
</table>

(Note: This total differs from the total losses reported because it does not allow for income in the form of fees, dividends etc, nor for general operating expenses.)

- These losses in 30 months were 37 times the profits earned in the previous three years.

- To 31 December 1991, the total losses since July 1988 amount to $2,667.2m - two and two-thirds billion dollars.

- Although other financial institutions have also suffered heavy losses, Tricontinental’s losses were uniquely disastrous because of the proportion of the total loan portfolio lost and the effect of that loss on its parent, SBV.
Tricontinental’s total losses amounted to some 62.3% of its total assets.

Its losses exceeded its own capital base by more than 24 times, and the capital base of SBV by more than twice.

Its losses were incurred earlier and quicker than those of most other financial institutions.

CHAPTER 7 - THE COST TO THE VICTORIAN TAXPAYER

Victorians have already contributed $726.6m to Tricontinental. The potential cost to Victorians of the failure of Tricontinental exceeds $2,400m.

The likely cost could also be expressed as $840m plus the loss of SBV.

CHAPTER 8 - WHERE DID THE MONEY GO?

Tricontinental borrowed money from banks and other financial institutions which it was later unable to repay without the intervention of SBV and the Victorian Government. Tricontinental had mainly used that money to lend to clients or to purchase shares. Tricontinental’s losses arose from the failure of those borrowers to repay and, to a much smaller extent, from unsuccessful share investments.

In the case of the shares purchased, Tricontinental has simply resold them at a loss, which clearly cannot be recovered.

In the case of the moneys lent, the law does not permit the lender to attempt to recover its money from a third person who has received it, in good faith, from the borrower.

Tricontinental’s only rights to recover are against the borrower itself and any guarantors of the particular loan. There could, theoretically, be a
cause of action in some limited circumstances against the directors of a
borrowing company. Such claims would be difficult to establish and the
Commission has not been able to identify any particular instance where
such a claim would be likely to succeed.

- The only other source of recovery for Tricontinental is to take control of,
  and to sell, any asset of a borrower over which it held first mortgage
  rights. In many cases, such security as Tricontinental held has proved to be
  of little, if any, value.

- The reason that so many of Tricontinental’s loans were not repaid is closely
  connected with the nature of Tricontinental’s borrowers. Features common
to most of them were that they had high levels of debt compared with
equity, and their ability to repay often depended upon an increase in, or at
least the maintenance of, the value of certain assets - usually commercial
property or shares.

- Quite often the actual borrower from Tricontinental was a private company
  controlled by someone like Mr Bond (Dallhold) or Mr Skase (Kahmea).

- The public companies which borrowed from Tricontinental tended to be
  entrepreneurial in their activities, and they were structured in such a way
  that a single person or a family could maintain control of the operations of
  the public companies.

- A second characteristic of the entrepreneurial public companies was their
  reliance on the stock market as a source of funding for their business
  activities. The issue of shares to the public was frequently preceded by
  borrowings from a financial institution, such as Tricontinental, which
  would then expect to be repaid from the moneys raised from the sale of
  shares to the public. If the issue was not well supported by the public, the
  moneys to repay the loan would not be raised. Tricontinental suffered in
there were four principal uses to which money borrowed from Tricontinental was put. The first of these was the acquisition of shares. This was sometimes for purposes of share speculation by the borrower, which might lead on to a threatened or actual takeover bid. On other occasions shares were purchased to enable the borrower to retain control of a public group of companies.

The other major use to which Tricontinental's loans were put by borrowers was the acquisition and development of commercial property. This applied particularly to commercial developments such as shopping centres, office buildings and tourist developments. Money would be borrowed to purchase and prepare a site for development. The construction phase might then be financed by a fresh lender, or the original lender might continue to fund it, either alone or as part of a syndicate.

Tricontinental also held itself out as very willing to support new enterprises in areas such as "tourism, leisure, entertainment and high technology". The Commission saw some evidence of this type of lending, but it was a good deal less common than lending for shares or property development.

Finally, lending for company takeovers and the acquisition of existing businesses was quite common.

There were a number of cases, which came to the notice of the Commission, where Tricontinental took an equity in the borrower's investment, in the sense that it entered into an arrangement to share profits as part of its recompense for the loan. There were other cases in which, because the loan was badly structured, Tricontinental was bearing the primary risk of any losses that were incurred, while not necessarily sharing
in possible profits. In a number of cases it lent 100% of the costs of the venture.

- The cases which Tricontinental recognised as involving the acquisition of equity investments were referred to as ‘investment banking’. This could take any one of four forms. Tricontinental could purchase shares:
  (i) as an investor,
  (ii) in support of client companies,
  (iii) as a result or underwriting or sub-underwriting arrangements, and
  (iv) as a means of funding clients.

- Because of the poor documentation maintained by Mr Johns, it was often difficult to tell into which of these categories a particular investment banking transaction fell.

- Looking at the conduct of borrowers generally, the Commission is unable to say that any misleading conduct or breaches of contract by borrowers (other than failures to service or repay loans) caused or contributed to Tricontinental’s losses. This again is partly due to poor documentation. Such information as was obtained from borrowers was subjected to little, if any, independent checking. The effort of trying to establish at this late stage whether statements made several years ago were fair and accurate could not be justified.

- If it were possible to establish that Tricontinental had been misled, or a breach of contract, resulting in loss, had occurred, it would be theoretically possible to take action against any director who was personally responsible for the misrepresentation or breach of contract. However, the Commission has found no sufficient evidence to justify such a recommendation in any particular case.
In a more general sense, it could be said that a number of the borrowers from Tricontinental were to blame for Tricontinental's losses in the sense that they, in buying and selling shares and other assets, were really gambling at high risk with other people's money - including Tricontinental's. In this sense, the contribution of Tricontinental's borrowers to its losses should not be ignored. However, Tricontinental must bear primary responsibility for agreeing to make the high risk loans.

CHAPTER 9 - DEREGULATION AND THE ECONOMIC ENVIRONMENT

The process of deregulation which came to a head in the first half of the 1980s thrust the banks into a new era of freedom in the conduct of their lending business. Decisions regarding the creation of credit were now left to banks and other financial institutions and their customers, based on market forces of supply and demand.

With this new-found freedom and increased competition came the associated responsibility of prudent credit risk management. Many banks, and some other financial institutions, lacked the expertise and experience necessary to assess credit risk adequately.

The situation was aggravated by an economic environment in which inflationary expectations were high, and there was a strong growth in economic activity and share values after the recession of the early 1980s.

Tricontinental participated strongly in this rapid growth in credit, particularly after it became a wholly-owned subsidiary of SBV and so was able to raise funds more readily and more cheaply.

Tricontinental's established clients were exactly those private companies and small public companies which were anxious to participate in the profits to be made from the asset-price inflation of the mid-to-late 1980s.
That asset-price inflation was bound to be reversed at some time, although the timing and extent of the reversal were matters for speculation.

Undoubtedly the deregulation and economic circumstances of the 1980s were a contributing factor to Tricontinental’s losses.

However the extraordinary size and timing of those losses clearly indicate that were other more important factors which caused those losses. The differences between institutions lay, mainly, in the effectiveness of their assessment and management of credit risk.

In Tricontinental’s case, this assessment and management was seriously deficient.

CHAPTER 10 - THE NATURE OF TRICONTINENTAL’S LENDING BUSINESS

Some important aspects of Tricontinental’s activities before its 100% acquisition by SBV in 1985 continued afterwards and played a part in its collapse. These were:

(i) the nature of its borrowers - private companies and second-level public companies - which included a number controlled by ‘entrepreneurs’ such as Alan Bond, Christopher Skase, George Herscu, Abraham Goldberg, John Avram and others;

(ii) reliance on taking security to manage risk, rather than looking as well to established cash flows;

(iii) the size of individual loan exposures, relative to Tricontinental’s capital base; and

(iv) the concentration on lending for property.

Most of the key officers in the conduct and reporting of Tricontinental’s lending business were in place when Touche Ross made its rather critical report of that business in 1985. They remained until 1989.
- Tricontinental’s status as a merchant bank was important because:
  (i) the changing rules affecting trading and merchant banks explained why SBV became involved in the first place, and why it later had little choice but to take full ownership;
  (ii) it dictated the general nature of Tricontinental’s lending business and the ethos by which it operated; and
  (iii) it meant that there would be a minimum of regulatory controls.

- Tricontinental’s deliberate response to financial deregulation was to continue and increase heavy lending to existing clients, most of it for the acquisition of assets, and secured against shares or property.

- Government ownership of Tricontinental meant:
  (i) funds were more readily available to it, and at lower cost;
  (ii) its parent was not subject to the formal supervision of the RBA; and
  (iii) there was no informal ‘supervision’ through the operation of market forces on its ability to borrow funds or on the price of its shares.

- The key elements of Tricontinental’s lending strategy were:
  (i) the provision of large loans, particularly to regular clients;
  (ii) a concentration on private and medium-sized or smaller public companies;
  (iii) giving clients access to the most senior managers;
  (iv) stressing flexibility in structuring loans, and speed of approvals;
  (v) the granting of loans secured by shares, even large parcels of shares which could prove difficult to realise;
  (vi) making a high proportion of loans available for commercial property purposes; and
  (vii) an approach to lending which treated it as marketing a product.
These elements of the lending strategy were all made plain in proposals put to the board and in public documents.

Tricontinental constantly failed to limit lending to its budgeted aims; this put continuing stress upon its own capital adequacy, and therefore that of its parent group.

Asset growth was needed to maintain profits, because much of that profit came from loan establishment fees.

Strategic planning paid too little attention to:
(i) prudential lending controls; and
(ii) the economic outlook.

Tricontinental's clients were typically:
(i) highly geared;
(ii) with limited cash flow; and
(iii) in constant need of funds for further expansion.

In the result, Tricontinental lent:
(i) too much,
(ii) to too few,
(iii) mainly for the purchase of shares or development of commercial property,
(iv) and with inadequate security - often in the form of shares.

Although its previous history, the fact of Government ownership, and the lending strategy it adopted from 1985 onwards all contributed to Tricontinental's ultimate collapse, these were not the most immediate and important causes of that collapse. That distinction belongs to the way in which credit risk was managed.
CHAPTER 11 - TRICONTINENTAL’S MANAGEMENT OF CREDIT RISK

- Tricontinental’s management of credit risk failed at almost every turn. The merchant bank was left exposed to the business risks of its clients. In effect, it became a joint venturer with them in the share investment and commercial property speculation of the mid-to-late 1980s. The clients identified and pursued the opportunities: Tricontinental provided the finance. Tricontinental’s fortunes rose and then fell with those of its clients.

- Tricontinental failed to evaluate credit proposals adequately and to manage the credit risk effectively. This failure occurred at every level - directors, senior management, lending staff and credit staff.

- The documented lending guidelines were inadequate, by themselves, to form a basis for the prudent conduct of the lending business.

- The absence of extensive documented policies meant that Tricontinental’s evaluation and management of credit risk depended critically upon the application of the skills and experience of all persons involved in the credit risk procedures.

- The procedures actually applied were devoid of any substantial evaluative content. This was especially so in the many transactions in which Mr Johns was, directly or indirectly, the account manager.

- Lending officers were encouraged, even required, to market Tricontinental’s ‘products’ and services, and to be flexible and responsive to the needs of borrowers.

- Credit officers proceeded - in the main - on the basis that their role was to present such information as was readily available, in the form of a credit submission, without any serious analytical content.
Credit submissions failed to evaluate the financial weaknesses of many of Tricontinental's clients. They placed almost complete reliance upon the business judgment of borrowers, without evaluating independently the risks associated with the proposed use of the borrowed funds (if that use was disclosed), or whether projections provided by borrowers were realistic.

Instead, Tricontinental placed its faith in the taking of security - without appreciating the limitations of much of the security that it held - and upon the 'locking in' of proprietors, and other related companies, by the taking of guarantees.

The credit committee members reviewed credit submissions on a round robin basis and, subject possibly to suggestions for additional covenants or other terms, they treated the recommendation of proposals emanating from Mr Johns as a matter of course.

Directors also considered credit submissions on a round robin basis, and sought to perform the task of credit approval when most of them were not adequately qualified or experienced to do so by themselves. They relied heavily upon a presumption that the relevant information had been properly collected, analysed and presented to them by staff and management. However it must have been obvious to all directors that, frequently, the information upon which they were expected to make decisions was seriously deficient, and that the analysis presented to them was negligible.

Credit submissions had the flavour of marketing proposals that might have been prepared by applicants for loans, rather than critical evaluations of credit risk. This reflected the dominance of the lending division over the credit division, and the dominance of the lending strategy of high reward for high risk.
The procedure for "formal confirmation" at board meetings did not act as an effective review of the loans approved during the preceding month.

Once a loan had been made, little effort was made to monitor the ability of the borrower to repay - usually from asset sales or refinancing - until there had actually been a failure to pay interest or repay principal.

There was a notable reluctance to admit the probability of losses arising from under-secured and non-performing loans. Loans which could not be repaid were routinely extended, in the hope that some arrangement might be found to resolve the problem.

The most glaring deficiency in Tricontinental's management of credit risk was the absence of any reasonable prudential policies concerning the concentration of risk. To the extent that limits were set, they were not clearly documented, not clearly understood, and in any event they were not applied.

CHAPTER 12 - AUDITORS’ COMMUNICATIONS WITH MANAGEMENT AND BOARD TOUCHING CREDIT RISK

The officers of KPMG Peat Marwick who were responsible for both the internal and external audits, met the audit committee of the Tricontinental Board five times between the establishment of that committee in May 1986 and the integration of Tricontinental into SBV in May 1989. They met once each in 1986 and 1987 and three times in 1988. Three of these meetings were primarily concerned with the annual accounts.

In the same time, 66 internal audit reports were presented to Tricontinental’s management. Of these, six dealt with lending and lending procedures and one with investment banking.
• Mr Johns had instructed the internal auditors to give emphasis to liability risk management rather than asset management and security, because he was more familiar with the latter.

• Mr Johns made it clear at all times that the internal auditors were to check compliance with guidelines and procedures, and not be concerned with the adequacy or appropriateness of such guidelines, procedures or prudential policies generally. They were not to undertake efficiency auditing.

• In September 1987 the audit committee was told that the internal audit had disclosed no matters deserving the attention of the board. The main control problem identified had been the lack of documentation for category A investment banking transactions. Mr Johns was said to be trying to ensure better documentation.

• The audit committee meeting of February 1988 was again informed that investment banking controls were lacking, particularly as to documentation.

• At the same meeting the committee again accepted that it would not review all internal audit reports, but would be informed of any matters of concern.

• Auditors and directors agreed on provisioning of $12m for 1987 and $17.5m for 1988, although the auditors had initially suggested $22m for 1988. The concentration of risk in Tricontinental’s lending portfolio may have been discussed in connexion with provisioning in June or August 1988. The evidence suggests that it was raised by the auditors at the June meeting, but not in such a way as to stay in the memory of directors, none of whom could recall such a discussion.

• When Mrs Wilson was appointed to the credit risk internal audit team, she quickly perceived Tricontinental’s basic problem in the lending area - a fundamental lack of conceptual knowledge of credit risk and all issues
associated with it. Johns' outburst when he met her provided a clear picture of everything that was wrong with his management - arrogance, resentment of criticism or questioning, over-confidence in his own capacities and determination to give clients what they wanted.

- None of Mrs Wilson's criticisms or concerns ever reached the audit committee or the non-executive directors. Mr Johns had complete control of the internal audit process. This was facilitated by the absence of any agreed statement as to the role of the internal auditors. Everything was left to an annual strategy document, which he approved, and his oral instructions.

- Any concerns of the auditors about category A investment banking transactions, and whether warehousing or insider trading might have been involved, were conveyed to directors only obliquely. If those terms were mentioned at all, it was in the context of appearances rather than realities.

- There was nothing in the communications from auditors which should have alerted Tricontinental's non-executive directors to potentially heavy losses in the lending portfolio or to any improper or illegal conduct in investment banking. Those directors are entitled to take some comfort from those facts.

CHAPTER 13 - IAN MALCOLM JOHNS

- Mr Johns' rise at Tricontinental from 1980 to January 1986 was meteoric, even though he was only twenty-seven at the beginning of that time and had no tertiary qualifications.

- He had been very successful as a lending manager, in the sense that he had continually increased the company's share of the market and earned a high rate of fees.
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- His appointment as managing director has proved to be a serious error of judgment on the part of those responsible but, in spite of his age and comparative inexperience, the decision to appoint him was not unreasonable at the time.

- He initiated few changes and maintained existing lending policies. This was in line with the guidance of Mr Moyle, the chief executive officer of SBV, who had asked for "more of the same". Mr Johns' particular contribution lay in the way in which those policies were pursued.

- Mr Johns maintained a close association with all major borrowers and, until late in 1988, was effectively the account manager for the majority of large loans.

- He acted as manager for investment banking and was solely responsible for all category A transactions.

- Although he introduced three-year plans combined with annual budgets, he continued to put almost all his efforts into lending and investment banking. It was little wonder that the planned development of other areas did not proceed satisfactorily.

- His constant references to high risk for high rewards, together with his sole control of substantial share dealings, suggest that he had something of a gambler's instinct.

- He put great emphasis on speed of handling loan applications, which often brought about hasty and defective decisions.

- There were a number of cases in which important information was withheld from directors.
• There were also a number of cases in which decisions made by directors were later varied by Mr Johns. These variations included changes in the identity of the borrower, the purpose of the loan, or the nature of security, and the amendment or waiving of preconditions.

• When a borrower was in difficulties, Mr Johns was very reluctant to admit the failure of a loan. He would always try to find some way of deferring such action, even if it meant lending additional moneys as part of a so-called workout.

• The lending decisions which he made were reached without consultation. He trusted his own judgment completely.

• His decisions were never challenged by other managers, who gave him loyal support.

• He did not expect credit analysts to do much more than a clerical task in collecting materials for a submission. He saw it as no part of their function to make any critical comments on a loan proposal.

• Mr Johns' philosophy of getting close to entrepreneurial clients seemed to lead, in time, to a loss of objectivity. He would go to almost any lengths to accommodate the requirements of a major borrower such as Alan Bond, Christopher Skase, Abraham Goldberg, George Herscu or Malcolm Edwards. He seemed to accept at face value anything which such substantial clients told him.

• In structuring a loan he considered mainly the security offered and the size of the fees which he was able to extract. Questions of cash flow and the source of ultimate repayment received comparatively little attention.
In spite of his concentration on security, he was often satisfied with security which was obviously of doubtful quality and in fact proved to be valueless.

Although some of his merchant banking transactions had the hallmarks of warehousing or possible insider trading, they were mostly not sufficiently serious or clear-cut to warrant further attention.

Mr Johns maintained great pressure on his staff and himself at all times. He was very hard-working and expected others to be the same. He was obviously not good at delegating in fields which particularly interested him.

Generally speaking, he regarded the non-executive directors as a potential hindrance to his lending proposals. They had to be placated and persuaded. He did not regard them as a source of wisdom to be shared.

Mr Johns was, in the words of his chairman at the time of integration, a "one man band" at Tricontinental. He must accept a large share of the responsibility for its collapse.

However the Commission has concluded, for the reasons which follow, that action against Mr Johns pursuant to s229(2) of the Companies (Victoria) Code would not be justified.

Although Mr Johns has chosen not to give evidence, there are a number of points in his favour which should be noted.

(i) When he was appointed managing director he was young and comparatively inexperienced.

(ii) He inherited a situation which contained hidden dangers - particularly a high concentration of exposures to a comparatively small number of adventurous entrepreneurs.
(iii) He operated in the heady atmosphere of the late 1980s, which saw frantic competition for market shares. He had no substantial experience of other times.

(iv) He was dedicated to his job, driving himself hard over long hours of work.

(v) He was encouraged by generally favourable comment in the financial press during 1986 and early 1987.

- Mr Johns' faults lay in his personal qualities and his style of management. He had an exaggerated opinion of his own abilities and so did not trouble to consult with others before making major decisions. He discouraged checks and balances to those decisions, and resented criticism.

- The result was that bad decisions were made in haste after inadequate investigation. The non-executive directors became the victims of Mr Johns' over-confidence and his excessive emphasis on speed of action.

- He saw himself as free to change the decisions of directors in major ways without consultation and without reporting back.

- These serious faults in Mr Johns' management amounted to an improper course of conduct, but that does not readily lend itself to criminal proceedings. As to any particular default, there would be considerable difficulties of proof, particularly because of the poor records maintained by Tricontinental.

- The costs of a potentially complex criminal action, for breach of s229(2) of the Companies Code, would be out of all proportion to the maximum penalty of $5,000 for any offence proved.

- Mr Johns must accept a major share of the responsibility for Tricontinental's collapse. This was due to consistently bad decisions
arising from his arrogant over-confidence, lack of business acumen, naivety when dealing with well-known entrepreneurs, lack of candour amounting at times to deviousness, and unwillingness to admit error. These are serious personal failings but they do not provide a foundation for criminal action.

The Commission recommends that no action be taken against Mr Johns arising out of his management of Tricontinental’s lending portfolio. Several other matters, which could give rise to proceedings, are discussed in confidential volume 4 of this report.

CHAPTER 14 - THE PERFORMANCE OF TRICONTINENTAL’S MANAGERS

The senior managers considered by the Commission were:

(i) Mr Ken Mountford, general manager lending;
(ii) Mr Lynton Stott, assistant general manager credit and securities;
(iii) Mr Warren Atlas, assistant general manager project finance; and
(iv) Mr Neil Hunter, group manager securities.

Mr Mountford joined Tricontinental in May 1986, brought in to succeed Mr Johns as general manager lending. It took him at least 12 months to become familiar with Tricontinental’s practices and his own responsibilities.

He was a loyal and hard-working deputy to Mr Johns in the lending operations area. He followed his managing director’s lead, and adapted himself to Mr Johns’ style of working.

Through his almost daily meetings with Mr Johns, and his membership of the credit committee, he was kept well informed about lending matters.

After the October 1987 stock market crash, he spend about 70% of his time working on problem loans. From late 1988 onwards, he took over day-to-
day control of a number of Mr Johns’ accounts, but continued to keep Mr Johns well informed about these.

- Mr Mountford was guilty of a number of serious errors of judgment, particularly in the last six months or so before integration, when he was accepting greater responsibilities and working under considerable pressure.

- At the request of the board, Mr Mountford produced a revealing draft of proposed amended lending guidelines in May 1989. It called, among other things, for a general tightening up of security requirements, and provided that, when money was lent for shares, they should be designated from the outset.

- In Mr Stott’s credit and securities department, credit issues were treated more as a clerical or processing function than as an important management control.

- All credit submissions prepared by Mr Stott’s staff came to him for review and comment. He usually approved them again as a member of the credit committee. He queried aspects of most credit submissions, but often this related only to matters of presentation rather than of substance.

- Mr Stott, like other managers, saw Tricontinental’s lending guidelines as “general indicators rather than rules. They were ... a framework in which ... 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 that by 1987/88 there was an increasing number of quick turnarounds of large facilities. These were approved by Mr Johns speaking to board members and obtaining oral approvals. The credit committee was not involved in such cases.
In Mr Stott's experience, "Speed was a feature of Tricontinental's culture. ... Tricontinental ... was recognised for its quick turnaround of credit submissions. The intention was for credit submissions to be processed through the system as quickly as possible."

Mr Hunter was theoretically responsible to Mr Stott but, in practice, he reported directly to Mr Johns.

In Mr Hunter's view, "It was not the duty of the securities division to analyse the adequacy or appropriateness of security."

Letters of offer were checked by Mr Hunter or his senior assistant, to ensure accuracy and completeness. The job was more mechanical than analytical. Legal advisers were relied upon to ensure the enforceability of documents.

The securities division was responsible for monitoring share prices, but not for monitoring such things as reporting conditions.

Valuations of freehold property were arranged by the securities division, but valuation of mortgage debentures were undertaken by credit analysts.

There was no-one at Tricontinental who, as a matter of routine, undertook critical assessments of assumptions underlying property valuations - unless the lending officer chose to ask for and read the valuation.

Mr Hunter always had reservations about placing a value on debenture mortgages, which often turned out to be valueless if companies ran into trouble.
• Mr Hunter was responsible for the preparation of the problem loans reports, but comments as to the likelihood of recovery were those of the account managers, not Mr Hunter.

• So far as Mr Hunter was concerned, monitoring compliance with covenants restricting the incurring of additional debt by the borrower was a matter for the account manager. Mr Johns, however, believed that the securities division ensured that all such covenants were observed.

• Mr Hunter was anxious to stress that his overall role was mechanical rather than analytical. There was evidence that he had refused to take over full responsibility for managing default loans. He would carry out instructions from others, but would not accept final responsibility.

• Mr Atlas' division was concerned with the marketing of tax-effective finance structures, non-taxed-based innovative structures, packaging and advising on lending for real property-based investments and resource-based financing, and packaging syndicated debt facilities.

• Mr Atlas estimated that 80-90% of project finance clients were either controlled or initiated by Mr Johns. Mr Atlas reported directly to Mr Johns.

• The project finance division was not affected to any extent by the share market crash, but the later downturn in the property market had a marked impact. By late 1988, or early 1989, the division was regularly making reports of problem loans and defaults.

• Most of project finance's clients came from within the existing Tricontinental client base. It was difficult to attract new clients because of the strongly competitive environment.
For purposes of s229 of the Companies Code, Mr Mountford was almost certainly an ‘executive officer’, and Mr Atlas was also, at least for certain purposes. It was unlikely that Mr Stott was an ‘executive officer’ within the meaning of the Code and Mr Hunter was almost certainly not.

It would be extremely unjust if, by reason of the distinction between directors and other officers in the exculpatory provisions of the State Bank Acts, proceedings for the recovery of damages were taken against a manager of Tricontinental.

It would, in any case, be extremely difficult to prove that any particular act of individual negligence by an executive officer produced a particular quantifiable loss for Tricontinental. Any amounts actually recovered would necessarily be small.

In considering the liability of senior managers for their failings, it is necessary to remember the pervasive influence of Mr Johns, the managing director, in the whole of the lending process. The managers all supported him loyally.

The managers (other than the executive directors) have, at different times and in varying degrees, been guilty of poor performance - sometimes amounting to negligence. But they were always acting 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 carries the heaviest burden of responsibility among the managers for the failures of the lending division, spent long and trying periods, spread over many months, in the witness box and appeared to give his evidence fully and frankly.
• In the view of the Commission its criticisms, set out in this public report, represent a sufficient penalty for any defaults of which Mr Mountford or the other less senior managers might be thought guilty. The expense of any further proceedings could not be justified in the public interest.

• The Commission has reached the firm view that no action for penalties, arising from lending transactions, should be taken against any manager of Tricontinental. It recommends accordingly.

CHAPTER 15 - THE RESPONSIBILITIES OF TRICONTINENTAL'S DIRECTORS

A. Membership of Board

• The relevant directors of Tricontinental during the crucial period were Messrs N A Smith, J F Ryan, I M Johns, L G C Moyle, I K Morton, B A Ziebell, and J St G D Rawlins (to April 1988) and then R M Carr.

B. Qualifications of Directors

• At the time of appointment each of the directors brought to the board substantial experience in a relevant field or fields of activity.

• The Commission does not accept the proposition that more members of the board should have been technically skilled and experienced in merchant banking. The Tricontinental board needed to have a sufficient number of directors who had technical merchant banking expertise. It was also appropriate, however, for directors with other skills and experience to be appointed to the board.

• The collective skills and experience of the Tricontinental directors appeared adequate for a merchant bank board, at the time when the members were appointed. But it was always important that those skills and that experience be applied collectively. In the vital matter of loan approvals they were not.
As it turned out, one of the major problems was the lending strategy adopted by the board, yet that was an area in which the non-executive directors, particularly those with commercial lending experience, were in a position to exert considerable influence, had they chosen to do so.

Another serious defect was that no-one among the non-executive directors consistently applied an enquiring and critical approach to the activities of the board and senior management.

The third major flaw in the board’s performance arose from the round robin system, which meant that the non-executive directors were called upon to perform individually a vital executive task for which they were not fully qualified (with the exception of Mr Moyle and, to a lesser extent, Mr Ryan). They were deprived of the necessary mutual support that would have been available had they acted on a collective basis.

C. Directors’ Perceptions of their Role

Mr Smith had a very limited view of the requirements of his role as chairman of Tricontinental, and the amount of time and attention needed for proper performance. Important activities elsewhere made very onerous demands upon his time.

He concedes that he knew little about merchant banking. He had great confidence in Mr Johns and he took very considerable comfort from having Mr Moyle, the chief executive officer of SBV, on the board.

His approach to his role as chairman of Tricontinental really amounted to running a relatively smooth board meeting, taking credit submissions home to read and assess to the best of his non-banking ability, and entrusting the rest to the experts.
Mr Smith's idea of his role fell well short of what was needed from him in the circumstances, and this attitude was reflected in his performance.

Mr Ryan was willing and available to perform fully the tasks of a non-executive director of Tricontinental. Any problem lay not in his perception of the role, or in his general qualifications, but in his actual performance.

In the process of approving credit submissions, approval by Mr Ryan seems to have carried weight with other directors. This was no doubt due to his general banking experience, his 'hands-on' experience at Tricontinental, and the fact that in his retirement he had sufficient time to study submissions closely and talk to senior managers.

As a witness before the Commission, he gave the impression of a man with a realistic view of the world, and one who would have had a healthy distrust of anybody who thought that boom times would never end. He did begin to ask more probing questions in the second half of 1988.

Nevertheless, one of the puzzling questions in this inquiry is why it took Mr Ryan so long to get to the point of making an appeal to the board to reassess its credit policy and to adopt a more conservative approach to lending - as he did, so urgently, in April 1989.

Mr Moyle correctly considered himself to be in a difficult position as a result of the way in which the Tricontinental board was constituted from January 1986. He had favoured the appointment of an SBV executive board for Tricontinental, with himself as chairman and other key SBV divisional heads, together with Johns and Ryan, as members.

The chairman of SBV, Mr Hancock, considered that autonomous operation by Tricontinental was necessary because of the very different cultures of Tricontinental and SBV, and because SBV wanted to ensure that it would
be able to dispose of Tricontinental at some future time. Moyle deferred to Hancock's view.

- The result was that Mr Johns, as chief executive officer of the subsidiary corporation, did not report to the chief executive officer of the parent corporation. However, Mr Moyle could not escape the heavy reliance placed upon his views by all other directors, and he was well aware of the very real influence that he wielded.

- Most importantly, he was well placed to initiate any necessary remedial action. It is unlikely that the Tricontinental board, including Johns, could have resisted any well-justified argument presented by Moyle. It is also probable that Moyle could have persuaded the SBV board to intervene, through the directors common to SBV and Tricontinental, to rectify any serious problem in the conduct of Tricontinental's affairs. Respecting the autonomy of a subsidiary was one thing. The protection of SBV from exposure to grave financial risk was quite another, and much more important. In fact, in most respects, Mr Moyle was very supportive of Mr Johns.

- Mr Moyle was probably influenced by the need to build up Tricontinental for sale or float and, when difficulties started to emerge in the conduct of Tricontinental's affairs, he would have been reluctant to do anything that might prejudice a profitable disposal of Tricontinental in the near future.

- Thus he would have been reluctant to do anything that would cause Mr Johns to resign, or would be seen to undermine Johns' authority, as he was widely regarded as the driving force behind Tricontinental's apparent success. The probability of Mr Moyle being influenced in this way is illustrated by the weakness of his response to the requests for change made by Mr Rawlins.
• Mr Rawlins brought to the board a strong background in stockbroking and treasury functions.

• Following the share market crash of October 1987, he was not satisfied with the information being given to the board, nor was he satisfied with Mr Johns' attitude to the board.

• It is significant that Mr Rawlins turned to Mr Moyle alone, and not to Mr Smith, in his search for support. It is unfortunate that he did not continue to press his objections formally at the Tricontinental board, so as to force a response, one way or the other. No doubt he felt somewhat inhibited by the presence and attitude of Mr Moyle, his chief executive officer at SBV.

• Mr Carr brought no experience in merchant banking matters to the Tricontinental board. However, he did have a long experience in general banking, and particularly in banking administration. He was adequately equipped to make a useful contribution to the Tricontinental board.

• Mr Carr played a major role in the round robin system, but he must be regarded as one of the weaker links in it. It seems however, that he did become more critical as time went on, because towards the end he was joining Ryan in querying whether particular approvals should be given. No doubt, like Mr Rawlins, he was generally influenced by the presence and attitude of Mr Moyle, to whom he was a loyal lieutenant.

• Mr Morton's long experience in financial institutions, including membership of the SBV board since 1971, and the SBV credit committee since 1985, qualified him to bring a range of relevant skills to the Tricontinental board.
• He was less involved than any other director, except Mr Ziebell, in the approval of credit submissions. In this connection, it must be remembered that he was very busy with his commitments elsewhere.

• It is puzzling that he did not speak out at any stage against the more obvious defects in Tricontinental's policies and practices. There were at least two considerations. First, he was busy, and not likely to have focused deeply on Tricontinental's affairs unless actually at the board table of Tricontinental or SBV. Secondly, he accepted Mr Johns as a competent chief executive, was impressed by his knowledge, and was satisfied with the explanations given at board meetings.

• Mr Ziebell had a vital role in the general administration of Tricontinental. He attended board meetings in the dual capacity of executive director and company secretary. At board meetings he was, at least in a formal sense, a party to the formulation of policy, and to decisions in other matters raised.

• He only rarely participated in the round robin process for the approval of credit submissions. He was unenthusiastic about the role and was actively discouraged by Mr Johns. This non-participation seems to have been accepted by the other directors without comment.

• In his executive capacity, Mr Ziebell implemented accounting practices, and devised tax-driven arrangements, that could not stand up to close examination.

D. Corporate Objectives and Policies

• The Tricontinental board deliberately adopted a strategy of providing large loans and other credit facilities to a relatively small number of clients. The result was a high concentration of credit risk.
• The nature of the clients, and their entrepreneurial business activities, meant that, as well as being concentrated, the credit risk was often high.

• The board deliberately accepted high risk in the pursuit of high reward. The theory was that the high risk would be confined within acceptable limits by skilled managers and staff, and by appropriate supervision by the board. In the event, the performance by both management and board was less than adequate for the strategy which the board had endorsed.

• Tricontinental’s lending strategy relied heavily upon perceptions of security, spiralling asset values, takeout arrangements, and ‘name lending’, rather than upon a client’s cash flow and basic ability to repay.

• This strategy was so fundamentally dangerous that its prospect of lasting success was never strong. This deliberate strategy of exposing Tricontinental to concentrated high risk, in the pursuit of high reward, was one of the principal factors that contributed to the merchant bank’s collapse.

• Plans were made to slow down the rate of new or increased lending, to run-off or sell-down some of the existing exposure, and to promote growth in less capital-intensive areas of merchant banking business. None of those plans was successful, and pressure was repeatedly put upon SBV to provide more capital. There was thus a constant struggle for Tricontinental to confine the total volume of its lending to a balance sheet maximum gearing ratio of 25:1.

• Notwithstanding the plans, budgets and intermittent exhortations to bring Tricontinental’s total lending within specified limits, targets were not met. Effective steps were not taken by either the board or management to reduce the volume or concentration of Tricontinental’s lending.
One of Tricontinental’s besetting problems was its apparent inability to deny the requirements of its major clients.

The size of credit facilities made available to each client affected not only the rate of growth of the loan portfolio, but also the concentration of risk, as increasingly large loans were made available to a relatively small number of clients.

Attempts by SBV senior managers to limit the amount of lending by Tricontinental to any one client or client group, were quashed by Mr Moyle. Their proposals were not brought to the notice of the SBV board.

Mr Moyle agreed with Mr Johns that Tricontinental could not function effectively as a merchant bank lender unless it could make up to $100m available on a secured basis to a client group. This was equivalent to approximately 20% of the SBV group’s then capital base, and was the same limit which SBV applied to its own commercial lending.

In fact, Tricontinental had already advanced more than $100m to several clients, and did so to a much greater extent later. Thus $100m was not applied as a limit at all. (Nor was 20% of the SBV group’s expanding capital base.) Had a limit of that order been rigorously observed (including the refusal of extensions of existing facilities beyond that amount), the losses suffered by Tricontinental would have been substantially less.

Had Tricontinental’s lending been confined to a volume related to its own capital base, as distinct from the SBV group’s capital base, there would have been a dramatic reduction in the total of its losses - probably in the order of 90%, if a limit of 20% of its own capital base, and the proportion of loss to volume of lending actually experienced, are assumed. Mr Johns and Mr Moyle argued that such a constraint on lending would have made Tricontinental unworkable as a merchant bank. But the limitations imposed
need not have been so strict, and losses would still have been greatly reduced.

• The formal lending guidelines were sparse. There was extensive scope within them for the exercise of discretion and the making of unspecified exceptions. There was no upper monetary limit expressed for credit facilities to any one client, or client group.

• Lending for construction was permitted up to the lesser of 70% of 'on-completion' valuation or 80% of total construction costs. By definition the construction costs included land costs, capitalised interest during construction, and all professional fees. Lending for real property was permitted up to 65% of independent valuation for mortgage purposes before January 1988, and 65% to 85% after then. In some cases 100% of the cost of commercial real estate development projects, particularly those structured on a tax-effective basis, was advanced.

• Lending secured by debenture charge was permitted by guidelines with fairly minimal covenant criteria.

• Lending against the security of shares was permitted with minimal criteria before March 1987, and with scope for wide discretion after then. In fact the criteria were so sketchy as to provide little guidance at all.

• The requirement for a minimum times cover was without meaning in the absence of any prescription of the shares which might be accepted as security. It was even possible for major credit 'trading lines' to be approved by directors, with approval of the shares to be purchased, or otherwise offered as security, left to the discretion of the managing director.
A very important aspect of the inadequacy of the criteria for lending for shares was the lack of any prohibition upon accepting as security shares in a related company upon which the borrower relied for cash flow. If the borrower or the related company got into difficulties, then it was almost certain that shares held as security would lose much, if not all, of their value.

Although the guidelines (from March 1987) required that shares held as security should not exceed 5% of the share capital of the company to which they related, the guidelines permitted exceptions of an unspecified nature. The Commission found no instance in which this guideline was considered as a possible inhibition, let alone applied. There were a number of examples of high percentages of issued shares being held, when those shares were unmarketable and proved to be of little or no value.

The need for detailed and well documented lending criteria could well vary according to:

(i) the levels of skill and experience of management and staff,
(ii) whether internal control procedures and practices ensured that credit risk was properly evaluated and managed, and
(iii) whether the quality of the loan portfolio was carefully monitored.

But on any view the lending guidelines were inadequate. Their inadequacy was further emphasised by the shortcomings in Tricontinental’s analytical, approval and monitoring processes.

The inadequacy of the lending guidelines was a factor that contributed to Tricontinental’s losses, and for that the board is responsible.

Non-executive directors expected all persons exercising delegated authority below the level of directors to comply strictly with lending guidelines. The expectation extended to approvals by the managing director.
On the other hand, Mr Johns believed that he, and other holders of delegated authority, could depart from the guidelines, as they saw fit, in the exercise of their powers. He actively encouraged managers to solicit lending business and to present credit submissions without feeling constrained by guidelines. This approach inevitably filtered through to other staff.

This difference in understanding between directors and management was quite fundamental. It was partly the result of a failure by the board to make its intentions clear in the guidelines themselves. It was also partly the result of the attitude of Mr Johns, who was primarily concerned with Tricontinental's "ability to handle volume".

The directors were at liberty to depart from their own guidelines; they had a sufficient working knowledge of those guidelines.

There was no requirement in the guidelines that the directors should be informed of any proposed departure from guidelines in a credit submission put to them for approval, nor that reasons should be provided to justify the departure.

Senior management, lending officers and credit analysts did not attempt to ensure that the directors were specifically informed of proposed departures. Mr Johns was principally responsible for this.

When credit transactions did involve departures from the guidelines, in some cases the departures were discernible from the material in the credit submissions (ranging from the obvious to the obscure), and in some cases the departures could not be detected.

However, directors must have noticed many such unannounced departures in the submissions put to them for approval; so they were on notice that
transactions might involve departures, even though not specifically brought to their attention. They took no action to remedy this situation.

- Compliance with the guidelines was no guarantee of commercial prudence. This was because of their hollow nature. But there was likely to be even less guarantee in the event of departure from the guidelines.

- The most important issue is not whether directors complied with or departed from their own lending guidelines. It is whether they made their lending decisions upon proper information, and whether they tested that information against appropriate prudential criteria, and had proper grounds for satisfaction, before granting their approval for any particular transaction.

E. Approval of Credit Submissions

- The directors undertook an important function - the approval of all credit submissions for more than $6.5m. It was a heavy burden, and accounted for more than 90% (by value) of new or increased credit facilities provided by Tricontinental in the period 1986-1989.

- Four directors, or the three (and sometimes two) directors available "on the day", were required. Submissions were considered on a round robin basis. Consultation took place on some occasions, but most of the decision-making was done by directors acting individually, without the advantages of meeting and exchanging views and together making enquiries of the relevant executives.

- Approvals were communicated to management by each director. The transactions went to the next board meeting for 'formal confirmation', but in reality that was little more than a noting exercise.
Mr Johns participated in almost all approvals, but the effective result of the round robin system was that most of Tricontinental's lending was authorised by non-executive directors who were not sufficiently qualified to act alone, except for Mr Moyle and, to a lesser extent, Mr Ryan. The system deprived directors of the mutual support that was necessary to compensate for their individual limitations.

Directors referred in evidence to a heavy reliance on management in the preparation and presentation of submissions. This was a mistaken trust in the system. There was a lack of proper criteria for the assessment of credit risk, the influence of Mr Johns in pushing for volume of lending precluded balanced appraisal, and the submissions to directors were akin to selling documents, designed to ensure board approval. Urgency of preparation and quick turnaround by directors, were the hallmarks of the system.

The quality of the submissions was often poor. In some cases, omissions had the effect of misleading the directors. In many cases, necessary information was absent or deficient.

Major defects included the lack of critical evaluation, the absence of cash flow analyses and projections, and the paucity of other information relevant to credit risk. There was failure to include relevant information available in Tricontinental's own files (especially as to past default), or to update information that was obtained from the files.

There was heavy reliance upon security, but without adequate analysis of its real worth. The willingness to meet clients' needs led to loan structures which left Tricontinental poorly secured.

The transaction reports reveal how poorly the directors performed their task in approving those submissions. For the most part, inadequate financial information and analysis was accepted without question, and was acted
upon by directors. The situation is clearly distinguishable from one where non-executive directors may be entitled to rely upon information put to them by management, in the absence of reason for suspicion, to enable issues of policy to be determined. In this matter, Tricontinental's non-executive directors descended into the executive arena itself, and undertook one of the most important tasks.

- Each of the non-executive directors possessed substantial skills and experience in at least one or more areas of general banking, accounting or senior corporate executive management. In the circumstances, it is not necessary to test the limits of what might be expected of a director without any particular skills. The skills that each of these directors did have, were more than enough to ensure that they were capable of recognising obvious deficiencies in the credit submissions. The directors did not act competently when approving credit submissions.

**F. Monitoring of Credit Transactions**

- The standard of reporting to the board about the state of credit facilities was seriously deficient. To a large extent this reflected a deep reluctance by Johns to tell the board bad news - he would attempt to trade his way out of a situation rather than make appropriate and timely disclosure to the board. Omissions and errors included -
  (i) failure to report variation of facilities from the approved basis;
  (ii) failure to report breaches of security cover and other covenants to the board;
  (iii) provision of misleading information to the board regarding prospects of recovery of loans in default; and
  (iv) failure to report loans in default.

- As a result, directors were less fully informed than they were entitled to be. The lending reports gave the directors false comfort. The greatest dangers lay with the problem loans which were not reported.
The directors were entitled to rely upon the reports provided by management, in the absence of grounds to suspect that they were not correct.

However, following the stock market crash in October 1987, Mr Ryan had suspicions that the board was not getting the full story on problem loans. Mr Rawlins resigned in April 1988 because he felt that Mr Johns was not giving the board adequate information. Other board members had heard Rawlins’ complaints at board meetings, and Rawlins had discussed the matter privately with Mr Moyle. Defects which were readily apparent in credit submissions for new or extended transactions should have aroused suspicions about the standard of reporting on existing transactions.

Despite these grounds for suspicion, the board continued to accept both the written and oral reporting as generally satisfactory. Had the board probed, serious defects in reporting on credit transactions would have been revealed.

The absence of true and full information in the reports to the board contributed greatly to the failure by the board to take adequate and timely action to improve Tricontinental’s lending policy and operations.

The absence of information was primarily the fault of management, and in turn that was almost entirely the fault of the managing director, who directed the contents of most reports, and through whom all reports were filtered.

The board must also accept its share of the blame, due to its lack of perception and its generally compliant acceptance of inadequate reports.

**G. Investment Banking Transactions**

Category A transactions were entered into to finance the acquisition of
shares on behalf of clients, in circumstances where the identity of the clients was not to be disclosed. In providing this service the directors were motivated by the good profits that were to be made.

- Investment banking guidelines were extremely sparse and said nothing about the types of shares suitable for investment.

- Selection of shares, both category A and others, was left entirely to Mr Johns. He had no particular qualifications for the task and there is no suggestion in the evidence that he consulted anyone else in Tricontinental, or took outside advice, before making decisions.

- Mr Johns received no guidance as to the nature or extent of any arrangements which he could enter into in the case of category A transactions.

- The great bulk of transactions, by number, came within his delegated discretion. In those cases, credit submissions were simply records made after the event. Although directors were asked to approve only 8% of investment banking credit submissions, those did represent 31.6% by value.

- Directors probably approved all or part of seven out of the 30 identified category A transactions. Credit submissions provided the absolute minimum of information. This was particularly true in category A matters.

- Mr Johns reported on investment banking transactions at board meetings. Material before the board showed how particular shares were trading. In the case of category A transactions, Mr Johns disclosed the name of the client and the general nature of any special arrangements made.

- Documentation for category A transactions was poor, and in some cases there was no record of related agreements.
The directors appeared reluctant to put pressure on Mr Johns to keep better records, in spite of such recommendations from the auditors.

Mr Moyle sought assurances from time to time about the legality of category A transactions. He was content with assurances, and the directors generally showed no inclination to probe such issues.

The Commission recommends that one investment banking transaction, involving the shares of Windsor Resources NL, be further investigated by the Australian Securities Commission. In transaction reports 17, 18 and 19 it draws the attention of the ASC to certain other transactions, but without recommendation.

H. Liability of Directors

All directors of Tricontinental must take corporate responsibility for the failure of Tricontinental, with Mr Johns bearing the primary responsibility, and Mr Moyle bearing the greatest share of responsibility amongst other directors.

There are serious difficulties in establishing breaches of s229(2) of the Companies Code, on the criminal standard of proof beyond reasonable doubt.

Subject to the further investigation or consideration of the investment banking transactions referred to above, and except for other matters relating to Mr Johns that are referred to in the confidential fourth volume of this report, no proceedings should be taken against any of the directors under s229, or otherwise. The reasons for this are summarised in chapter 23.
CHAPTER 16 - THE RESPONSIBILITIES OF SBV'S DIRECTORS AND EXECUTIVES

- After SBV acquired 100% of Tricontinental, the SBV board kept clear of the day-to-day conduct of Tricontinental's operations.

- The SBV board did not, at any time after acquisition, give close consideration to the possible consequences if Tricontinental should run into major problems with its lending portfolio. This was because the SBV board received repeated assurances that appropriate prudential policies and practices were in place at Tricontinental and were working effectively. These assurances were given by Mr Moyle but implicitly supported by the other common directors - Mr Smith and Mr Morton - and SBV executives - Mr Carr and Mr Rawlins.

- The SBV board received brief monthly operational reports about Tricontinental. These were presented by Mr Moyle and covered profitability, liquidity, balance sheet aggregates, gearing and other items of interest.

- These reports did not cover such detailed matters as the identity of borrowers, the size of individual loans, total group exposures or the nature of security taken.

- The reports never suggested any serious difficulty with the quality of Tricontinental's loan portfolio, even after the stock market crash of October 1987.

- SBV board members received Tricontinental's annual reports. They also saw, from time to time, valuations of Tricontinental, and internal SBV reviews when additional facilities for Tricontinental were being considered. They no doubt saw occasional press reports also.
• All the SBV directors were well aware of Tricontinental's rapid growth in lending.

• The SBV board was not informed by Mr Moyle of the arrangement, discussed at the Tricontinental board, that Tricontinental could lend $100m, or 20% of the SBV group's capital base, to any one borrower or group.

• Individual SBV board members knew of substantial Tricontinental loans, but none of the non-common directors had a proper understanding of the extent of Tricontinental's exposure to particular groups. The very fact that it was operating with a gearing ratio of 25:1 indicated that it was relying to some extent on its ownership by SBV.

• The non-common directors did not know about Mr Johns' domination of Tricontinental's investment banking activities, or of any suggestions of the possibility of warehousing or insider trading. The Commission does not accept that those directors should have known of such matters.

• The common directors failed to give the SBV board a full and true picture of the state of affairs at Tricontinental. This was largely due to the fact that they were themselves ignorant of that true picture.

• Mr Moyle must accept primary responsibility for the assurances that appropriate prudential policies and systems were in place and operating effectively. This was an honest assessment on his part, but it was misguided. Mr Smith and Mr Morton acquiesced in these statements.

• The failure of Mr Moyle and the other common directors to seek SBV board approval of, or even to report to the SBV board about, the arrangement concerning a lending limit of $100m or 20% of the SBV group's capital base, was a serious and significant omission. It is difficult to believe that it was not deliberate, at least on Mr Moyle's part.
If the SBV board had been consulted on this matter, it is likely that there would have been a lively debate and, at least, some tightening of SBV controls over Tricontinental’s lending policies.

Amongst the non-common members of the SBV board, Mr Renard was conspicuously attentive to matters concerning Tricontinental. He asked the right questions at the right time, and received satisfactory answers. The Commission is unable to identify any point at which he failed in his duty as a director of SBV to take an appropriate interest in the affairs of Tricontinental.

The other non-common directors of SBV are entitled to take comfort from Mr Renard’s activities. They heard the issues which he raised at board meetings and are just as entitled as he to rely upon the answers he received.

CHAPTER 17 - THE PART PLAYED BY THE RESERVE BANK OF AUSTRALIA

The supervisory role of the RBA over SBV arose from a voluntary agreement entered into in 1986 by which SBV undertook to observe the RBA’s prudential guidelines, and to provide the RBA with relevant information.

The general supervisory role of the RBA was to preserve confidence in the stability and integrity of the banking system and protect bank deposits. Its role was not designed to protect banks from poor commercial decisions.

The RBA was aware that it had responsibilities, both to overseas authorities and to the Australian public, concerning the observance by State banks of prudential requirements.
• The State Government and its officers took considerable comfort from the prudential supervision of SBV by the RBA.

• The supervisory role of the RBA did not extend to merchant banks, and so did not focus directly on Tricontinental.

• However, prudential statements issued by the RBA were designed to provide guidelines to banks which would, among other things, govern their relationships with non-bank financial subsidiaries. The RBA recognised that such subsidiaries could represent a threat to the financial stability of their parent banks.

• The relevant Prudential Statement of the RBA, Statement G1, provides that the financial subsidiary of a bank should be prudently managed so that it has "undoubted viability" within the limits of its own capital resources.

• The RBA was, over a long period, concerned about the effect of Tricontinental's growth rate on the capital adequacy of SBV.

• The RBA was aware, as early as March 1988, that Tricontinental's large exposures relied on the SBV group's capital base, and that exposures to individual clients would be well in excess of normal standards. It sought no details of those exposures, but they were supplied in January 1989 in connection with the proposal to merge Tricontinental with Australian Bank Limited.

• The only action taken by the RBA to allay its concerns, before May 1989, was the seeking of appropriate assurances from the management of SBV. These were given.

• Any probing questions from mid-1986 onwards would have revealed that Tricontinental was permitted to lend to any borrower up to 20% of the
capital base of SBV. Some Tricontinental loans were even larger. If the RBA had known either of these facts, it would have taken action to dissuade SBV, or if necessary the State Government, from permitting such a situation to continue.

- In the light of its continuing concerns about Tricontinental, the RBA should have sought the necessary information to satisfy itself that Prudential Statement G1 was being observed. Its knowledge of Tricontinental’s rapid rate of growth should have led the RBA to doubt whether Tricontinental was being prudently managed within the limits of its own capital resources.

- While having sympathy with the difficult task of the RBA in the years following deregulation, the Commission believes that the RBA must accept some share of responsibility for the events leading up to the forced sale of SBV. It had seen the dangers, but was too easily satisfied by formal assurances.

CHAPTER 18 - ROLE OF AUDITORS, VALUERS AND ADVISERS

- The Commission has not attempted to determine whether Tricontinental’s auditors were negligent, or in breach of the terms of their contract, in the carrying out of their functions. This is the subject of proceedings in the Supreme Court.

- The Commission has found no evidence to suggest any failing on the part of property valuers engaged by Tricontinental. Any problems arising from valuations have been caused by misuse of those valuations by Tricontinental’s management.

- The Commission has not found any evidence of negligence in the work of accountants called upon to value Tricontinental at different times. Their views were based upon the material provided to them by Tricontinental, and carried appropriate disclaimers.
• One instance of possible negligence by a firm of solicitors has been considered by the Commission, but it has not been able to reach a firm conclusion on the material before it.

CHAPTER 20 - APPARENT LIABILITY TO MAKE RESTITUTION

• If the necessary facts were established, any of the former directors and executive officers of Tricontinental could be prosecuted, under s229(2) of the Companies (Victoria) Code, for failing to exercise a reasonable degree of care and diligence in their work. Section 229(6) and (7) provides for orders for compensation against defaulting officers.

• However, the former directors of Tricontinental and SBV are immune from any civil action for damages, or compensation pursuant to s229(6) or (7), by virtue of relevant State Bank Acts. So are any directors or officers of Tricontinental appointed after SBV was sold to the Commonwealth Bank.

• The former managers of Tricontinental who were not directors, but were 'executive officers', are capable of being sued for damages for failing to exercise a reasonable degree of care and diligence in their work. It would, however, be unjust to take such action when directors, including the managing director, are exempt.

• The Commission did not consider any question of auditors' liability. That is being dealt with in the Supreme Court.

• The Commission found no sufficient evidence of negligence by any other advisers or consultants of Tricontinental to lead it to recommend action for compensation.

• The Commission found no grounds for possible actions against directors or managers of borrowing companies for misleading conduct or breach of contract.
• Actions against borrowers and guarantors are in the hands of Tricontinental's advisers. The Commission has kept clear of such issues at their request.

CHAPTER 21 - RECOMMENDATIONS FOR LAW REFORM

• The Commission has no specific recommendations to make about amendments to corporations or securities law, but comments are made about proposals to amend s232(4) of the Corporations Law 1991, with particular reference to the decriminalisation of proceedings, and the role and duties of non-executive directors.

• Legislative changes are essential if Royal Commissions are in future to be able effectively to investigate matters which could involve criminal offences.

• The Commission recommends that consideration be given to enacting a Victorian Royal Commissions Act which would make compulsory the answering of a Royal Commission's questions - with appropriate safeguards. It could also deal with a number of procedural difficulties which face many Royal Commissions.

• Existing legislative provisions enabling Royal Commissions and Boards of Inquiry to serve summonses and other documents outside Victoria are inadequate.

• The Commission recommends that the present situation be examined by State and Federal authorities with a view to finding a more simple way of effecting service anywhere in Australia.
CHAPTER 23

CONCLUSIONS

23.1 This Commission was established because the total failure of Tricontinental, the State Bank of Victoria’s merchant bank subsidiary, led to the forced sale of SBV and a huge debt burden for the State of Victoria. Tricontinental’s losses in 1989-1991 totalled $2.667 billion - amounting to almost $630 for each man, woman and child resident in the State. The actual cost to taxpayers is currently estimated at $840m plus the loss of SBV.

23.2 Naturally, the government and people of Victoria wanted to know how this could have happened, and it was generally agreed that nothing short of a full public inquiry would satisfy the public’s demand for answers. Accordingly, the Commission was established and was given what appeared to be very full powers. Expectations were high that the Commission would be able to find the answers to all relevant questions.

23.3 In the event, the task has proved much more difficult than anyone envisaged at the outset. To begin with there were the unavoidable problems of time and cost. So far as time is concerned, the Commission was always expected to take more than a year to complete its task, but it was important that it should not take any longer than was absolutely necessary, because the State needed to put this economic tragedy behind it as soon as possible, so that it could forget recriminations and get on with the job of rebuilding its economy.

23.4 With regard to costs, to conduct a public enquiry, with all interested parties having the right to be represented and to cross-examine witnesses, and to have all those witnesses who were at risk of later legal actions properly
represented, necessarily created a cumbersome and expensive public face for the inquiry. In addition to this, a large staff of skilled lawyers, bank officers, accountants and other investigators was required to conduct the necessary detailed investigation into the merchant bank's activities over a number of years. All this made it inevitable that the direct costs of the Commission would be well in excess of $10m; but it was obviously important that the burden on the State of Victoria should not be increased any more than was absolutely necessary. The result has been that the Commission has decided to be selective in the areas of its inquiry. However, apart from putting aside the issues concerning auditors (see paras 3.10-18), the Commission is satisfied that it has dealt sufficiently with all the major issues. Most commentators have understood the difficulties which the Commission faced and have been reasonably sympathetic in their approach.

23.5 One particular difficulty of the Commission, which was not envisaged when it began, was its lack of power to require answers to possibly incriminating questions in public hearings. When the Commission was established, it was given powers under the National Companies and Securities Commission Act which would have enabled it to make use of the provisions of that Act to compel answers to incriminating questions. However, soon after it was established, that Act was repealed and replaced by the Australian Securities Commission Act, which gave no power for answers to be compelled in public hearings.

23.6 This did not become a problem until the former managing director of Tricontinental, Mr Ian Johns, was eventually called to the witness box. After giving some general evidence, he refused to answer questions on matters of detail on the ground that his answers might incriminate him. When his right to do so was challenged in the Supreme Court - in view of the comparatively innocuous nature of the questions asked at the point where the refusal took place - the Supreme Court took a very liberal view
of the rights of a witness and found, in effect, that Mr Johns did not have to answer any questions relating to his role as managing director which he did not wish to answer.

23.7 For these reasons, the Commission has not heard any detailed explanations of his conduct from Mr Johns, and it has only been able to complete its task at all by reason of the fact that the other directors and managers of Tricontinental did not shelter behind any such claim of privilege, and were prepared to submit to lengthy cross-examination about their conduct. The Commission recommends the enactment of legislation to prevent such claims of privilege against self-incrimination before a Royal Commission.

23.8 In the event, the Commission has not been seriously inhibited by Mr Johns' unwillingness to co-operate. It has received a wealth of evidence from all the other players on the scene, and the contemporary documents recording Tricontinental's transactions naturally speak for themselves. The Commission has therefore been able to reach firm conclusions about the various factors which together caused the collapse of Tricontinental. It has done so on the basis of sworn and detailed evidence, which has supplanted the rumours, gossip and assumptions on which early judgments of the situation were based.

23.9 In the first place, it has accepted that the economic environment of Australia in the 1980s played a significant part in events at Tricontinental. The deregulation of the banking and finance industries in the first half of the decade created a situation in which banks and other financial institutions were competing vigorously, and in some cases almost frantically, for a share of the market. This led to a concentration on profits, and the accumulation of assets in the form of loans, at the expense of the prudential considerations which had generally governed such institutions in the past. Banks, merchant banks and finance houses were no longer lending to approved customers who sought loans from them; they were out in the
market place selling products. Lip-service was still paid to the prudent management of risk; but many of them were, like Tricontinental in the words of one of its executive directors, "lending flat out".

23.10 It was easy for them to do so, and to find willing consumers of their products, at a time when share prices were constantly rising and almost any investment on the stock market seemed sound. Even when the stock market crashed, there were still ready profits to be made in property, which was booming as the investment emphasis switched away from shares. In these circumstances there were a number of businessmen who were anxious to indulge in high risk gambling with other people's money. They are the ones who have given the word 'entrepreneur' a pejorative flavour.

23.11 Tricontinental was not the only bank or financial institution to make a number of large loans which eventually could not be recovered. It has not been practicable for the Commission to make any detailed investigation of the lending practices, or the reasons for losses, of other financial institutions. No fair comparisons could be made without subjecting those institutions to the same sort of detailed inquiry which has occurred in relation to Tricontinental. The Commission could not have justified the cost or the intrusion involved. It is prepared to accept, in fairness to Tricontinental, that other institutions made many of the same mistakes.

23.12 However, two points need to be noted. The first is that common practice is not necessarily good practice or even acceptable practice. It may well be that, if some other institutions were subjected to the same detailed scrutiny as Tricontinental, their boards and managers might properly receive the same type of criticism which the Commission makes in the case of Tricontinental. Secondly, the fact remains, as evidenced by publicly
available figures, that Tricontinental's losses as a proportion of the total loan portfolio were of an order entirely different from any others.

23.13 Having noted the economic environment as providing at least a partial explanation for what happened at Tricontinental, but not an excuse, the Commission has then sought to identify the major causes of Tricontinental's failure. How did Tricontinental come to sustain losses in 1989-1991 amounting to 24 times its entire capital, which required it in 1990 to make provision for losses representing 62.3% of its loan portfolio? The Commission believes the answer lies very largely in the following propositions:

(i) Too much emphasis was placed on chasing market share - selling products in order quickly to become Australia's largest merchant bank.

(ii) The policy of high risks for high fees was taken too far.

(iii) There was an unacceptable concentration of risk - very large loans to comparatively few clients and, importantly, to a number of high-risk clients.

(iv) There was a dangerous emphasis on lending for share purchases and property development.

(v) In considering proposed loans, there was an undue emphasis on security, rather than on sources of servicing and repayment.

(vi) In spite of that emphasis, security was consistently of poor quality - of a type likely to dissipate if called upon - such as large parcels of shares in second-tier public companies related to the borrower, or over-valued debenture charges over assets of the company relied upon for servicing and repayment.

(vii) The approval process sacrificed quality for speed.

(viii) Credit submissions were part of the sales mechanism; there was no proper evaluation of risks.
23.14 Who then must bear responsibility for these and other mistakes? In the Commission's view the chief responsibility clearly rests with the managing director, Mr Ian Johns. It was his poor judgment, and exaggerated idea of his own abilities, which was at the heart of Tricontinental's failure.

23.15 Mr Johns elected to perform his task at Tricontinental as if the merchant bank were his personal property. He kept far too many of the day-to-day activities of the bank under his personal control, he treated his board of directors as a group of men to be placated and manipulated, rather than as a source of shared wisdom and shared responsibility. He ensured that there were no checks and balances which would inhibit him in the making of what he saw to be appropriate decisions.

23.16 It should be stressed that the Commission has not found that any conduct on the part of Mr Johns aimed at personal gain has contributed in any important way to the losses of Tricontinental. The Commission accepts that all those decisions of Mr Johns' which directly brought about the huge losses suffered by Tricontinental, were made by Mr Johns in the belief that they were in the best interests of the group. He believed that he knew what was required; he backed his judgment without consulting others; he made reckless decisions on inadequate information; he put his faith in many apparently successful businessmen who proved unworthy of his confidence; and when they seemed to be failing him, he was unwilling to admit the possibility of losses. These were the faults of an over-confident gambler, not of a criminal.

23.17 Even the instances where he misled or by-passed his fellow directors were cases, in the view of the Commission, where he was confident of his own judgment and did not want to have his plans interfered with by people who might not be prepared to take the risks which he deliberately - and indeed proudly - took. Because of difficulties of proof and, as a matter of discretion, because Johns believed he was acting in Tricontinental's best
interests, the Commission does not recommend that any of these instances should be made the subject of prosecutions under s229 of the Companies Code. The comparatively few instances in which it appears that he may have pursued his own personal interests, at a possible cost to Tricontinental, are dealt with in the confidential fourth volume of this report.

23.18 Mr Johns was, throughout his time as managing director, backed by the other managers who have given evidence before the Commission. While critical, at times, of his arrogance and intolerance, they supported him loyally and respected his business abilities. There is no persuasive evidence, in anything the Commission has seen, that any other of these managers was guilty of personal misconduct. Some of them have certainly been guilty of errors of judgment, sometimes amounting to negligence, but the Commission accepts that, at all times, they believed they were acting in the best interests of Tricontinental. They were carrying out the policies and practices of their managing director - which frequently required them to perform tasks or make decisions under great pressure of time. It is not surprising that mistakes were made. Although they were well paid, they worked very long hours and believed that what they were doing was what was required of them.

23.19 The manager against whom it could most strongly be alleged that poor decisions had serious results was Mr Ken Mountford. He has submitted himself to close examination on many different occasions and, in the opinion of the Commission, has done his best to be frank and open at all times. He has not, as some other witnesses have done, hidden behind an impenetrable wall of memory lapse. He has done his best to help with all transactions in which he was involved, and he has admitted frankly several instances in which he can now see that he made bad decisions. In the Commission's view, having allowed himself to be put through this very public ordeal, it would be quite wrong that he should be penalised further.
And if no action is to be taken against Mr Mountford, then it would be equally wrong to proceed against any other manager, such as Mr Hunter - who was also guilty of one serious lapse. They were all just doing what was expected of them by their managing director and, as they no doubt believed, the board of directors.

23.20 So far as the board itself is concerned, there can be no doubt that it must take corporate responsibility for the collapse of the company. It approved high risk lending strategies, regulated by inadequate guidelines. And although, as the Commission has found, the primary responsibility clearly lies with Mr Johns, and it accepts that, in principle, other board members were entitled to trust him, they cannot escape their share of the blame. To put the criticism at its lowest, they were too complacent. A board should not let a chief executive become a "one man band", to use the Tricontinental chairman's description of Mr Johns. Accountability, together with checks and balances, were the necessary elements which were sadly lacking at Tricontinental. For this state of affairs, both the managing director and the board were to blame.

23.21 Directors also, individually, approved too many dubious loans, often acting on inadequate information, for them to be able to hide entirely behind Mr Johns. They were aware that many of the loans they were approving exceeded the capital base of the Tricontinental group, and impinged upon the capital base of the parent SBV in a very serious way. However they took no special steps to satisfy themselves of the appropriateness of these huge loans. They also acquiesced in an investment banking system in which, in the most important cases, they saw almost no papers. In each of the category A transactions they were satisfied with an oral description, from the managing director, of the client and the underlying arrangement.

23.22 They accepted a lending system in which speed was all important; and they were called upon to give their individual approvals in the so-called 'round
robin’ system, which meant they had little opportunity to discuss any of the loans amongst themselves. The Commission accepts that there were times when one director would raise a possible matter of concern with another director, usually by telephone but, having regard to the whole of the evidence, and the practicalities of the situation, it believes that these contacts were infrequent. The Commission also believes that further questioning of the managing director or other senior managers by individual directors was just as infrequent, except in the case of Mr Ryan who spent a good deal of time at the Tricontinental offices.

23.23 The Commission also believes that there were relatively few occasions on which a transaction which had previously been approved by individual directors was usefully debated at a later board meeting. The directors acquiesced in a system which resulted in their seeing, at board meetings, only the name of each new or renewed borrower, the amount involved, and the nature of the security described in two or three words.

23.24 Although the evidence has shown that a number of significant loans were approved without directors seeing any documentation at all, or with approvals coming from only two directors in addition to Johns, the Commission was not told of any occasion on which a director at a board meeting seriously questioned a loan because it had not been submitted to him for approval or, if it had, it had been submitted to him orally without his sighting any relevant documents. The Commission believes that detailed discussions of loans at board meetings only occurred where there was interest in the particular borrower, and that such discussions were infrequent.

23.25 Of course the responsibilities of individual board members were not identical. For example, Mr Rawlins only served on the board until April 1988 and, while he was there, he asked a number of awkward questions - particularly about treasury matters, his own area of expertise. Although
he, in his time, approved a number of loans of doubtful quality, he was not called upon to the same extent as Messrs Moyle, Smith or Ryan; and it is to his credit that he finally rebelled against Johns’ cavalier reporting of doubtful loans, and resigned from the board.

23.26 The other executive director, apart from Mr Johns, was Mr Ziebell. He ran the administrative side of Tricontinental and generally stayed clear of the lending work. He did have some knowledge of investment banking transactions. It was his job to bring the results of those transactions to account, and it is clear that this, on occasions, led to some creative accounting. However, because his failure to become involved in the lending operations of Tricontinental was known and accepted by his fellow directors, he cannot be saddled with any direct personal responsibility for Tricontinental’s lending losses in particular cases. He must, however, accept his share of the unavoidable corporate responsibility of the board for the lending policies and strategies which it approved.

23.27 Although he was on the board throughout the relevant time, Mr Morton was another who was called upon to approve loans far less often than most directors. He says that he did not give any instruction that he was only to be called upon in case of necessity, and he does not believe that anyone else would have given that instruction on his behalf. However Mr Stott, who was responsible for distributing the loan submissions, insists that he did receive such a message, and the statistics make it clear that Mr Morton was not regularly called upon. This makes it surprising that he could maintain to the Commission that, after some months of getting to know the ropes, he saw all or most credit submissions and was never surprised by those appearing in the list presented to the board.

23.28 However, the Commission does not doubt Mr Morton’s honesty of belief, and it can be accepted that he had heavy responsibilities with his Rural Finance Corporation, particularly when he became responsible, in October
1988, for overseeing the dismantling of the failed Victorian Economic Development Corporation.

23.29 Because of his convenient position in the building, Mr Carr was often called upon to approve credit submissions. In fact he did so on several hundred occasions before becoming a full director of the board after Mr Rawlins resigned. He did so in his capacity as Mr Moyle's alternate director, whenever Mr Moyle was away or too busy to give attention to the submissions. The Commission does not doubt that Mr Carr approached his work as a board member conscientiously. But he was Mr Moyle's loyal deputy, and could not have been expected to do much more, as a board member, than support Mr Moyle's lead on policy matters, and act for him in his absence at the SBV board.

23.30 So far as Mr Ryan is concerned, it is clear that he had something of a head start on other directors because, in 1985, he spent some nine months as chief executive of Tricontinental. In the eyes of the board of SBV, Mr Ryan had a triple role while chief executive officer and managing director. His main function was to negotiate the best possible price for the purchase of the other shareholders' interests in Tricontinental. The second function which he was seen as performing was checking upon, and tidying up, the Tricontinental loan book. Finally, he had to carry out the ordinary functions of a chief executive officer, although he was only expected to play an interim role.

23.31 After giving a favourable reference for Mr Johns as his successor, Mr Ryan very properly spent the following year keeping in reasonably close contact with Johns and offering advice where necessary, both on individual loans and on other more general questions. After Johns asked him to back away, and let him run the business without having another director looking over his shoulder, Mr Ryan continued to visit the office regularly for the purpose, in particular, of reviewing credit submissions. In doing so he
quite often asked questions of Mr Johns himself, other managers or lending officers. The Commission accepts that, as time went on, Mr Ryan questioned more and more of the submissions put to him. However, on the several occasions when he decided to make an issue of one of them, he did not receive much support from other board members. Nor did he receive any support when he suggested that Johns' $6m discretion limit for loans should be reduced.

23.32 It must be said that Mr Ryan did his best to grapple with his responsibilities as a non-executive director of Tricontinental. And although having only fragmentary memories of most transactions, and being naturally defensive about his part in a number of them, Mr Ryan did his best to assist the Commission in each case. In the event he spent more time than any other director in the witness box. In spite of the fact that he has clearly been guilty of errors of judgment in a number of cases, the Commission, having considered his detailed evidence, accepts that he approached his task very conscientiously.

23.33 Mr Smith, the chairman of Tricontinental, acknowledged at the outset of his evidence that he had never really come to terms with the intricacies of merchant banking. He undertook the chairmanship at a time when he was recuperating from a serious illness, because it appeared that it would be less demanding than another chairmanship which he had held for SBV. In spite of his doubtful state of health, Mr Smith continued to hold a number of other demanding public and private offices throughout his time as chairman of Tricontinental. It is obvious, from a study of the list, that he could not have had much time to spare for Tricontinental beyond attendance at board meetings, and whatever time was necessary for the review of credit submissions.

23.34 It is clear from his evidence that Mr Smith had great faith in Mr Johns, and was not troubled by any appearance of arrogance or over-confidence which
was apparent to most other witnesses. This is no doubt one reason why Mr Johns, when he felt the need to discuss any matter with a director after 1986, usually chose either Mr Smith or Mr Moyle. It must be said that the chairman and the chief executive officer of the sole shareholder were obvious people for Mr Johns to confide in. However, Mr Ryan was deputy chairman and was more readily available than Mr Smith or even Mr Moyle, who were very busy men, so it seems likely that the main reason for Johns’ preference was that they were more supportive and less critical of him than Mr Ryan.

23.35 In the view of the Commission, the chairman of a board of directors has a special responsibility, if he or she is to be an effective chairman, to become more familiar with the workings of the organization than most non-executive directors. The role of chairman, with its additional fees - in this case $20,000 as against $15,000 for Mr Ryan (plus an allowance of $5,000 because of the additional time he spent), and $12,000 for Mr Morton (there were no fees for Mr Moyle or the other officers of SBV) - should not be accepted unless he or she is prepared to make the time available to get on top of the job. Merely being an efficient conductor of meetings is not enough.

23.36 The Commission was not able to place a great deal of confidence in Mr Smith’s evidence, because he had so little recollection of any of the transactions which he was said to have approved; and on at least one major and comparatively recent occasion - namely the vital SBV board meeting of 21 May 1989 - part of his evidence, which was given with complete confidence, was contradicted by other evidence including the written record, and the Commission has no hesitation in preferring that other evidence.

23.37 Turning finally to Mr Moyle, the Commission is bound to say that the heaviest responsibility for any failings of the board of directors, both as a
policy-making body and as supervisor of the chief executive officer, must lie with him. Although he gave evidence that he saw himself as, in effect, just another non-executive director, this was not the way he was seen by others. He was at all times the chief executive officer of the sole shareholder and so, naturally, other directors looked to him for guidance on all policy issues. This would be particularly true, of course, of Mr Rawlins and Mr Carr. In addition, he was the only director with extensive experience in merchant banking, an area in which he had, in fact, a high reputation.

23.38 Mr Moyle must accept full responsibility for the crucial decision that Tricontinental could lend against the SBV group’s capital base, up to the same level as SBV itself, in any particular case. He gave this authority to Johns in a personal communication, following its approval in principle at the Tricontinental board in July 1986. However, the meeting finished without formal resolution of the issue being recorded. It was never taken to the SBV board, and was not brought back to the Tricontinental board for further consideration as the SBV group’s capital base grew steadily.

23.39 Having thus put Tricontinental in a position in which it could prove to be, at least, an acute embarrassment to SBV, Mr Moyle should have kept a particularly close eye upon Tricontinental’s lending. Although it is clear from his contemporaneous notes that he did look at each credit submission with some care, and often noted particular questions, he seems to have been easily satisfied with the replies that he received. It was very rare for him to decline any loan - this of course was true of all directors, even Mr Ryan, who was most likely to raise queries. The fact remains that Mr Moyle approved a number of very large loans which, in the Commission’s view, even making due allowance for hindsight, should not have been approved.
There were other occasions on which he appears to have been weak when he should have been strong. The most obvious case was when Mr Rawlins took to Mr Moyle his concerns about Mr Johns’ approach to problem loans and other matters, and Mr Moyle simply told him that there was nothing he (Moyle) could do. In view of his position of influence as chief executive officer of the sole shareholder, this seems an inadequate response. The result was that he, faced with a choice between speaking seriously to Mr Johns about his attitude, or acquiescing in Mr Rawlins’ resignation, chose the easier course of permitting the resignation, and not informing the chairman and other directors of SBV and Tricontinental of the central reason for it.

It was Mr Moyle who, as Tricontinental minutes showed, frequently asked for assurances about the legality of Tricontinental’s investment banking activities. He also, on occasions, laid down guiding rules for the conduct of the company, including observance of prudential policies, which were carefully recorded in the minutes. It was also Mr Moyle who reported on Tricontinental at the regular meetings of the SBV board. One might have expected that, if there had been a strong chairman, he would have wanted to perform that task. In all these ways Mr Moyle was, in practice, making it quite clear that his was the guiding SBV hand behind the Tricontinental subsidiary. This was as it should have been. The Commission cannot accept that Mr Moyle was just another non-executive director of Tricontinental.

For these reasons, although all directors of Tricontinental must share some degree of blame for the total failure of the group, there can be no doubt that, amongst those directors other than Mr Johns, Mr Moyle must accept the greatest share of responsibility.

Mr Moyle was subjected, like Mr Ryan and to a lesser extent the other directors, to many days of rigorous examination in the witness box. The Commission is satisfied that he answered all questions honestly and to the
best of his ability. It does not doubt his integrity or the quality of his banking experience. The fact that, as chief executive officer, he presided over the collapse of an historic bank, must have been a cause of great concern to him. His health suffered seriously last year, and he was unable to return to the witness box when the final round of questioning was conducted.

23.44 In all these circumstances the Commission is firmly of the view that no useful purpose would be served by taking any form of legal action against Mr Moyle. For similar reasons, but primarily because they subjected themselves to the galling experience of having all their business judgments publicly questioned over a period of many months, and have suffered the critical judgment of this Commission, no action should be taken against the other non-executive directors of Tricontinental, or Mr Ziebell either.

23.45 It has been said by one media commentator that this Commission can only justify its cost if it produces blood or money for the people of Victoria. The Commission, however, believes that the people of Victoria are more intelligent and less vengeful than this view would suggest. So far as money is concerned, the new board of Tricontinental, along with a number of very competent solicitors and accountants, are pursuing all avenues of recovery; and the Commission has, at their request, been as careful as possible not to muddy the waters of future litigation for them.

23.46 With regard to blood, it is certainly true that the easiest course for the Commission to take would be to recommend widespread prosecutions. It would thus give an appearance of having ‘delivered the goods’, and avoid any possible allegations of waste or ‘whitewash’. But to do so would be unjust and would not advance the public interest.

23.47 The Commission has constantly to bear in mind that Tricontinental and SBV were part of the real world of business and finance. Judgments of
them must be based on what can realistically be expected of directors and managers by way of good business practices. The Commission has no wish to add to any pressures for unrealistic and unworkable standards to be applied, which can only have the effect of stifling initiative, and progress, in favour of 'safe' and unimaginative policies.

23.48 The important facts to emerge from this inquiry are that, disastrous as the Tricontinental losses have been, they did not result from government failures, an incompetent bureaucracy, official or commercial corruption, or indeed any behaviour that could fairly be called criminal. They were essentially caused by ordinary human failings, such as the careless taking of risks while chasing high rewards (in a decade noted for its commercial greed), complacent belief in the reliability of others, lack of attention to detail, and arrogant self-confidence in decision-making - all of which resulted in poor management and unsound business judgments.

23.49 The Commission has carefully considered all the many instances in which counsel assisting have submitted that action could be taken against directors or managers under s229(2) of the Companies Code, which provides a maximum penalty of $5,000 for a director or other executive officer who fails to "exercise a reasonable degree of care and diligence." These instances are set out in the transaction reports of volume 3. Having given such questions much thought over many months, the Commission finds itself entirely unpersuaded of the appropriateness of such action.

23.50 Directors and managers who lie and cheat, or who feather their own nests at the expense of the company they are supposed to be serving - or its clients or creditors - deserve to be prosecuted rigorously. Directors and managers who, in taking risks in the hope of increasing profits, make bad decisions in good faith, do not deserve to be treated as criminals, and pursued with all the powers of the state. This applies even if those decisions, when later closely examined, can be described as negligent.
Nor, in the view of this Commission, should the resources of the state be used to hound such directors or managers into bankruptcy through civil proceedings - at least in cases where all they have received from the company over time is the market rate for their services. Different considerations apply where a company has been bled white by unconscionable fees, or the diversion of its funds to other interests of the persons concerned. This question of civil proceedings is only presently relevant in the case of Tricontinental's managers. The directors are exempt from civil action by virtue of the provisions of the State Bank Acts. It would be anomalous and unjust for civil proceedings to be taken against Tricontinental's managers, when the directors of Tricontinental, and the directors and officers of SBV, are all exempted by statute.

23.51 Any attempt to punish the directors or managers, by seeking to prosecute them for failing to exercise a reasonable degree of care and diligence, could only produce, if successful, heavy legal costs on both sides and modest fines. It would not be easy to establish, on the evidence available, and on the criminal burden of proof beyond reasonable doubt, that any of their individual errors of judgment actually amounted to a breach of the Companies Code. The Commission strongly recommends against such action being taken, first, because there are many more serious cases of wrongdoing awaiting the attention of the prosecutors and the courts and, secondly, because the directors and managers, and their reputations, have suffered enough already.

23.52 The question whether proceedings under the Companies Code should be taken against Mr Johns is more difficult. His unwillingness to co-operate with the Commission deprives him of the strongest argument available to the other directors and managers. And his undoubtedly central role in all the decisions which led to Tricontinental's collapse makes him a prime candidate for prosecution.
However, the imperfect recollections of other witnesses, and the lack of important documentation in many transactions, mean that the problems of proof beyond reasonable doubt would be very great. There is a vast difference between the ability of this Commission to be comfortably satisfied about events, as the result of a wide-ranging inquisitorial investigation, and the satisfaction of a court of law beyond reasonable doubt on a specific issue, on the basis of narrowly focused, technically admissible evidence.

The Commission is specifically required to confine its recommendations for further proceedings to those for which there is sufficient technically admissible evidence. Moreover, the Commission believes that it should not make any such recommendations unless there appears to be a good chance of success. Added to these considerations are the high costs of prosecutions.

Further, as the Commission has explained, it is able to find some exculpatory factors even in Mr Johns' case - his youth, hard-working dedication to his job, and the dangerous situation he inherited - and the defects of character and judgment which led to his failure as a managing director do not give rise to criminal prosecutions in other walks of life. All these factors have led the Commission to recommend against the prosecution of Mr Johns under s229(2) of the Companies Code. Questions as to whether there may have been conduct of a more serious kind in breach of other areas of the law are dealt with in a confidential report in volume 4.

Turning next to the board of SBV, it is obvious that the comments made earlier about the three common directors of the two organisations, Messrs Moyle, Smith and Morton, are relevant again. In particular, Mr Moyle must bear responsibility for having deliberately permitted Tricontinental to lend up to 20% of SBV's capital base to any one borrower. He did so
without obtaining the express approval of the SBV board or, indeed, directly reporting to the board what he had done. It is true that the board collectively should have realized that Tricontinental was lending very large amounts which could not have been justified by reference to its own capital base. SBV board members were also aware of Tricontinental’s permitted gearing ratio of 25:1, which was at times exceeded. But it is reasonable to assume that, if SBV directors had been told expressly that Tricontinental was being permitted, and perhaps encouraged, to lend up to the same levels as SBV itself, there would have been some active debate on the subject and, even if they had allowed the arrangement to stand, SBV directors would have been much clearer in their own minds about the threat which Tricontinental posed. It is fair to assume that they would have taken a much closer interest in its activities.

23.57 Having had evidence from all the SBV directors, the Commission is confident that Mr Renard, in particular, would have been much more concerned than he already was if he had been given a truer picture of what was happening at Tricontinental. There is a very good chance that he, at least, would have insisted on much firmer action being taken to monitor the activities of the subsidiary and, in this, he would probably have received the support of at least some of his fellow directors including, very likely, the chairman, Mr Hancock.

23.58 In fairness to the board of SBV it must be remembered that they had determined to dispose of Tricontinental in mid-1987. It was outside circumstances, and the high price they were encouraged by valuers to ask for the group, which had prevented a sale taking place.

23.59 Although the board of SBV must accept some collective responsibility for the time it took them to reach this decision to sell, and for the lack of clear guidance to the subsidiary in the meantime, it is difficult to see that individual members of the board, other than the common directors, could
have done any more than they did. Mr Renard, particularly, raised a number of serious issues about which he pressed for answers. However the common directors, and Mr Moyle in particular, constantly reassured their fellow directors that all was well at Tricontinental. In view of Mr Moyle’s position and experience, there was no reason for other directors to try to go behind his assurances, supported as they were by Mr Smith from time to time and, at least implicitly, by Mr Morton.

23.60 Next, the Commission believes that the Reserve Bank, having undertaken to monitor the prudential practices of the State Bank of Victoria, failed to take sufficient action over its concerns about the viability of SBV’s subsidiary, Tricontinental, within its own capital resources. From 1986 onwards, SBV was in serious breach of the Reserve Bank’s prudential statement on this subject and the Reserve Bank knew, or at least should have known, that this breach was occurring.

23.61 The Reserve Bank denies, quite correctly, that it had any statutory responsibility for the affairs of SBV or of any merchant bank. But, given the fact of supervision by agreement (and the reasons for it), the Reserve Bank was cast in the role of watchdog of SBV, and it failed to perform that task adequately.

23.62 Finally, the Commission stresses that it has not considered the possible responsibility of auditors for Tricontinental’s failure. It has, in general terms, apportioned blame between the other parties to this financial tragedy. The degree of responsibility, if any, to be attributed to auditors will be determined in the courts. All that the Commission has found is that there was nothing in the communications from auditors which should have alerted Tricontinental’s non-executive directors to possible heavy losses in its lending portfolio, or to actual conduct in investment banking which was improper or illegal.
ACKNOWLEDGEMENTS

24.1 The Commission has, without exception, been well served by all the staff and consultants who have worked for it.

24.2 Counsel assisting, Mrs Susan Crennan QC, Mr Ian Sutherland QC, and Mr Anthony Howard, have been an effective and cohesive team. They have worked hard, often under considerable pressure, and have done promptly and very willingly everything that the Commission has asked of them.

24.3 Clayton Utz, under the guiding hand of Mr Brian Doyle as responsible partner, have proved to be an excellent choice as the Commission's solicitors. A considerable number of solicitors from the firm have worked for the Commission at various stages of its inquiry. It would not be appropriate to try to acknowledge them all by name, but one member of the team was of special value to the Commission. Mr Gregory Clifton brought to the task a very useful background in economics and accountancy in addition to his expertise in the law. The Commission gratefully acknowledges a particular debt to him.

24.4 The Commission also employed a substantial and efficient team of investigators - both accountants and lawyers - under the capable and energetic leadership of Mrs Noreen Megay. As with the solicitors of Clayton Utz, their work was largely behind the scenes, but the Commission came to recognise and appreciate their individual contributions when it conducted its private review of particular transactions.

24.5 There have been three secretaries to the Commission during its course, and each of them has performed his functions to the Commission's complete satisfaction. Mr Gerard Nooney had the difficult task of making all the
administrative arrangements to get the Commission started. He remained secretary for a good part of the Commission's duration. He was succeeded for a time by Mr Ted Johnston, and the task of winding up the Commission has fallen to Mr Graeme Horsburgh. The Commission is grateful to all of them for relieving it of most of its administrative responsibilities. The staff who have supported them in the hearing room, in the maintenance of records and in other duties have all worked cheerfully and effectively.

24.6 The Victorian Government Reporting Service has, as usual, provided accurate and timely transcripts of all the Commission's proceedings.

24.7 Finally, we would like to record our appreciation of the work of the several secretaries who, in addition to all their other duties, have worked their way through numerous drafts of our reports. We refer particularly to Felicia Amoroso, Eliza Causer and Margo Prophet, who worked directly for Commissioners, but also to Lois Djatschenko and Diane Gersch.

24.8 The Commission would also like to acknowledge the contribution of those counsel and solicitors who regularly appeared before it during its sittings. They all worked hard in their respective clients' interests, but at the same time they co-operated responsibly with counsel assisting and other Commission staff, to ensure the smooth running of the inquiry, without friction or avoidable delay.
APPENDIX 1

TERMS OF REFERENCE

To Inquire into and Report upon the affairs of, and transactions engaged in, by the corporations described in the Schedule hereto ("the Tricontinental Group") and, in particular, without limiting the generality of the foregoing -

1. Whether any person (which expression shall include any corporation) has committed any offence under or has contravened or failed to comply with the provisions of:
   (i) the Companies (Victoria) Code, the Securities Industry (Victoria) Code, the Futures Industry (Victoria) Code, the Companies (Acquisition of Shares) (Victoria) Code and corresponding legislation in the participating States and Territory; or
   (ii) the criminal law of Victoria or of any other State or Territory in the course of or in relation to the affairs of or transactions engaged in by any of the corporations in the Tricontinental Group.

2. Whether any officer of any of the corporations in the Tricontinental Group in the course of or in relation to the affairs of or transactions engaged in by any of the corporations in the Tricontinental Group has engaged in illegal, corrupt or improper activities or conduct or has acted in breach of any duty owed by that officer to any corporation in the Tricontinental Group.

3. What matters and events have caused or contributed to the present financial position of the corporations in the Tricontinental Group or to the financial losses suffered by corporations in the Tricontinental Group.

4. Whether any auditor, valuer or adviser to any corporation in the Tricontinental Group acted in breach of any duty owed by that person to that corporation in the Tricontinental Group or has made false or misleading statements or furnished false or misleading information to that corporation.
5. Whether the affairs, activities and transactions of the corporations in the Tricontinental Group were adequately or properly supervised, directed or controlled by:
   (i) officers of corporations in the Tricontinental Group;
   (ii) employees or directors of the State Bank of Victoria.

6. Whether any person appears liable to make restitution or pay compensation for loss or damage to any corporation in the Tricontinental Group or to the State Bank of Victoria.

7. Whether changes to the laws applicable to corporations or securities in Victoria or in any State or Territory should be made as a result of any of the matters ascertained in the course of the investigation into the affairs of and the transactions engaged in by corporations in the Tricontinental Group.

Unless the context otherwise requires the word -
   (i) "corporation" has the same meaning as that word is defined in s. 5 of the Companies (Victoria) Code, and includes a corporation that is in the course of being wound up or has been dissolved; and
   (ii) "officer" has the same meaning as that word is defined in s. 289(1) of the Companies (Victoria) Code.

Nothing in these Terms of Reference shall require an investigation into any transaction which has been made the subject of a criminal charge.

AND WE direct that any finding that any person appears to have engaged in conduct amounting to a criminal offence be made only on evidence admissible in a Court of Law, sufficient to place that person on trial for that offence.
AND WE direct you to make such recommendations arising out of your inquiry as you think appropriate, including recommendations regarding the changes to the law, if any, that are necessary or desirable.

AND WE do by these presents give and grant unto you full power and authority to call before you such person or persons as you shall judge likely to afford you any information upon the subject of this Our Commission, and to inquire of and concerning the premises by all lawful ways and means whatsoever.

AND WE declare that the powers of the Commission, at the discretion of the Chairman may, at any time, be exercised by any one or more Commissioners.

AND WE declare that you are authorised to conduct your inquiry into the matters mentioned aforesaid under these our Letters Patent in combination or together with:

(i) your appointments as inspectors pursuant to Part VII of the Companies (Victoria) Code;

(ii) your authorisations pursuant to s. 45 of the National Companies and Securities Commission Act 1979 of the Commonwealth and s. 12 of the National Companies and Securities Commission (State Provisions) Act 1981; and

(iii) any other appointments or authorisations you receive under the laws of the Commonwealth or of any State or Territory of the Commonwealth to conduct an investigation concerning the affairs of or transactions engaged in by corporations in the Tricontinental Group.

AND WE require you as expeditiously as possible to make your inquiry and to furnish -

(i) an interim report by 30 June 1991; and

(ii) a final report not later than 31 December 1991 or such later date as may be fixed

to the Governor of the State of Victoria.
AND WE will and command that this Our Commission shall continue in full force and virtue and that you shall and may from time to time and at any place or places proceed in the execution thereof, and of every matter and thing therein contained although the same be not continued from time to time by adjournment.

**SCHEDULE**

**NAME OF CORPORATION**

<table>
<thead>
<tr>
<th>NAME OF CORPORATION</th>
<th>PLACE OF INCORPORATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tricontinental Holdings Limited</td>
<td>VIC</td>
</tr>
<tr>
<td>Tricontinental Corporation Limited</td>
<td>ACT</td>
</tr>
<tr>
<td>Tricontinental Nominees Pty Limited</td>
<td>ACT</td>
</tr>
<tr>
<td>Tricontinental Securities Limited</td>
<td>VIC</td>
</tr>
<tr>
<td>Tricontinental Registry Service Pty Limited</td>
<td>NSW</td>
</tr>
<tr>
<td>Portview International B.V.</td>
<td>The Netherlands</td>
</tr>
<tr>
<td>T.C.L. International</td>
<td>The Netherlands</td>
</tr>
<tr>
<td>Finance N.V.</td>
<td>Antilles</td>
</tr>
<tr>
<td>Tricontinental Corporation (NZ) Limited</td>
<td>New Zealand</td>
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<tr>
<td>Tricontinental Futures Pty Limited</td>
<td>VIC</td>
</tr>
<tr>
<td>Tricontinental MBO Limited</td>
<td>VIC</td>
</tr>
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<td>Tricontinental Australia Limited</td>
<td>WA</td>
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<tr>
<td>Tricontinental Management Limited</td>
<td>VIC</td>
</tr>
<tr>
<td>Tricontinental Finance Corporation Limited</td>
<td>NSW</td>
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<tr>
<td>Tricontinental Leasing Pty Ltd</td>
<td>WA</td>
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<tr>
<td>Tricontinental Distribution Pty Limited</td>
<td>VIC</td>
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<td>Tricontinental Investments Limited</td>
<td>SA</td>
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<tr>
<td>Tricontinental Projects No. 1 Limited</td>
<td>VIC</td>
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<tr>
<td>Tricontinental Projects No. 2 Pty Limited</td>
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<tr>
<td>Tricontinental Projects No. 3 Limited</td>
<td>VIC</td>
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<tr>
<td>Tricontinental Projects No. 4 Pty Limited</td>
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<tr>
<td>Tricontinental Projects No. 5 Pty Limited</td>
<td>VIC</td>
</tr>
</tbody>
</table>
APPENDIX 2

ADDITIONAL TERMS OF REFERENCE

8. Whether there was dishonesty, impropriety, malfeasance or negligence on the part of any person;

9. Whether there was any failure on the part of any Minister of the Crown, officer or Government Department to conduct appropriate administration, supervision or monitoring; and

10. Whether Government policy caused or contributed to any losses incurred.
## APPENDIX 3

### WITNESSES AND DEONENTS WHO HAVE GIVEN EVIDENCE TO THE COMMISSION

<table>
<thead>
<tr>
<th>Witnesses</th>
<th>Principal Appointments at the Relevant Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adgemis, John Nicholas</td>
<td>Securities Officer, later Credit Analyst, Tricontinental</td>
</tr>
<tr>
<td>Atlas, Warren Nathan</td>
<td>Assistant General Manager Project Finance, Tricontinental</td>
</tr>
<tr>
<td>Baker, Ian George</td>
<td>Director of Finance, Victorian Treasury and Director, State Bank of Victoria</td>
</tr>
<tr>
<td>Birrell, Rodney David George</td>
<td>Secretary, State Bank of Victoria</td>
</tr>
<tr>
<td>Bray, Michael George</td>
<td>Accountant, employed by KPMG and predecessor firms, now partner of KPMG</td>
</tr>
<tr>
<td>Cain, Hon. John, MLA</td>
<td>Premier, State of Victoria</td>
</tr>
<tr>
<td>Caplice, Terrence Joseph</td>
<td>Director of Kolback Corporation Limited and Rebecca Fashions Pty Ltd</td>
</tr>
<tr>
<td>Carr, Raymond Maxwell</td>
<td>Deputy Chief Executive Officer, State Bank of Victoria and Director, Tricontinental</td>
</tr>
<tr>
<td>Casson, Barry John</td>
<td>Company Secretary of Dallhold group companies</td>
</tr>
<tr>
<td>Clark, Alistair David</td>
<td>Group Manager Credit, Tricontinental</td>
</tr>
<tr>
<td>Cooper-Thomas, Ronald James</td>
<td>Accountant, employed by KPMG and predecessor firms</td>
</tr>
<tr>
<td>Coutts, Claire Francis</td>
<td>Credit Analyst, Tricontinental</td>
</tr>
<tr>
<td>Cross, Michael Christopher</td>
<td>Director of Dallhold group companies</td>
</tr>
<tr>
<td>Donovan, Kevin Patrick</td>
<td>Director of Quatro group companies</td>
</tr>
<tr>
<td>Drieberg, Darrell</td>
<td>Director and shareholder of Oakwood Bond Pty Limited</td>
</tr>
<tr>
<td>Durlacher, John Peter</td>
<td>Financial Controller of Goldberg group companies</td>
</tr>
<tr>
<td>Dyring, David Ivan</td>
<td>Securities Officer, Tricontinental</td>
</tr>
<tr>
<td>Edwards, Malcolm Leslie</td>
<td>Managing Director of Essington group companies</td>
</tr>
<tr>
<td>Egan, Bernard Michael</td>
<td>Principal Research Officer, Reserve Bank of Australia</td>
</tr>
<tr>
<td>Witnesses</td>
<td>Principal Appointments at the Relevant Time</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Goad, Anthony Dennis</td>
<td>General Manager Administration, Tricontinental</td>
</tr>
<tr>
<td>Green, Douglas Edgar Wallace</td>
<td>General Manager Corporate Services, Tricontinental</td>
</tr>
<tr>
<td>Gurry, William Patrick</td>
<td>Managing Director, National Mutual Royal Bank</td>
</tr>
<tr>
<td>Hadley, David Frederick</td>
<td>Manager Regional Lending NSW, Tricontinental</td>
</tr>
<tr>
<td>Hancock, James Arnold</td>
<td>Chairman, State Bank of Victoria</td>
</tr>
<tr>
<td>Heffeman, Nicola Jane</td>
<td>Securities Officer, Perth, Tricontinental</td>
</tr>
<tr>
<td>Herscu, Jeffrey</td>
<td>Director of Hersfield Developments group companies and GSH group companies</td>
</tr>
<tr>
<td>Hill, Julian Christopher</td>
<td>Director and major shareholder of Markland House Limited</td>
</tr>
<tr>
<td>Hue Nguyen Ba Paul</td>
<td>Credit Analyst, Tricontinental</td>
</tr>
<tr>
<td>Hunt, Peter Francis</td>
<td>Director of DAC group companies</td>
</tr>
<tr>
<td>Hunter, Neil Edwin</td>
<td>Group Manager Securities, Tricontinental</td>
</tr>
<tr>
<td>Ironmonger, Dr Duncan Standon</td>
<td>Director, State Bank of Victoria</td>
</tr>
<tr>
<td>Isaac, John Anthony</td>
<td>Chairman and Managing Director of Coogal Properties Limited</td>
</tr>
<tr>
<td>James, Brenton Ronald</td>
<td>Accountant, employed by and later partner of Deloitte Ross Tohmatsu</td>
</tr>
<tr>
<td>Jeans, John Anthony</td>
<td>Consultant to Markland House Limited and related companies</td>
</tr>
<tr>
<td>Johns, Ian Malcolm</td>
<td>Managing Director, Tricontinental</td>
</tr>
<tr>
<td>Jolly, Hon. Robert Allen, MLA</td>
<td>Treasurer, State of Victoria</td>
</tr>
<tr>
<td>Kavanagh, John Patrick</td>
<td>Director of Quatro group companies</td>
</tr>
<tr>
<td>Scott-Kemmis, Leigh</td>
<td>Chief Executive Officer of BNZ in Australia</td>
</tr>
<tr>
<td>Leonard, Michael Allan</td>
<td>General Manager Corporate Banking, State Bank of Victoria</td>
</tr>
<tr>
<td>Maddison, John Stephen</td>
<td>Group Manager Credit, Tricontinental</td>
</tr>
<tr>
<td>McAnany, James Michael</td>
<td>Chief General Manager Corporate and International, State Bank of Victoria</td>
</tr>
<tr>
<td>Witnesses</td>
<td>Principal Appointments at the Relevant Time</td>
</tr>
<tr>
<td>------------------------------</td>
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</tr>
<tr>
<td>Matthews, Stephen Lewis</td>
<td>Director of DAC group companies</td>
</tr>
<tr>
<td>Morton, Ian Kenneth</td>
<td>Director, State Bank of Victoria and Director, Tricontinental</td>
</tr>
<tr>
<td>Mountford, Kenneth Wilson</td>
<td>General Manager Lending, Tricontinental</td>
</tr>
<tr>
<td>Moyle, Lindsay Gordon Crossley</td>
<td>Chief Executive Officer and Director, State Bank of Victoria and Director, Tricontinental</td>
</tr>
<tr>
<td>Nicholson, George Desmond</td>
<td>Financial Controller of Hersfield Development group companies and GSH group companies</td>
</tr>
<tr>
<td>Parisi, Deidre</td>
<td>Accountant, employed by KPMG and predecessor firm</td>
</tr>
<tr>
<td>Payne, Robin Keith</td>
<td>Accountant, employed by KPMG and predecessor firm</td>
</tr>
<tr>
<td>Pearce, Robert Ashley</td>
<td>Executive Director, Dallhold Investments Pty Limited</td>
</tr>
<tr>
<td>Perry, James Grimaldi</td>
<td>Financial Consultant and member of ASX</td>
</tr>
<tr>
<td>Pratt, Craig Darryl</td>
<td>Assistant Treasurer of Qintex group companies</td>
</tr>
<tr>
<td>Rasmussen, Bruce Douglas</td>
<td>Assistant Director-General (Finance), Department of Management and Budget, State of Victoria</td>
</tr>
<tr>
<td>Rawlins, John St George Delme</td>
<td>Chief General Manager Treasury, State Bank of Victoria and Director, Tricontinental</td>
</tr>
<tr>
<td>Renard, Ian Andrew</td>
<td>Director, State Bank of Victoria</td>
</tr>
<tr>
<td>Rigato, Antoinetta</td>
<td>Secretary employed by Cleary &amp; Hoare, solicitors</td>
</tr>
<tr>
<td>Rogers, Zulal</td>
<td>Credit Analyst, Tricontinental</td>
</tr>
<tr>
<td>Ryan, Fergus Dennis</td>
<td>Managing Partner, Arthur Andersen &amp; Co., Chartered Accountants, Melbourne</td>
</tr>
<tr>
<td>Ryan, Jack Francis</td>
<td>Director, Tricontinental, and Deputy Chief Executive Officer, State Bank of Victoria</td>
</tr>
<tr>
<td>Sanders, Peter James</td>
<td>Director of Red River Limited and related companies including Camsan Pty Limited</td>
</tr>
<tr>
<td>Witnesses</td>
<td>Principal Appointments at the Relevant Time</td>
</tr>
<tr>
<td>-------------------------------</td>
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</tr>
<tr>
<td>Sheehan, Dr Peter James</td>
<td>Director-General, Department of Management and Budget, State of Victoria</td>
</tr>
<tr>
<td>Smith, Neil Andrew</td>
<td>Chairman of Directors, Tricontinental, Chairman of Directors, Australian Bank Limited, and Director, State Bank of Victoria</td>
</tr>
<tr>
<td>Stott, Lynton Edward</td>
<td>Assistant General Manager Credit and Securities, Tricontinental</td>
</tr>
<tr>
<td>Thompson, Graeme John</td>
<td>Assistant-Governor Financial Institutions, Reserve Bank of Australia</td>
</tr>
<tr>
<td>Tilley, Gary Anthony</td>
<td>Accountant, employed by KMPG and predecessor firms</td>
</tr>
<tr>
<td>Torrens, Henry Ernest</td>
<td>General Manager, State Bank of Victoria and Director, Tricontinental</td>
</tr>
<tr>
<td>Venner, David</td>
<td>Securities Officer, later Credit Analyst and eventually Lending Manager, Tricontinental</td>
</tr>
<tr>
<td>Waldron, Mark Andrew</td>
<td>Credit Analyst, later Special Projects Manager, Lending Division, Tricontinental</td>
</tr>
<tr>
<td>Wallace, Brent Kelvin</td>
<td>Accountant, employed by KPMG and predecessor firms</td>
</tr>
<tr>
<td>Weaving, Peter Albert George</td>
<td>Retired banker, former Director and General Manager of Corporate Finance, ANZ McCaughan</td>
</tr>
<tr>
<td>Weir, Barry John</td>
<td>Accountant, partner of KPMG and predecessor firms</td>
</tr>
<tr>
<td>Wigginton, James Anthony</td>
<td>Assistant General Manager Lending, Tricontinental</td>
</tr>
<tr>
<td>Williams, David Gregory</td>
<td>Solicitor, employed by and later partner of Cleary &amp; Hoare</td>
</tr>
<tr>
<td>Wilson, Louise Ann</td>
<td>Accountant, employed by KPMG predecessor firm</td>
</tr>
<tr>
<td>Ziebell, Bruce Albert</td>
<td>Director, General Manager Administration and Company Secretary, Tricontinental</td>
</tr>
</tbody>
</table>
In addition, evidence upon affidavit from the following persons has been tendered:-

Brown, Stephen Andrew  Credit Analyst, Tricontinental
Brouwer, George Eugene Pascal  Secretary, Department of Premier and Cabinet, State of Victoria
Marsh, Peter Ronald  Commissioner, State Bank of Victoria
APPENDIX 4

TRANSACTIONS EXAMINED PRIVATELY

1. BARRINGTON LTD
2. CENTAUR MINING AND EXPLORATION LTD
3. DANDENONG VALLEY RETIREMENT VILLAGE PTY LTD
4. ELDERS RESOURCES LTD SHARES
5. EMAIL LTD SHARES
6. GENOA RESOURCES & INVESTMENT LTD
7. GRANFIELD PTY LTD
8. HARTOGEN ENERGY LTD
9. HUNTHILL HOLDINGS PTY LTD
10. INTEGRO INDUSTRIES LTD

INTERWEST GROUP:

11. Avram House Pty Ltd
12. Interwest Ltd (Gateway Hotel)
13. Interwest Ltd (syndicated facility)
14. Kabaskel Ltd
15. Magnetic Keys Ltd
16. Somerley Pty Ltd
17. N&B Estates Ltd Shares

18. KIMBERLEY SECURITIES LTD SHARES

KOLBACK GROUP:

19. Kulim Ltd Shares
20. Epoch Mining NL Shares
21. Arboyne NL Shares

22. MAGIC MILLIONS (HOLDINGS) PTY LTD
23. MILATOS GROUP OF COMPANIES
24. MONITUS PTY LTD
25. THE ONION STRING (1983) LTD

PETER LAURANCE GROUP:

26. Pivot Group
27. Q-West Pty Ltd

28. PLYMOUTH PETROLEUM RESOURCES NL SHARES &
    CORNWALL PETROLEUM CORPORATION NL SHARES
29. POWERSEAL (MIAMI) PTY LTD

RIGIL KENT GROUP:
30. Rigil Kent Ltd
31. Toskel Fisheries Pty Ltd

32. ROCHFORD PASTORAL COMPANY PTY LTD

RUSSELL HINZE GROUP:
33. Rosteph Pty Ltd

34. SKIMA IMPORTS AUSTRALIA PTY LTD
35. SMALLWOOD PTY LTD

SOLOMON LEW GROUP:
36. Premier Investments Ltd Shares

37. SOUVAN PTY LTD

Notes: (i) There were six other transactions reviewed but not named in the above list - see para 2 of Transaction Report 20, below.

(ii) Investment banking transactions, as distinct from loans, are indicated by use of the word ‘Shares’.
"Now that we have heard evidence of four different groups of transactions, involving over a dozen companies and many separate loans and extensions of loans, we feel that a pattern is emerging which, if it continues over the groups to be examined in coming weeks, may enable the Commission to conclude hearing evidence on central issues by the end of the year. At worst, there would be several weeks of evidence in 1992.

There is, in our view, little point in dealing in detail, in public hearings, with a long series of transactions which provide, in each case, a broadly similar picture. It is true that each case provides some extra insights into the respective roles of staff, management and directors of Tricontinental. But with each passing week there are fewer surprises and a clearer pattern is discerned.

It is the intention of the Commission, once it feels sufficiently confident that the picture is indeed becoming clear, to review privately a number of additional transactions, which have been examined by its investigators. Its purpose in doing so will be to see whether any of them raise new or significantly different issues which ought to be canvassed publicly. If they do not, the Commission will not advent directly to these transactions in its final report, but will be confident that the picture it then presents is fair and comprehensive. If they do, further hearings will be scheduled. One issue which the Commission will examine further on this basis is whether there is any cogent evidence to suggest that the losses of Tricontinental were, to any relevant extent, caused by bad decisions or negligent omissions by State Bank staff, management or directors in their handling of Tricontinental's affairs after the integration of the two organizations in May 1989.
The Commission recognizes that its proposed selection process will leave a large number of failed loans without public examination. However, the new management of Tricontinental, with its own teams of solicitors and accountants, will continue to pursue those cases in which it seems that, by legal action or negotiation, something can be saved from the debacle. Indeed, in a number of cases, counsel for Tricontinental has asked the Commission to steer clear of cases where public inquiry could muddy the waters of negotiation. The Commission has willingly done so because it is in the best interests of Victorian taxpayers that claims by and against Tricontinental be resolved on the best possible terms. Also, there are sufficient cases for the Commission to consider which would not prejudice any existing claims or negotiations.

As a result of the selective approach proposed, the Commission’s final report will probably be limited in its answer to the sixth term of reference -

"Whether any person appears liable to make restitution or pay compensation for loss or damage to [Tricontinental or the State Bank]."

The answers to these questions call primarily for a case by case review which is not suited to the necessarily cumbersome and expensive proceedings of a public inquiry.

It is against this background of diminishing returns from the analysis of particular transactions that the question arises whether the Commission should proceed further with its fourth terms of reference -

"Whether any auditor, valuer or adviser to [Tricontinental] acted in breach of any duty owed by that person [to Tricontinental] or has made false or misleading statements or furnished false or misleading information to [Tricontinental]."

It is clear that some evidence from and about Tricontinental’s auditors will be necessary. In order to determine the parts played by Tricontinental’s management and directors, it is necessary to know what instructions they gave to internal auditors, what questions they asked of both the internal and external auditors, and what answers they received. But this evidence is likely to fall a long way short of covering the duties the auditors owed under company law, in contract, under the laws of negligence, or under
Fair Trading legislation, in their respective roles as internal and external auditors; whether they fell short in the performance of any of these duties; and, if so, what the possible relevance of these shortcomings was to Tricontinental’s losses.

Counsel for the auditors have submitted that to investigate these wider issues properly would add some 25 weeks to the hearing time of the Commission. In our view this is a responsible estimate, but is probably excessive because it allowed the Commission to examine publicly the auditors’ role in some 16 groups of transactions. In the event, the Commission will probably examine publicly rather fewer groups. This could reduce the estimate to some 20 weeks. Counsel for Tricontinental suggested a figure of 12 weeks, but we believe that this does not allow sufficient time for expert evidence on both sides, additional examination and cross-examination about alleged errors and omissions in relation to each transaction selected for review by the Commission, together with those transactions singled out for special attention by Mr Fergus Ryan, the expert originally retained by Tricontinental and asked by the Commission to complete his inquiries for the purpose of giving evidence.

Allowance must also be made for additional time for final addresses on the issues involved and for the preparation of the relevant chapter or chapters of the Commission’s report.

We believe the additional time required would be not less than four months and the additional cost to the Victorian taxpayer - of the Commission (including its staff and premises), and of other counsel, solicitors and witnesses retained ultimately at public expense - would be several million dollars. And, as counsel have pointed out, after all that expenditure of time and money, there would be no finding of liability or quantification of damage. Only the courts can determine those issues.

On the other hand, counsel of the new management of Tricontinental has argued that the public has a right to know the full story as to why the group failed. The auditors are part of that story and, if the question of their liability were left to litigation the action might well be settled - perhaps on confidential terms - and the public would
never know. Furthermore, counsel pointed out, there is the specific term of reference relating to the auditors, along with valuers and others, and another concerning compensation for loss or damage to Tricontinental.

As against these substantial arguments as to where public interest lies, there are the equally important questions of cost and time. Although the time limit given to the Commission is obviously negotiable, it does indicate the Government’s general intention. It is clear that the sooner that basic questions concerning Tricontinental can be put to rest, the better for the economic health of Victoria. The longer the inquiry takes, the less value it has for the people of Victoria.

In the Commission’s view, the cost/benefit analysis of a detailed inquiry into the possible liability of Tricontinental’s auditors is a matter for the Government; but the Government is entitled to have the advice of the Commission before reaching its decision. That decision will take the form of an amendment to the Commission’s date for reporting and the provision of funding for the Commission in 1992. On any view, the Commission will need to be funded to the end of March, and that will probably extend to the end of April or into May. If the liability of auditors is to be examined, the earliest date for the final report would be the end of July, and this could extend as far as September. There would be a cost of several million dollars involved in such an extension.

The most costly outcome would be for the inquiry to cover the issue of auditors’ responsibility and, in spite of that, for the Supreme Court action later to go ahead. This is entirely possible, and in that event the total cost would be very great indeed.

It would be less costly if there were a full inquiry into audit matters, followed by a settlement of the Supreme Court action, on the basis of the Commission’s findings. The cost savings in not proceeding with the court action could be offset against
the cost of extending the inquiry. There is no guarantee, however, that settlement would occur in this way.

On the basis that the cost of the court action should be less than the cost of extending the necessarily cumbersome inquiry, the least costly of these alternatives would be for the inquiry into audit matters not to proceed but, instead, for the court action alone to proceed. We believe that the cost savings could be substantial. The cost would be event less, of course, if settlement were reached at some stage before completion of the court action.

In the Commission's opinion, the Victorian public would be most interested in knowing whether the management and boards of Tricontinental and SBV were responsible for having caused or permitted the massive losses to occur. The other matter of great public interest, the responsibility of ministers and senior public servants, has already been dealt with. The question of auditors' responsibility, although of considerable interest - particularly to the business community - is not a primary issue in determining responsibility for Tricontinental's losses. The primary responsibility must lie amongst those responsible for the running of the group.

It is notorious that there are a number of current proposed actions before the courts, both in Australia and in other common law countries, concerning the responsibility of auditors. They raise a number of difficult questions to which the auditing and legal professions and corporate regulatory bodies are also giving attention. It is questionable whether this Commission, conducted at the expense of the Victorian taxpayer, is the most appropriate place for the consideration of fundamental questions affecting the auditing profession. One example of such issues is whether it is appropriate for the same firm to conduct both the internal and external audits of a corporation.

In our view, the public would be content to know that relevant auditing issues were being dealt with by the ordinary processes of the law, and would prefer that the money saved was spent on some other area of great public concern. But, as we have
said, this is a question which should be decided by government. The Commission stands ready to undertake the task if the Government wishes to provide the necessary funding.

The Commission will ask that its reporting be extended to 30 April 1992, which should allow time for the Commission to consider those aspects of audit matters which bear upon the conduct of the directors and senior management of Tricontinental and SBV. This is the course which, in all the circumstances, the Commission recommends.

If the Government wishes the Commission to deal fully with all audit issues, it will be necessary to seek an extension of the reporting time of the Commission to 30 August 1992."
RULING ON FURTHER EVIDENCE BY MR JOHNS

31 January 1992

On the question as to whether any further steps should be taken to try to obtain evidence from Mr Johns, the Commission has now obtained and read the reasons for judgment delivered by Marks J on 20 January 1992 in the Supreme Court action of Attorney-General for the State of Victoria v Ian Malcolm Johns. It has also received general advice from counsel assisting, about the courses open to it.

Having given careful consideration to all possibilities, the Commission has decided not to make any further attempt to require Mr Johns to give evidence against his will. The reasons for reaching this decision can be summarized in the following way:

1. In the light of the reasons for judgment of the Supreme Court, there appears to be no way in which any further answers from Mr Johns, concerning particular transactions in which he was involved, can be obtained by the Commission using its powers under the Victorian Evidence Act. In view of the Commission’s timing constraints, an appeal against the Court’s decision is not thought to be practicable.

2. Wide powers of compulsory examination were initially granted to the Commission under the National Companies and Securities Commission Act, but those powers largely evaporated when the Australian Securities Commission legislation was enacted. This problem was adverted to by the Commission in its first report, at paragraphs 2.5 to 2.7.

3. The Commission is reluctant to use such powers of compulsion as it might now be able to obtain under the ASC Act. First, it is by no means certain that the Commission could effectively be clothed with the necessary ASC powers at this stage of its proceedings. An
attempt to obtain those powers would almost certainly be challenged in the courts, leading to unacceptable delay and wasteful expense. Further, the use of ASC powers could be represented as an attempt to evade the effect of a Supreme Court decision squarely based on principles of civil liberty.

4. In any event, an ASC type of hearing is unsatisfactory from the Commission’s point of view for a number of practical reasons. Chief amongst these is the requirement that a hearing must be held in private, there is also a widened prohibition upon later use of the evidence obtained, and there is no provision for cross-examination by individuals and companies who are likely to be vitally affected by the evidence given.

5. For reasons which appear good to Mr Johns and his legal advisers, he has chosen to forgo an opportunity to give his explanation of particular transactions. The Commission does not believe that it would be assisted materially by any process of compelling reluctant answers from Mr Johns. At this late stage, when a vast body of evidence has been received from other sources, the Commission could be further assisted only by the willing co-operation of Mr Johns in the Commission’s processes.

6. It should be added that the way remains open for Mr Johns and his legal advisers, along with other interested persons, to make such submissions to the Commission as may be appropriate in due course, concerning the conclusions to be drawn from the evidence that is before the Commission.
RULINGS ON APPLICATIONS BY MR JOHNS AND OTHERS
14 February 1992

1. On 6 and 7 February 1992, the Commission heard several applications made by Mr R Merkel QC, who appeared with Mr J D Hammond for Mr Ian Johns. At the same time it heard applications by Mr M A Dreyfus of counsel for David Syme & Co Ltd, Herald & Weekly Times Ltd and the Australian Broadcasting Commission. Most of these applications were heard in open session but several points, because of their sensitivity, were dealt with in closed session.

2. These applications have raised two issues -
(A) the publication and proper use of confidential transcripts and exhibits, arising out of Mr Johns' evidence about his financial resources, given at the special sittings held on 3 and 4 October 1991; and
(B) the publication and proper use of transcripts of Mr Johns' ASC examinations, conducted on various dates during the second half of 1991.

3. We think it is necessary, at the outset, to recall that everything said by the Commission and its staff in relation to issue (A), and the public tendering of most transcripts referred to under issue (B), occurred against the following background:-
(a) Until 11 December 1991 there was no suggestion that Mr Johns would not be giving substantial evidence about particular transactions engaged in by Tricontinental.
(b) All the discussions about legal assistance which the Commission or its staff had held with Mr Johns' legal advisers on the one hand and the Attorney-General's Department on the other, were based on the assumption that funding would be required to cover Mr Johns'
evidence over a number of weeks in the witness box. This implied that, provided funds were available for legal representation for Mr Johns, he would co-operate in the examination of Tricontinental's major lending facilities and other activities such as investment banking.

(c) As recently as 3 December 1991, counsel for Mr Johns, Mr R Wild QC, informed the Commission before Mr Johns began a week of general evidence, that Mr Johns was aware of his rights, aware that answers that he might give could be used for investigative purposes, and that he was conscious of section 229 of the Companies Code "and of further matters that may arise in the course of his evidence and allegations that may be put to him." Counsel went on, "Having said all of those things, he is anxious to co-operate with the Commission ..... and he intends, during the course of his examination, as far as he possibly can, to answer all questions put to him." Counsel noted, however, that "He can claim privilege in respect of certain of them." 

(d) Indeed on 10 December 1991, the day before Mr Johns made his claim of privilege in relation to all evidence dealing with transactions, counsel for Mr Johns informed the Commission -

".... my client has, since we were last here, been working busily, preparing himself in respect of the transactions, ..... With the best will in the world, Mr Chairman, he has been unable to properly prepare himself for examination today and the application that I make .... is that we have the day to further spend in preparation for that matter." Counsel then went on to say "I should say, Mr Chairman, so that we do not appear to be disingenuous, that there are other matters in respect of which our client is taking advice, other considerations which bear upon his appearance here, and we would use the time, if granted, to consider those matters carefully as well....".

This was the first hint which the Commission received that Mr Johns might object generally to answering questions on matters related to Tricontinental transactions.
A. Evidence given in closed session on 3-4 October 1991

4. The Commission notes the following matters with regard to this hearing:-

(a) The hearing involved a special sittings for a particular purpose. It arose from a letter from the Attorney-General's Department, dated 18 September 1991, addressed to Mr Johns' solicitor, which stated, among other things,

"I am writing to advise you that the Government has agreed to grant a legal costs indemnity to Mr Johns in respect of the legal representation at the hearings of the Royal Commission subject to the following conditions -

(a) as a precondition for the grant of legal representation, Mr Johns provide evidence on oath before the Commission of the financial resources under his control and as to any assets which he has disposed of or moved out of his control. This evidence will be examined by the Government to ensure that it is reasonable to fund Mr Johns' representation. If the evidence is not satisfactory, no legal representation will be provided."

Thus the sittings were not held at the instigation of the Commission, and it was clear that a number of matters would have to be dealt with which had no necessary connection with the Commission's terms of reference.

The Commission said at the time, in ruling that the session should be closed in spite of submissions to the contrary on behalf of the media, that the sittings were very special, and that some of the evidence would involve matters personal to Mr Johns, having nothing to do with the terms of reference. The Commission, at the same time, conceded that much of the questioning could prove to be within those terms.

(b) It is significant that the Commission was not asked to make any findings or recommendations on the subject-matter of the hearing - and did not do so. The evidence was to be studied by the Attorney-General's Department, which would reach its own conclusions and
make a recommendation to the Government. In order to assist in this process, counsel assisting the Commission prepared a summary of the evidence, but the only role of the Commission itself was to preside over the special sittings.

(c) Bearing in mind what has been said in paragraph 3 above, it was envisaged that all relevant material would be presented again, in convenient form, at a later public hearing. The Chairman said,

"Any matter which is in our terms of reference which may come out in the course of this morning's hearing will, of course, be raised again on another occasion. That may be done by further questioning when Mr Johns comes back to the witness box, or it may more conveniently be done by reference to passages in the transcript which we shall keep, although it will be a confidential transcript of the sittings which will follow."

(d) The letter of 18 September 1991 from the Attorney-General's Department appears to have been received by Mr Johns' solicitors on 23 September 1991, and the hearing took place on 3-4 October 1991. There was no great time to prepare for it.

(e) Because the hearing was a precondition of further funding, no objection to answer questions could be taken by counsel for Mr Johns, except on the ground that they were not relevant to his financial circumstances. Even an objection of that type could not be pressed very strongly. Because Mr Johns was a supplicant, he was in a vulnerable position. In particular, no objection could be taken on the ground that a question was irrelevant to the Commission's terms of reference, and it would not have been easy for Mr Johns to object to answering a question on the ground of self-incrimination. No such objection was taken, although there was at least one point at which it might have been.

In the light of the later objection, taken on 11 December 1991, to answer any questions concerned with Tricontinental's transactions (which objection was upheld in the widest terms by the Supreme Court) it now seems to the
Commission to be unfair - by reason of the matters set out in the previous paragraph - to make use of answers given in special sittings held for a different purpose. Counsel assisting relied on *In re Preston* [1985] 1 AC 835 and *Bunning v Cross* (1978) 141 CLR 54 for the proposition that evidence should only be rejected in a case such as the present if it had been obtained with an improper motive, by mistake of law or in circumstances giving rise to a contractual estoppel. We accept that there was no improper motive on the part of any of the officers of the Commission, nor was there any mistake of law or statements made or assurances given which could amount to an estoppel. However that is not the end of the matter. We believe the Commission has a responsibility to do what is fair in all the circumstances having regard both to the public interest and to the common law privilege against self incrimination. Stephen and Aickin JJ in *Bunning v Cross* at 77, stressed the importance of not constructing legal rules which would fetter judicial discretion to do what is fair in any particular case.

6. The Commission's solicitors, in correspondence, and counsel assisting in statements made at the time, both made it clear that they reserved the right to rely on evidence given to the special sittings for the general purposes of the Commission. Equally, it is clear that solicitors for Mr Johns challenged that approach and reserved their right to argue questions of wider admissibility at a later time. It is clear that the question of the later use to which evidence given at the special sittings could be put was left to be argued, if necessary, at another time. This was done because of the expectation that Mr Johns would soon be giving more detailed evidence about any matters that were relevant to the terms of reference, and the remainder of his evidence at the special sittings would then become irrelevant.

7. Since then, two significant events have occurred. The first of these was the claim of privilege made by Mr Johns on 11 December 1991, and the second was the upholding of that claim by the Supreme Court on 20
January 1992. In our view it would clearly be contrary to the spirit of that Supreme Court judgment to make use of the answers given at the special sittings, when Mr Johns had no real freedom of choice as to whether he would answer questions or not. Counsel assisting have urged on us that Mr Johns' chose to attend and give evidence at this time, that he did so for his own purposes - namely to obtain financial assistance - and that this "does not create the kind of unfairness which would preclude the Royal Commission from subsequently receiving that evidence." However the fact remains that Mr Johns' evidence would not have been given on this occasion except for his application for funding, which was made conditional upon his giving evidence as required.

Since we take the view that the evidence from the special sittings should not be used further before the Commission, it follows that it should not be published. We acknowledge the force of the argument by Mr Dreyfus that, except in special circumstances, evidence should be made public. That has been the principle followed by this Commission throughout its proceedings. But, upon weighing up the competing public interests involved, we conclude that the rights of the individual, in this case, must prevail. Accordingly, it is directed that no further use be made, for the Royal Commission's purposes, of the evidence given by Mr Johns at the special sittings on 3-4 October 1991. The transcript of those days, and the documents then tendered, will remain confidential.

9. Counsel for Mr Johns have challenged the validity of the examinations of Mr Johns conducted by members of the Australian Securities Commission ('ASC') staff seconded to the Royal Commission ('the Commission'), and the tendering and use of the transcripts before the Commission, on a number of grounds. [These were then set out.]
10. All these contentions have been strenuously opposed by counsel assisting the Commission, supported by other counsel. [Submissions by counsel assisting were then set out.]

11. Challenges to the conduct of the ASC examinations, and to the release of the transcripts to the Commission, involve the proper interpretation of the ASC Act and the application of that Act to the particular facts and circumstances of this inquiry. There is not sufficient evidence presently before the Commission to enable it to form a concluded view on these matters, but in any event, such questions could only be properly determined by proceedings in an appropriate court, to which the ASC was a party.

12. We note, in passing, that the Commission at all times accepted that, when conducting examinations, Mrs. Megay and the other ASC officers seconded to the Commission were acting as officers of the ASC. The Commission made no attempt to direct or influence them in the conduct of any ASC examinations.

13. It should also be stressed that, on the material available to us, we do not accept the submission put by counsel for Mr Johns that the ASC staff seconded to the Commission exceeded or misused the powers delegated to them by the Australian Securities Commission and by the Chairman of the ASC under sections 102 and 127 of the ASC Act, either in compelling Mr Johns to answer questions about specific transactions or in making the transcripts available to this Commission. However, for reasons which follow, relating to the issue of fairness to Mr Johns, we do not find it necessary for the purposes of the present application to pursue the question of ASC powers any further.

14. At the ASC examinations Mr Johns was not represented, nor did he seek legal advice about his rights concerning the power of ASC staff to conduct the examinations or to make the transcripts available to the Commission.
Mr Johns did not have his counsel present to re-examine him to clear up any possible ambiguities or misconceptions in his answers. (Nor was there opportunity under the ASC Act for counsel for other persons to cross-examine Mr Johns.)

There is nothing in the ASC Act to suggest that the person examined must be given an opportunity to be heard before a transcript or other information is released in accordance with the Act. There is evidence that Mr Johns received notification that the first ASC transcript, relating to the Atoll transaction, had been released to the Commission. There is also evidence that he did not turn his mind to the validity of the release or subsequent use of that or later transcripts, until the question was raised by his legal advisers in January 1992, at the time of the Supreme Court proceedings concerning the privilege claim.

In the proceedings before the Commission the transcripts were treated, in effect, like preliminary proofs of evidence. There were strong reasons to expect that the statements would be subsumed by detailed evidence to be given to the Commission by Mr Johns at a later date. However, the exercise of a claim of privilege after the tender of the transcripts resulted in evidence as to specific transactions not being given.

In the light of the subsequent events, it would have been better if the Commission had confined the tender of the transcripts to the tender of extracts on a confidential basis, pending the actual giving of evidence to the Commission by Mr Johns.

A vast array of material as to specific transactions has now been collected by the Commission's investigators from a wide range of sources and tendered in evidence. Having regard to the limited extent of the material contained in Mr Johns' ASC transcripts, we feel that in most cases they are now of marginal value for the Commission's purposes.
19. We have taken into account the submissions by counsel assisting based on Hamilton v Oades (above), and recognize that it is possible for the statutory scheme in the ASC Act to co-exist with the operation elsewhere of the common law privilege against self-incrimination. However, when we consider the next step as to what may be done with the results of the examination, we feel that the statutory ASC processes for compelling answers exist uneasily beside the lawful entitlement of Mr Johns to claim privilege in proceedings before the Commission.

20. We have already referred in paragraph 5 to the principles set out in Bunning v Cross. See especially per Stephen and Aickin JJ at 74 and 77. The extent of the claim of privilege made by Mr Johns against giving evidence to the Commission about specific transactions, and the strong endorsement of that claim by the Supreme Court, have in our view now created a situation where the public interest in the presentation of evidence lawfully obtained from Mr Johns under the ASC processes is outweighed by the unfairness to Mr Johns in using that evidence.

21. These difficulties faced by the Commission will be an appropriate subject for comment and recommendation by the Commission in its final report, concerning the statutory powers that need to be available to a body such as itself for the comprehensive and efficient conduct of a complex commercial inquiry. In the meantime, we have reached a clear view as to the ruling which ought to be made in the circumstances that presently exist.

22. It is ordered that no tender of further transcripts [of Mr Johns' examinations] will be accepted, and that there be no further publication of those already tendered and distributed. It is also ordered that no further use be made before this Commission of the transcripts already tendered. The latter order does not preclude counsel from relying on evidence that was given by other witnesses after those witnesses had been referred to extracts from the transcripts. Further directions may need to be given to
ensure the confidentiality of the extracts in question, during the course in final addresses of any submissions to the Commission based upon the evidence given by those witnesses.

23. It should be noted that the circumstances of this ruling are peculiar to Mr Johns. There is no similar inhibition in referring to the few ASC transcripts of statements by other witnesses which have been tendered as exhibits.
RULING ON APPLICATION BY MR. JOHNS

3 March 1992

1. On 25 February 1992 Mr. R. Merkel QC, who appeared with Mr. J.D. Hammond, made an application to the Commission on behalf of Ian Malcolm Johns. The terms of the application were set out in a letter dated 17 February 1992. In substance, the following rulings were sought:

(i) That the Commission will not make any findings adverse or prejudicial to Mr. Johns about the specific banking transactions examined by the Commission.

(ii) That no further use will be made by or before the Commission of any transcripts of evidence and documents ("the ASC material") obtained or produced by the exercise of powers pursuant to the Australian Securities Commission Act 1989 ("the ASC Act") and certain arrangements between the ASC and the Royal Commission ("the Commission").

(iii) That the Commission will not make any findings adverse or prejudicial to Mr. Johns about the specific transactions in reliance upon or as a consequence of the ASC material.

Mr. Merkel confirmed that the rulings sought were proposed as alternatives, in descending order of preference.

2. Submissions made in support of the application included the following contentions:

(i) The ASC material was obtained by the improper use of powers by the ASC. This was because the ASC used its powers for the substantial purpose of assisting the Commission to gather evidence.

(ii) The ASC staff seconded to the Commission did not have any powers validly delegated to them by the ASC, or alternatively they exceeded the powers that were delegated.
(iii) The Commission, through its officers, was a party to the improper use of powers by the ASC. This was because of arrangements made between the ASC and the Commission's officers for obtaining and using the ASC material.

(iv) The Commission was obliged to act lawfully, but by entering into the arrangements, and receiving the ASC material, acted unlawfully.

(v) By reason of these matters, the ASC material should not be used by the Commission to make findings adverse or prejudicial to Mr. Johns.

3. In order to explain the Commission's approach to this application, it is necessary to fill in some of the background. In the first place, the Commission's final report will, of course, be based upon the evidence it has heard from the witness stand, and the documents tendered in evidence.

4. Findings of fact must be made about the transactions examined in open hearings over many months. This cannot be done in a way which is fair to all parties, or indeed in any sensible way, without referring to the part played in those transactions by Mr. Johns, the managing director of Tricontinental. Mr. Johns, along with other directors and managers concerned, is at risk that "adverse or prejudicial" findings could possibly be made.

5. In reaching its findings, the Commission will be relying very largely upon documentary evidence from Tricontinental and SBV files, oral evidence from Tricontinental and SBV directors and staff, and other witnesses who dealt with Tricontinental. The great bulk of this evidence has been obtained and presented by using the ordinary powers of the Commission under the Victorian Evidence Act.

6. Oral examinations were made of a number of persons by the use of ASC powers, but use of the resulting transcripts in evidence in Commission
hearings was very limited. Apart from transcripts of examinations of Mr. Johns which have already been dealt with and eliminated by the Commission's ruling on 14 February 1992, tenders were made of ASC transcripts of examinations of Antoinetta Rigato (exhibit 342.20), John Hoare (342.21), David Williams (342.22), Jack Ryan (376.09), Peter Searson (424.3), Peter Laurance (424.4) and John Messara (430.5).

At all times counsel for the former directors and employees of Tricontinental and SBV (other than Mr. Johns) formally objected to the admission of the ASC transcripts (other than that of Mr. Ryan) and reserved their position to make submissions in due course on the use that may be made of the transcripts.

Miss Rigato and Messrs. Hoare, Williams, and Ryan were called as witnesses before the Commission, and they gave direct evidence about the matters dealt with in their ASC examinations. The transcripts of Messrs. Searson and Laurance were of no value to the Commission, and there was no point in calling them. Mr. Messara was not available at a time convenient to the Commission, and the particular subject matter of his examination was sufficiently covered by evidence given by Terrence Caplice.

It is clear that statements and documents obtained under ASC powers have been of assistance to Commission staff in their investigations and preparation of other material, including the compilation of many folders of relevant documents, and instructions for questions to be put by counsel assisting to witnesses in the Commission hearings. Although the ASC material comprises a relatively small proportion of the total material gathered by Commission staff, and an even smaller proportion of the material tendered in evidence in Commission hearings, we would nevertheless agree with Mr. Merkel's description of the material as being "inextricably interwoven with the general conduct of the Commission".
10. Attention has been directed to the fact that, in addition to the transactions reviewed in detail in public hearings, a number of transactions have been reviewed briefly in private by the Commission. The latter review was carried out in order to determine the nature of other available material and to enable the Commission to decide for itself whether any of those transactions raised new or significantly different issues which, in the Commission's view, ought to be canvassed in detail in public hearing. The intention to make this check, and the reason for it, were foreshadowed in the Commission's ruling on 10 October 1991 (see transcript, pp. 12,232-3). As a result, transactions relating to Kahmea (Skase Group) and Windsor Resources, Mid-East Minerals, and Metals Exploration (the Bond Group) were brought forward in public hearings. The rest of the transactions that were reviewed privately fell within the general pattern already established in the public hearings, and their consideration was not taken any further.

11. The Commission does not intend to base any findings upon the transactions which it reviewed privately, except to draw some statistical or methodological comfort from the conclusion that the transactions selected for detailed public examination over many months of hearings were properly representative of a larger number of transactions.

12. We consider that in relation to the present application nothing turns upon the private review of transactions referred to above, having regard to the limited purpose of that review. However, during the course of submissions, in which Mr. Merkel referred to Kioa v West (1985) 159 CLR 550, the Commission offered access to the material so reviewed, on a confidential basis, to the legal representatives of all participants in the proceedings, subject to the Commission first being able to obtain the necessary consent from the ASC for release of any ASC material that was included in the transaction documents.
13. Although it is said that this Commission has "been proceeding unlawfully by enabling its staff to act as staff of the ASC for the purpose of gathering evidence", the real attack by counsel for Mr. Johns has been on the ASC. Indeed the Commission has been asked to summon officers of the ASC to give evidence, and to subpoena documents from the ASC, in order to determine whether the ASC and its officers have exceeded their powers by, in effect, co-operating with this Commission in the obtaining of information about Tricontinental's dealings.

14. Its terms of reference clearly called for this Commission to work closely with the NCSC, and consequently its successor the ASC. As a matter of principle, it is entirely sensible and proper that investigating agencies with overlapping interests should work to assist each other and avoid duplication of effort and public expense.

15. The Commission made clear in its first report, dated 30 July 1991, particularly at paragraphs 2.7 and 2.45 to 2.46, how it was handling this aspect of its work. The report also indicated that the Commission was about to embark upon the detailed examination of specific transactions - see paragraphs 2.72 to 2.74. This present challenge to the use of ASC powers comes at an extremely late stage of the proceedings.

16. The Commission has no reason to believe that there has been any irregularity in the use of ASC powers by the officers seconded to it, or in the circumstances of their secondment by the ASC and the later delegation of powers to them by the ASC. In particular, we see no proper basis for the submission that the ASC could not use its powers in aid of the Commission's inquiry, given that the material in question related to matters which were in any event appropriate for investigation by the ASC itself, in accordance with its legislation. It must also be remembered that one of the functions of the Commission is to make recommendations as to whether proceedings should be instituted against any person or persons, in which
case the ASC would most likely be involved. The Commission regards all the ASC material as being, ultimately, subject to the control of the ASC. That material will remain within the control of the ASC when the Commission is wound up.

17. Even if the Commission were satisfied (which it certainly is not) that there had been an exceeding of power by the ASC or its officers, the question would remain whether the Commission could use information so obtained. There is clear authority that such information can be used even in a criminal prosecution - see R v Matthews [1972] VR 3, at 13-14 (a joint judgment of Adam, Gowans and Anderson JJ), and the cases there cited. As their Honours say, the obtaining of evidence by unlawful means is not a ground in itself for excluding the evidence. The test is "whether the admission of the evidence would operate unfairly. .... It is the use of the evidence, not the manner of its being obtained, that is the decisive factor. The fact that the evidence has been obtained irregularly .... does not conclude the matter". There should, in our view, be fewer inhibitions in the case of a Royal Commission, where the liberty of the subject is not in issue. There is further support for the view that evidence may be used despite unlawful acquisition, in Bunnin v Cross (1978) 141 CLR 54, especially at 64-5 (Barwick CJ) and 74-5 (Stephen and Aickin JJ).

18. To the extent that admissibility is a matter of discretion, it is relevant that, in the view of the Commission -

(i) any excess of power by the ASC or its staff was unwitting and carried out in good faith,
(ii) ASC material obtained as a result of any possible excess was of comparatively minor importance when viewed against the whole weight of evidence available to the Commission from other sources, and
(iii) the ASC material is (for all practical purposes) inextricably intermingled with unchallenged material.
19. It should also be noted that the Commission has concluded its hearing of evidence. Final submissions to the Commission are due to commence on March 24 or soon afterwards. After those addresses are completed, the Commission will then have, at most, seven weeks in which to prepare its final report, which is required to be made by 22 May next. These timings are very tight indeed and make no allowance for unforeseen contingencies.

20. Mr. Johns has received every consideration from the Commission throughout its hearings, and his claim of privilege against self-incrimination has been fully respected. However, we regard it as entirely inappropriate that the Commission should now embark upon an investigation of the powers and proceedings of the ASC and its staff. We repeat, the Commission has no reason to believe that there has been any irregularity in the use of ASC power. In any event, it is not within the province of the Commission to make definitive findings as to the purposes and proper interpretation of the ASC Act, the scope of the ASC's powers, or the propriety of the procedures carried out by the ASC or by its staff when exercising delegated powers. The Commission considers that its own conduct and that of its staff has been lawful in making arrangements for the receipt and use of material provided by the ASC and its staff, including staff seconded to the Commission. Further, the Commission is not prepared to assist the legal representatives of Mr. Johns in a fishing expedition designed to discover whether or not some alleged defect has occurred in the conduct of the ASC or its staff.

21. There is one final point. During the application, submissions were made about a particular transaction referred to by Mr. Johns on 4 October 1991 during evidence given in camera at the time of his financial means examination. On 14 February 1992 the Commission ruled that, as a matter of fairness, it would not act on that evidence. Mr. Merkel has now submitted that the nature of that evidence was such that the Commission could not make any findings or report concerning that transaction, which
were adverse or prejudicial to Mr. Johns. To do so, it was said, would offend against the 'apprehension of bias' principles, because a reasonable and fair-minded bystander could not expect the Commission to put the evidence in question out of mind.

22. Mr. Merkel referred us to the joint judgment of the High Court in Amoe v Director of Public Prosecutions (Nauru), delivered on 3 December 1991.

At pages 10-11 the court stated -

"From time to time, cases occur where the nature of the prejudicial material and its relationship with the issues which have to be decided is such that the appearance of impartiality is necessarily destroyed by a judge deciding the case after hearing or reading such material. In such a case, the prudent judge will disqualify him or herself from further hearing the matter, irrespective of the degree of confidence that the judge has in his or her ability to determine the case uninfluenced by the prejudicial material."

23. However, the court had previously noted at page 10 that in the case of a judge sitting without a jury, "it is only in the most exceptional case that a judge is required to disqualify him or herself because a prejudicial question has been asked or answered".

24. We consider that, when seen against the background of other relevant evidence, the nature of the questions asked of Mr. Johns and the answers given, and their relationship with the issues to be decided, were not of the exceptional character referred to in Amoe's case. Further, the Commission is confident that it will have no difficulty in segregating and disregarding the quite discrete evidence which has been put aside. Having regard to the composition of the Commission, it is reasonable and proper for it to proceed on that basis - Regina v Colchester Stipendiary Magistrate [1979] 1 QB 674, at 686. Any findings made by the Commission about the particular transaction referred to on 4 October last will be based entirely on other evidence. The alternative - making no findings at all on the matters touched on in the discarded evidence - would be a serious abdication of
responsibility. It will, however, be appropriate for final addresses in relation to the particular transaction to be held in camera, and for that aspect of the report to be confidential.