TRANSACTION REPORT 9
KAHMEA INVESTMENTS PTY LIMITED TRANSACTION

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A. Background and Summary

Kahmea Investments Pty Limited ('Kahmea') was the private investment company of Mr Christopher Skase. It owned 52% of the shares in Qintex Limited ('QL'), which owned 53% of the shares of Qintex Australia Limited ('QAL'). QAL conducted the various media and entertainment businesses of the Skase group. Kahmea received dividend and management fee income from QL, and QL received its income from QAL.

From 1984 Tricontinental provided a number of facilities to Kahmea, three of which were examined by the Commission:

Facility 1 - $9.06m to amalgamate existing facilities and provide $3.8m to enable Kahmea to acquire shares in QL. This facility was approved in October 1986, originally for a term of three years.

Facility 2 - $39m to enable Kahmea to take up its entitlement to convertible notes under an issue made to the ordinary shareholders of QL. This facility was approved in July 1987, originally for a term of three years.

Facility 3 - $4.5m to enable Kahmea to acquire further shares in QL as part of the strategy by Mr Skase to privatise the Qintex group. This facility was approved in March 1989 and expired on 31 December 1991.

In November 1988, the terms of facilities 1 and 2 were extended to expire on 31 December 1991 also.

The security for the facilities was almost exclusively in the form of shares or convertible notes in QL, which represented a shareholding in QL which far exceeded the percentage permitted as security under Tricontinental's guidelines. Personal guarantees were also given by Mr and Mrs Skase as security for facilities 1 and 3.

QL's and QAL's shares were suspended by the ASX in October 1989. Later, QAL was placed in receivership and QL went into liquidation. Kahmea failed
to meet interest payments to Tricontinental from October 1989. The Victorian Government has assumed from Tricontinental a debt of $52.56m.

B. Chronology

The chronology of relevant events is as follows:

1986
1 October Credit submission for $5.25m facility approved by Johns, Carr and Ryan (with Ryan’s approval specified to be subject to a "first mortgage over Dickson Terrace property")
9 October Johns, Carr and Ryan approved facility 1, which was an increase of the existing facility by $3.81m to accommodate an equity raising by QL
1 December Johns agreed to accept a deposit of certificates of title for the Dickson Terrace property, and additional shares, as security in place of the property mortgage

1987
26 June Letter sent to Kahmea by Johns confirming that Tricontinental was prepared to advance $39m (before board approval)
30 June Credit submission prepared for $39m facility (facility 2)
2 July Johns, Ryan, Moyle and Smith approved facility 2
28 August $18.7m drawdown of facility 2

1988
January The board noted the security cover shortfall on facilities 1 and 2
15 February Review of Kahmea completed showing security shortfalls:

$5.1m on facility 1
$3.3m on first tranche of facility 2
$6.6m projected on proposed second tranche of facility 2

18 February $20.3m drawdown of facility 2
3 November  Letter sent to Johns by Skase requesting an extension of all of the Skase group facilities to 31 December 1994
7 November  Johns instructed Clark to prepare credit submissions for extensions of the Kahmea facilities to 31 December 1994
24 November Ryan approved the extensions to 31 December 1991 only
30 November  Johns, Moyle and Carr approved extensions of facilities 1 and 2 to 31 December 1991

1989
16 January  Tricontinental returned certificates of title for the Dickson Terrace property to Skase

February  Skase's plan to privatise Qintex was discussed at board meeting

27 February  Johns asked Stott to prepare urgently a credit submission for a $4.5m facility to assist with the privatisation of QL (facility 3)

7 March  Credit submission for facility 3 declined by Moyle, Carr and Ryan

15 March  Credit submission for facility 3 approved on conditions: Carr and Ryan - subject to the $4.5m being a separate facility and share cover being maintained at a minimum of 1.25 times Moyle - subject to the above conditions and to a forthcoming reduction in overall group exposure

5 May  $0.5m drawdown of facility 3
31 May  $2.5m drawdown of facility 3 approved by Wigginton
15 June  Mountford approved a $1.5m drawdown under facility 3 and the release of QL shares held as security for facility 3 valued at about $1.4m

6 October  Letter sent to Skase group by SBV requesting that urgent action be taken to rectify the $39.6m security shortfall on facilities 1 and 2

November  Kahmea failed to meet interest payments
Notices of demand served on Kahmea for facilities 1, 2 and 3

C. Narrative

(a) Credit risk evaluation

Adequacy of financial information

The credit submission for facility 1, which was prepared in October 1986, relied on financial statements for the year ended 30 June 1984. The submissions prepared in June 1987 for facility 2 and March 1989 for facility 3 stated that financial information was not available. However, an annual return of Kahmea for the financial year ended 30 June 1987 had been lodged with the NCSC before approval of facility 3. It revealed that net tangible assets were $11.4m and that the company incurred an operating loss of $1.1m.

The submissions for all three facilities stated that servicing was to be from cash flow and repayment was to be from cash flow and/or refinance. Kahmea’s cash flow was from management fees and dividends from QL. The credit submissions did not evaluate Kahmea’s entitlement to receive these fees and dividends from QL.

Quality of security

The security for each facility consisted of shares or other equity interests in operating subsidiaries of the Skase group. As the assets of these subsidiaries were used as security for loans from other lenders, those lenders ranked ahead of Tricontinental for repayment of their loans. Mr Carr said that the fact that the underlying assets may have been encumbered to give security to other lenders would not be a matter about which he would seek information. He regarded that as a matter for the account manager to handle.

Mr Ryan did not accept that Tricontinental effectively provided facilities on an unsecured basis because, at the time they were approved, the security provided had a real value.
Departure from guidelines

Kahmea was required to maintain a minimum share cover to drawdown ratio of 1.25 times for facilities 1 and 3 and of 1.43 times for facility 2. The guidelines required cover of 1.3 times up to January 1988 and 1.5 times after January 1988. Shares held as security for the Kahmea facilities represented approximately 52% of QL's issued share capital, whereas Tricontinental's guidelines, after March 1987, stipulated that shares held as security were not to exceed 5% of the company's issued share capital.

(b) Failure to obtain a property mortgage as security

Mr Ryan's approval of a credit submission for a $5.25m facility in September 1986 was given on the condition that a first registered mortgage be obtained over the Skases' property in Dickson Terrace, Brisbane, the purchase price of which was approximately $1m. The credit submission for facility 1, which was prepared in October 1986, stated that a first registered mortgage over this property formed part of the security.

In December 1986, Mr Johns agreed to accept the deposit of the certificates of title to this property, and additional shares, as security in place of the mortgage. The certificates of title to the property were provided to Tricontinental, and the credit submissions prepared in June 1987 for facility 2 and November 1988 for extensions of facilities 1 and 2 recorded the security as a deposit of certificates of title rather than a registered mortgage.

Mr Ryan, in evidence, said that when he approved the June 1987 and November 1988 credit submissions, he did not recall that he had previously insisted on a registered mortgage. The certificates of title were in fact returned to Mr Skase in January 1989, at which time Kahmea was in breach of security covenants.

Mr Carr and Mr Ryan gave evidence that the changes made in relation to this security were never referred to the directors for approval. Mr Ryan said that he would have expected to have been consulted on the change of security, and
would have opposed the change if given an opportunity to do so. Mr Carr could not explain why the directors did not require the deposit of titles to be converted into a mortgage to give additional security when facility 1 was extended in November 1988. This was not required as a condition of approving the extension of the facility at that time. The explanation may lie in the fact that several facilities were extended at the same time, following a discussion about the Skase group as a whole. It appears that the security position of each separate facility was not studied.

(c) Power exercised by Mr Johns

Facility 2

Mr Johns sent a letter, dated 26 June 1987, to Mr Skase referring to "recent discussions" and confirming that Tricontinental would advance a $39m facility to Kahmea (facility 2). The credit submission for this facility was not prepared until 30 June 1987, and Ryan, Moyle and Smith did not approve the facility until 2 July 1987. Mr Ryan said that Johns had not discussed the proposed $39m facility with him before he received the credit submission.

Facility 3

On 14 February 1989, Skase wrote to Johns requesting a further facility of $4.5m to enable Kahmea to acquire a further 3% in QL. A credit submission dated 1 March 1989 was prepared. When Ryan, Moyle and Carr first considered this facility, they declined it. After discussions with Johns, however, they approved the facility subject to the following conditions:

• the facility was treated on a separate basis to the existing Kahmea facilities;
• share security cover was to be maintained at a minimum of 1.25 times; and
• approval was to be subject to a "forthcoming reduction in overall group exposure".

Mr Ryan said that he was persuaded by Johns to approve what appeared to be "a very strange submission". He thought Johns must have advanced a very
persuasive and logical reason for the approval, but could not recall that reason. Mr Carr believed he would have initially declined the facility because of Tricontinental's under-secured position. He could not recall his discussion with Johns about this facility, but was sure that Johns must have provided "very convincing arguments" in support of the facility, which Carr also could not recall. Mr Moyle did not give evidence in relation to Kahmea because of illness. He had earlier given his evidence about QL and QAL.

(d) Actions which increased Tricontinental's exposure and weakened its security after breaches of security covenants had occurred

Kahmea was in breach of security cover covenants after the stock market crash in October 1987. The internal review of Kahmea, which was considered by the board at its meeting in February 1988, stated that the facilities were not under-secured if the shares of QL were valued on the basis of the purported value of its underlying assets, rather than their market price. Mr Ryan said that the directors accepted that Tricontinental was under-secured due to the stock market crash, and had decided to rely on information about the future profitability and viability of the group - not the revised valuations. Mr Carr confirmed this and said that, despite the review, he valued the shares held as security according to their market price, although he acknowledged that the revised valuations could provide comfort for the directors.

February 1988 - drawdown of $20.3m

In January 1988, the board noted the security shortfall for Kahmea's facilities. According to the internal review of Kahmea there was, at 11 February 1988, a security cover shortfall of $5.1m on facility 1, $3.3m on the first tranche of facility 2 (which had been drawn down) and a projected $6.6m shortfall on the proposed second tranche of facility 2. This review was noted by the members of the credit committee and by Johns and was presented to the board at its February 1988 meeting. No action was taken at this time to prevent further drawdowns by Kahmea and, on 18 February 1988, Kahmea drew down $20.3m, being the second tranche of facility 2. Mr Ryan said that he did not
think the directors were aware of this drawdown in February 1988 and that, if he had been aware of it, he would have disallowed it.

The directors probably first saw the internal review at the board meeting on 24 February 1988, and therefore received the information about the proposed second tranche drawdown of facility 2 after it had occurred. However, the fact that there was a security shortfall had been noted by directors in January 1988, and they apparently made no complaint about the second tranche drawdown when they were told of it.

November 1988 - extension of Facilities 1 and 2 to December 1991

In November 1988, Mr Skase requested a six year extension of the facilities provided to the Skase group including Kahmea. Mr Ryan decided that it was appropriate to extend the terms for three years, but not beyond that. The credit submission for the extensions of the Kahmea facilities stated that the security cover shortfall for Kahmea was $23.5m.

Mr Ryan said that, according to Johns, the group was undergoing a reconstruction process; and the fact that the company had already reduced debt and was talking about the sale of other assets was consistent with this information. He said further that the extension of the facility was considered to be the best way of recovering the moneys advanced, that the company was in fact performing well, and the projections indicated that the loan would be serviced and reduced over three years. He acknowledged that the directors approved the extension of facility 2, which was a $39m facility, in the knowledge that Kahmea would have no real cash flow until the third year of the extension and would have to use resources from outside the company to service the facility. He said the directors took the view that the underlying viability of the group was such that it was better to continue the exposures and allow the borrower to trade out of difficulty than to call in the loans and sustain immediate loss. Mr Carr agreed with Mr Ryan’s evidence.
Evidence was also given by the directors about the extensions of all the Skase group facilities in November 1988. Ryan, Moyle, Morton and Smith said that, in the circumstances that existed in November 1988, the directors had no choice but to extend the facilities. Ryan and Moyle indicated that they believed the prospects of repayment would improve during the three-year extension.

January 1989 - Returning certificates of title held as security

The letter of offer for the extension of facility 1 had a handwritten note on it which read, "Titles to 26-36 Dickson Terrace in names CC Skase and PN Skase to be returned to CC Skase". The handwriting has not been identified. The certificates were returned to Skase under cover of a letter dated 16 January 1989 signed by Mr Gold, an employee in the securities department of Tricontinental. This property was later mortgaged to the ANZ Bank. There is no evidence that the board was informed that the certificates of title, which had previously been held as security for facilities 1 and 2, had been returned to Skase.

March 1989 - Providing a $4.5m facility

The credit submission for this facility noted the security cover shortfall of $31.5m. By the time this facility was approved, in March 1989, directors were aware that the Skase group could not repay its other facilities and they had been alerted to the group's shortage of cash flow and security.

June 1989 - Returning shares held as security

A memorandum from Dyring to Mountford, dated 15 June 1989, stated that a request had been received from Skase for an additional $1.5m drawdown on facility 3, against lodgment of an additional parcel of QL scrip. In the same memorandum, a request was made for the release of scrip not required to maintain a 1.25 times cover. The memorandum notes that approval for the release was required due to a shortfall of cover on facilities 1 and 2.
On 15 June 1989, Mountford approved the release of QL shares valued at about $1.4m which were held as security for facility 3 and which were in excess of the required cover for that facility. Mountford approved the release subject to a 5 cents per share buffer in respect of facility 3. Mountford was aware at the time of approving the release that the security shortfalls for facilities 1 and 2 totalled $33m. He said that the scrip was returned in relation to facility 3 only.

(e) Failure to take additional security or realise security provided

During 1988, security top-ups were requested and obtained. By 6 October 1989, however, the security shortfall on the Kahmea facilities totalled $39.6m. The value of the security held would have been about $27.5m. On that date, SBV noted the shortfall and requested Kahmea to "please act urgently to rectify this shortfall." The shortfall was not remedied. QL was suspended on the ASX before a demand was served by Tricontinental.

D. Role of Mr Johns

Mr Johns was the account manager for all the facilities provided to Kahmea. The facilities were margin lending transactions. Johns had a special relationship with Christopher Skase, who was the executive chairman of the Skase group, and he (Johns) had extensive involvement in the facilities:

(i) He received approval from Ryan for a $5.25m facility, subject to obtaining a mortgage over a property owned by Mr and Mrs Skase, and for facility 1, the security for which included a mortgage over the same property.

(ii) He signed the letter of offer for facility 1 dated 9 October 1986.

(iii) Later he noted, in a letter dated 1 December 1986, that it was acceptable for Kahmea to provide additional shares as security in place of the property mortgage, and for Tricontinental simply to hold the certificates of title for the property.

(iv) He stated, in a letter dated 26 June 1987, that Tricontinental was prepared to advance a $39m facility to Kahmea, although directors had
not approved the facility, nor had a credit submission been prepared.

(v) He signed the letter of offer for facility 2, dated 3 July.

(vi) He requested information from Kahmea about the value of its assets, by a letter dated 2 November 1987.

(vii) In reply, he received a report from Kahmea, on 2 November, indicating that the net asset value per QL share was $7.87, and proposing that Tricontinental adopt a minimum value of $6.00 per QL share.

(viii) He told Skase, on 10 November, that further information was required about the investments of QL, to support the $6.00 valuation of its shares.

(ix) He received valuations of the primary Qintex group assets from Skase on 7 December.

(x) He arranged for a credit submission for a facility for Kahmea, which was rejected at the January 1988 board meeting, to be presented again as an internal review, detailing "the true security position as based on intrinsic values".

(xi) He did not prevent the $20.3m drawdown of facility 2, on 18 February 1988, despite his knowledge of a security shortfall on that facility.

(xii) He noted the internal review of Kahmea on 24 February 1988.

(xiii) He received a request in a letter from Skase, dated 3 November 1988, for a six year extension of facilities 1 and 2, and asked Clark to arrange credit submissions as quickly as possible.

(xiv) He was informed by Clark on 24 November that Ryan was only prepared to approve a three year extension.

(xv) He noted a $26.9m security shortfall on the Kahmea facilities in a memorandum dated 23 December 1988, requested advice from Stott on their current position, and received that advice orally on 5 January 1989.

(xvi) He was told by Skase, in a letter dated 14 February 1989, of plans to privatise QL, and of Kahmea's requirement for a $4.5m facility to purchase 3% of the shares.
(xvii) He asked Stott on 27 February, to discuss the Qintex group exposure and arrange the urgent preparation of a credit submission for facility 3.

(xviii) Finally, he obtained approvals for facility 3, from Ryan, Carr and Moyle, after they had previously declined the facility.

E. Role of Directors

The directors who approved the credit submissions for the three facilities were:

(i) facility 1 (credit submission dated 3 October 1986) - Johns, Ryan and Carr.
(ii) facility 2 (credit submission dated 30 June 1987) - Johns, Ryan, Moyle and Smith.
(iii) extension of facilities 1 and 2 (credit submission dated 18 November 1988) - Johns, Ryan, Moyle and Carr.
(iv) facility 3 (credit submission dated 1 March 1989) - Johns, Ryan, Moyle and Carr.

At its January 1988 meeting, the board noted the security shortfall on facilities 1 and 2 and rejected another proposed facility for Kahmea. According to Mr Ryan, the information provided in the credit submission looked at during the meeting, on the value of QL shares, was based on the supposed intrinsic value of net tangible assets, rather than market price. Mr Ryan said that the board was informed by Johns that, because of the share crash, the market value of the shares had fallen and that Tricontinental was under-secured "across the group". Johns suggested that Tricontinental rely upon the underlying value of the assets, rather than market price. Mr Ryan said that the board rejected the concept of intrinsic value as a means of valuing the security.

The directors considered and approved the internal review of the Kahmea facilities at the board meeting held on 24 February 1988. As already noted, the review showed that the existing security shortfall on the facilities was
$8.4m and that the shortfall was anticipated to increase by $6.6m if the second tranche of facility 2 was drawn down. These figures were calculated using the market price of QL shares. The review also included calculations for the security position based on the supposed intrinsic value of net tangible assets, which indicated that Tricontinental's security cover was adequate.

In March 1988 Mr Moyle, being concerned at the level of Tricontinental's exposure to the whole Skase group, requested a review of that exposure. The review was prepared by Stott and Maddison and considered by the board in June 1988. Johns' covering memorandum said,

"The Group does not appear to be in as tight a situation as market rumours indicate ... Internal Revenue, as presented, is on an extremely conservative basis ...".

The board was provided, from time to time, with reports of larger facilities. The report as at 30 September 1988, indicated that facilities provided to Kahmea had security cover of 0.88 times against the required cover of 1.25 times for facilities 1 and 3 and 1.43 times for facility 2. The report indicated that the board had noted the security deficiency in January 1988, and the fact that the facilities were partly unsecured.

The board received the schedule of listed equities for margin lending as at 31 January 1989, indicating that from 16 October 1987 until 31 January 1989 the value of QL shares had fallen by 36.1%.

The board, at its meeting in February 1989, discussed Skase's plan to privatise QL.

F. Role of Management
(a) Mr Hunter

A letter dated 12 May 1987, addressed to QL and signed by Hunter, stated that the security for facility 1 included a deposit of certificates of title for the
Dickson Terrace property - not a mortgage of that property as stipulated in the letter of offer.

Certificates for shares which were to form security for the facilities were sent to Hunter. Persons in the security department, for which Mr Hunter was responsible, requested and received some top-up security.

One of the securities officers, Mr Gold, signed a letter dated 16 January 1989 with which the certificates of title for the Dickson Terrace property were returned to Mr Skase.

(b) Mr Mountford

As a member of the credit committee, Mountford recommended facilities 1, 2 and 3 and the six-year extension of facilities 1 and 2 (later reduced to three years).

Mountford also:

(i) approved a $1.5m drawdown of facility 3, and the release of QL shares held as security for that facility on 15 June 1989, knowing of a $33.4m security shortfall on facilities 1 and 2;

(ii) received summaries of Tricontinental's exposure and security positions for the Skase group facilities prepared by Mr Wigginton; and

(iii) made attempts in September 1989 to arrange a meeting between Tricontinental and Mr Skase and to obtain further financial information from the Skase group.

G. Significant Issues Arising

(a) The credit risk evaluation

Adequacy of financial information

Counsel assisting submit that the credit submissions relating to the Kahmea facilities did not provide sufficient financial information concerning the borrower to enable the directors to assess the creditworthiness and ability of the borrower to repay the facilities. Kahmea's entitlement to receive
management fees and dividends from QL, being its source of cash flow, should have been evaluated in the credit submissions. They submit that directors failed to exercise the degree of care and diligence required by s229(2) in approving the facilities without requiring such an evaluation to be undertaken.

Counsel for the directors submit that no case has been made against any of the directors or members of management to suggest that they did not exercise a reasonable degree of care and diligence in the exercise of their powers and the discharge of their duties in this matter. They argue that a failure to exercise prudence does not mean that there has been a failure to exercise a reasonable degree of care and diligence. They further submit that there was sufficient information provided in the credit submissions to enable the directors to assess the creditworthiness and ability of the borrower to repay the facility.

Quality of security

The security provided to Tricontinental for the Kahmea facilities consisted principally of shares in QL. Counsel assisting submit that a prudent director of a merchant bank would have required independent verification that the proposed security was adequate and likely at least to maintain its value. They submit that this is particularly so where the board had not formulated any appropriate policy and guidelines relating to margin lending, or lending with shares as security, and the proposed security comprised a large parcel of shares in a company within the same group of companies as the borrower. They submit further that directors, in approving the Kahmea facilities in these circumstances, and in failing to formulate and implement appropriate policies and guidelines, failed to exercise the degree of care and diligence required by s229(2).

Counsel for the directors submit that where the security consists of shares listed on the stock exchange, there is no requirement for independent valuation. Their submission also notes that, in any event, Mr Ryan, when approving the extensions of Skase group facilities in November 1988 (see TR
9), relied upon some projections of Potter Partners, which he thought indicated an ability both to service and to reduce the debt.

(b) **Failure to obtain property mortgage as security**

In relation to the failure to obtain mortgage security over the Skases' Brisbane property, counsel assisting submit that it is open to the Commission to find that both Johns and Hunter failed to exercise the degree of care and diligence required by s229(2) by agreeing to accept additional shares and the deposit of certificates of title as security, in place of a property mortgage, without first obtaining the approval of the directors.

Counsel for Mr Hunter submit that it is clear, on the evidence, that Mr Johns approved the substitution of additional shares in lieu of a first mortgage over the Dickson Terrace property without obtaining board approval. They further submit that this did not fall within the ambit of his discretion and was a matter which ought to have been referred to the directors.

They submit, in relation to Mr Hunter, that he was merely following the directions of Mr Johns and that it cannot be said that, as an employee following a direction of the managing director, he failed to exercise the care and diligence required by s229(2).

(c) **Confirmation of facility 2 by Mr Johns before directors’ approval**

Counsel assisting submit that Mr Johns failed to exercise the degree of care and diligence required by s229(2) when, before the directors had approved it, he told the borrower that facility 2 would be provided.

Counsel for the directors submit that this is a further example of Mr Johns carrying out his functions as managing director autonomously and without informing and obtaining approval from the board for his actions. In respect of the submission prepared later, they submit that it can be justified as a commercial transaction.
(d) Actions which increased Tricontinental's exposure and weakened its security after breaches of security covenants had occurred

February 1988 - Drawdown of $20.3m

In relation to the drawdown of $20.3m in February 1988, counsel assisting submit that the failure by Johns and the other directors to take action to prevent further drawdowns, after noting the security shortfall as at January 1988, amounted to a failure to exercise the degree of care and diligence required by s229(2).

In reply, counsel for the directors submit that the only matter brought to the directors' attention was the fact of the security shortfall in January 1988, one month before the drawdown was made under the facility. They submit that directors give approvals for a certain maximum amount and drawdowns occur within the approved maximum amount, presumably subject to a discretion being exercised by management. They submit it was the responsibility of management to ensure that, after approval, drawdown was carried out in accordance with the approval. In this case they submit that Johns, as account manager, was responsible for permitting drawdown to occur.

November 1988 - Extension of Facilities 1 and 2 to December 1991

Counsel assisting submit that the directors who approved the three year extension of facilities 1 and 2 did not exercise the degree of care and diligence required by s229(2), particularly having regard to the $23.5m security shortfall and their serious concerns about other Skase group facilities.

Counsel for the directors submit that the board, in exercising its commercial judgment, must look at the group as a whole, in so far as Tricontinental's exposure was concerned, and not deal in isolation with companies within that group. They further submit that the extension of the facilities was justified on commercial grounds, and was approved in reliance principally upon a verbal presentation by Johns, and after considering a comprehensive internal review of the Qintex/Skase group which contained financial information about the group.
January 1989 - Returning certificates of title held as security

Counsel assisting submit that Mr Hunter failed to exercise the degree of care and diligence required by s229(2) in returning the certificates of title, which had been held as security, to Mr Skase. They submit further that this fact further demonstrates the extent to which the absence of appropriate policies and guidelines contributed to Tricontinental’s losses.

Counsel for Mr Hunter submit that it is probable that the certificates of title were returned to Skase on the instructions of Johns. They submit that Johns was the account manager for Kahmea and that the release of security was his responsibility.

March 1989 - Providing a $4.5m facility

Counsel assisting submit that the directors who approved facility 3 failed to exercise the degree of care and diligence required by s229(2) in approving this facility, particularly as it increased Tricontinental’s exposure to the Skase group in spite of concerns which had been expressed by the directors since early 1988 about the size of Tricontinental’s exposure, its under-secured position, and the fact that the security shortfall on facilities 1 and 2 was $31.5m.

Counsel for the directors submit that, because none of the directors who gave evidence in relation to this matter could recall what they were told by Mr Johns in order to persuade them to change their minds and approve the submission, it is not open to the Commission to make any finding in respect of the approval of facility 3 in the absence of Mr Johns being called to give evidence and being cross-examined as to the circumstances surrounding the giving of their approval.

June 1989 - Returning shares held as security

Counsel assisting submit that Mr Mountford failed to exercise the degree of care and diligence required by s229(2) by authorising the release of security when he was aware of the security shortfalls on facilities 1 and 2.
However, counsel for Mr Mountford submit that it cannot be said that he was negligent without looking at his role and function, and the surrounding circumstances relating to the return of the shares and the various responsibilities that Mr Mountford had. They submit that no investigation was carried out by the Commission as to the position of the State Bank and the management structure after May 1989, or as to the responsibilities that Mr Mountford had and his workload after that time.

(e) Failure to take additional security or realise security provided

Counsel assisting submit that, given the extent of the security shortfall and the length of time for which the shortfalls existed, enforcement action should have been taken before November 1989. They submit that the directors failed to exercise the degree of care and diligence required by s229(2) in failing to ensure that enforcement action was taken in cases of serious and persistent breaches of security covenants.

Counsel for the directors submit that there is no evidence as to what events took place after May 1989, or what communications took place between the relevant parties. They submit that it may be that it was impractical to take enforcement action, and this was a matter properly taken into account, having regard to what information was given to Tricontinental and the position of the Skase group. They submit, therefore, that there is no evidence to suggest that the directors failed to exercise the degree of care and diligence required by s229(2) in failing to ensure that enforcement action was taken in cases of serious persistent breaches of security covenants. They further submit that, in any event, the directors were entitled to assume that appropriate action would be taken by management.

H. Conclusions and Findings

This transaction provides another example of Mr Johns' willingness to agree, on behalf of Tricontinental, to almost anything asked of him by an established client, and his ability to persuade directors to his point of view, even against
their better judgment. He was so confident of their agreement that he anticipated their approval of facility 2.

64 The way in which Johns ignored Mr Ryan’s specific requirement that the security taken should be a first mortgage over named property, provides another clear example of his deliberately exceeding his authority.

65 The provision of facility 3 was, in all the circumstances, an extraordinary proposal by Mr Johns. It is difficult to imagine what he could have told directors to persuade them to agree to it.

66 There is also evidence in this case of a number of the other besetting problems of Tricontinental:

(i) inadequate analysis of the source of servicing and repayment of the loan,

(ii) acceptance, by way of security, of large parcels of shares in the operating company which were likely to prove of little value if the security ever had to be called upon,

(iii) failure to act upon serious security shortfalls, and

(iv) the allowance of further drawdowns, and release of some useful securities, after alarm bells (in the form of large shortfalls of security) were ringing.
TRANSACTION REPORT 10

THE MARKLAND HOUSE GROUP

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A. **Background and Summary**

(a) **Markland House**

Markland House Limited ('Markland House') (incorporated as Leighton Mining NL in 1985) was an investment company publicly listed in Perth, Western Australia. The company specialised in merchant banking and property developments. Its major shareholder was Mr Julian Christopher Hill (21%) who was also chairman and chief executive officer. Other major shareholders were Bond Corporation Holdings Limited (15%) and Mr Brian Coppin (20%). Mr Michael John Wilkins was a financial manager and a director from April 1989. Mr John Anthony (Tony) Jeans was a consultant to the group.

Markland House had interests in a number of companies, including:
- Merchant Capital Limited ('Merchant Capital') (60%), an unlisted merchant bank; and
- Yalfa Investments Limited ('Yalfa') (62.5%), a second board listed investment company.

In December 1987 Markland House purchased 50% of the shares in Coogal Properties Pty Ltd ('Coogal'), a property development and project management company. The remaining 50% interest in Coogal was held by Cadalso Pty Ltd ('Cadalso'), a company representing the interests of Mr John Anthony (Tony) Isaac and his wife.

(b) **Ramuz**

Ramuz Pty Ltd ('Ramuz') was incorporated in New South Wales in February 1988. It was a wholly-owned subsidiary of Coogal and used as a special purpose borrowing vehicle for a $19m facility granted by Tricontinental in October 1988. At that time the directors of Ramuz were Messrs Isaac and Wilkins. The facility was to finance the site acquisition and initial development of a 42-storey 'Atcherley' hotel in Brisbane. Although initially capped at $17m, full drawdown of the facility was
permitted following Tricontinental’s integration with SBV in May 1989. Later the facility was increased to $21.35 m.

(c) Summary

The Commission’s examination of the Markland House transaction has involved consideration of a number of significant matters. These include:

(i) Tricontinental’s attitude to the provision of a major loan at a time when it was undergoing its own liquidity crisis;

(ii) Tricontinental’s response to the borrower’s desperate financial position, particularly its need for urgent financial support;

(iii) apparent inadequacies in the process of credit risk analysis;

(iv) the alleged taking of insufficient security, particularly Tricontinental’s undertaking to finance part of that security;

(v) the apparent failure of management to provide approving directors with adequate information about the proposed loan;

(vi) directors’ approval of facilities in the absence of any or any adequate credit submissions;

(vii) increasing an agreed facility so that Tricontinental could sell off some non-performing assets to the borrower;

(viii) the allegation that Tricontinental management subjected the Markland House group to unwarranted pressure and duress which forced the borrower to enter into a second facility agreement for $9 m so that it could purchase Tricontinental’s non-performing assets;

(ix) the suggestion that the method of selection of those assets was improper and that fees or other benefits were secretly provided by Tricontinental to a third party involved in setting up the deal;

(x) the allegation that Tricontinental committed itself to continuing support of Markland House, which support it failed to provide;

(xi) the suggestion of collusion between Markland House, Tricontinental, Essington and Jeans in negotiating the facilities and failing to include Isaac in such negotiations;
(xii) the assertion that Tricontinental was committed to take up an equity position in Coogal on default by Markland House and that this was concealed from the directors of Tricontinental;

(xiii) the contention that SBV failed to act properly and decisively in its handling of the Markland House and Ramuz facilities after default;

(xiv) the contention that a belated credit submission was intentionally drafted in such a way as to mask the true purpose for which part of the facility was to be used, and that it omitted significant information concerning Tricontinental’s agreement to finance part of the security - matters, it was said, which gave rise to the commission of offences against s229(1) of the Companies Code (‘the Code’); and

(xv) the contention that management in recommending the proposals, and directors in approving facilities, failed to exercise a reasonable degree of care and diligence, contrary to s229(2) of the Code.

The Markland House transaction may be shortly summarised. Tricontinental agreed to lend $6m to assist the Markland House group, which was experiencing short term liquidity problems. After the facility was agreed to, and an establishment fee paid, a new proposal was negotiated - the facility was to be increased by $10m (to $16m) to enable Markland House to purchase (for $9m) substantial non-performing assets belonging to Tricontinental. Markland House paid Tricontinental the book value for those assets, which was far in excess of current market value, thus allowing Tricontinental to avoid taking a loss of at least $5.78m. Tricontinental failed to take adequate security. Markland House’s financial position worsened. Eventually the group collapsed and was placed in receivership. The anticipated loss is approximately $15.9m out of $16m.

The Ramuz transaction only becomes relevant to this Commission when considering questions of monitoring and enforcing the Markland House facility. The failure of the Markland House group led ultimately to the
failure of the Ramuz loan. The anticipated loss is approximately $17m out of $21.3m.

B. Chronology

The chronology of relevant events is as follows:

1988

14-19 October Facility of $19m to Ramuz approved by Johns, Ryan, Morton and Moyle

1989

8 February Markland House approached Tricontinental with proposal for a $5m loan

23 March $6m facility approved by Johns, Morton, Carr and Smith. Letter of offer sent to Markland House specifying a put option to Brian Coppin

28 March Variation to security approved by Johns to provide that the required guaranteed put option was to be between Markland House and Essington Developments Ltd. Essington Securities Ltd was later substituted

29 March Amended letter of offer to Markland House for $6m facility

30 March Offer accepted by Markland House and $45,000 establishment fee paid

11 April Jeans submitted proposal involving Kimberley shares and Chard/Poltaz assets

14 April Mountford told Markland House that Tricontinental was prepared to provide facilities of $7m and $9m, subject to directors' approval

17 April Meeting at Tricontinental between Mountford, Hill, Wilkins and Jeans. Facilities for $7m and $9m approved by Johns, Smith, Ryan and Moyle. Markland House accepted and $3m of the $7m
facility drawn down on that day. Mortgage of Coogal shares executed

21 April A further $1.3m drawn down on the $7m facility plus the total of the $9m facility. Tricontinental confirmed agreement to fund the put option (if exercised within twelve months). Remaining security documentation executed together with separate agreement between Tricontinental, Markland House, Coogal and Cadalso as to the exercise of the put option

26 April Credit submission prepared

27 April Remaining $2.7m of the $7m facility drawn down

22 May $45,000 establishment fee repaid by Tricontinental to Markland House

23 August Hill raised allegations of duress

23 and 24 August Bills totalling $16m matured and were placed in the unpaid bills account

28 August Hill alleged that Markland House did not receive full value on initial drawdown

29 August Markland House shares suspended. Merchant Capital placed in provisional liquidation

15 September Hill repeated his allegations

19 October Notice of demand issued. Hill raised allegation of third party benefits

24 October Receivers and managers appointed to Markland House by Tricontinental

5 December Credit submission approved for $10m to enable Cadalso to purchase Coogal shares, and in principle approval obtained for $25m mezzanine debt financing

20 December Isaac advised SBV he did not wish to proceed with the purchase of the Coogal shares
1990

31 January  Offer of $1.5m received for Coogal shares
27 February  Offer increased to $2.05m
1 March     SBV decided to accept this offer
30 March    Ramuz failed to meet interest payments
27 April    Offer to purchase Coogal shares stated to be subject
to continuation of mezzanine financing
26 June     Credit submission approved to extend Ramuz facility
to the end of 1990 together with in principle approval
of $25m mezzanine debt financing
13 August   Offer for Coogal shares withdrawn
28 November Notices of default issued to Ramuz
31 December Ramuz facility expired

C. Narrative - Markland House

(a) First transaction

In early February 1989 Merchant Capital was experiencing liquidity
problems. In a letter dated 8 February 1989 from Mr Hill to Mr
Mountford, Markland House sought a $5m standby facility for the
Merchant Capital group.

On 22 March 1989, Mountford sent a two page memorandum (‘the
Mountford memorandum’) to Johns indicating that he had spoken with Hill
and that there was now a revised proposal - Markland House would borrow
$6m, although the likely usage was only $3.5m. This memorandum
constituted the credit submission for the proposal. It did not contain any
financial documents or analysis. It is not clear whether it was actually put
before approving directors, or whether they were told orally of its contents.

Security for the facility was to be:

(i) a first registered charge over 50% of the issued share capital of
    Coogal. Reference was made to Coogal’s pro-forma balance sheet
as at 31 January 1989 (which had been previously provided to Mountford but was not attached); and

(ii) an assignment of a put option agreement between Markland House and Brian Coppin over Markland House's 50% shareholding in Coogal. The put option agreement was to be for $7.5m and to be guaranteed by Axis Company Limited ('Axis') (wholly owned by EIE Japan). Tricontinental was offered Essington Developments Ltd as an alternative to Mr Coppin, also to be guaranteed by Axis. (It would appear that at this time the Essington group (see Transaction Reports 3-5) was motivated by the prospect of merging with Markland House.) Mountford said he had "advised Hill Tricontinental's selection to be highly confidential ...".

Mountford recommended the proposal on the basis that the put option agreement was to be to the total satisfaction of Tricontinental's solicitors. The proposal was not considered by any other members of the credit committee.

Johns approved the submission. Although the sum of $6m was within his discretion, he made his approval subject to that of other directors. This referral may have been motivated by the fact that, at this time, Tricontinental had exposures of $20m to Coppin and $150m to the Essington group.

On the following day, 23 March, Mountford noted on the memorandum his receipt of the approvals of Messrs Carr, Smith and Morton. A letter of offer was issued that day requiring a guaranteed put option from Brian Coppin.

Also on the same day Mountford wrote to David Hadley (the account manager) informing him that drawdown was urgent. Mountford said that "... under no circumstances is Tony Isaac to be informed of this
transaction". In evidence, Mr Mountford explained that he said this to ensure that Mr Hill had an opportunity of speaking to Mr Isaac first - which is what Hill did.

16 An amended letter of offer was issued on 29 March 1989, indicating that the put option agreement was to be between Markland House and Essington Developments Ltd.

17 The offer was accepted on 30 March 1989, and a $45,000 establishment fee was paid by Markland House. The facility was to expire in six months time.

(b) Second transaction

18 Before any drawdown of the first facility took place, Mountford negotiated further with Mr Tony Jeans. Mr Jeans explained in evidence that his involvement came about after he was approached by Hill who told him that there seemed to be some delay at Tricontinental in the processing of the $6m facility. Hill asked Jeans if he knew anyone at Tricontinental who he could ring and find out what the problem was. Jeans suggested that Markland House could enhance its position by offering a deal to Tricontinental. Jeans said he was authorised and encouraged by Hill to negotiate a new deal.

19 Accordingly, on 11 April (acting on behalf of Markland House), Jeans wrote to Mountford outlining a new proposal, the main points being:

(i) Tricontinental to lend $12m to Markland House, secured by a charge over Markland House, for five years at 6.5% p.a. interest; and

(ii) Markland House to purchase from Tricontinental:

• shares Tricontinental held in Kimberley Securities Limited ('Kimberley') at $2 per share (the current price was 75c); and
to pay $3m for certain Tricontinental non-performing assets, namely an assignment of non-recourse mortgages held by Tricontinental against Poltaz Pty Ltd ('Poltaz') and Chard Holdings Pty Ltd ('Chard') ('the Chard/Poltaz mortgages').

In evidence, Mr Hill claimed to have had, at the time, no knowledge of this very significant proposal affecting Markland House. Mr Hill acknowledged that he asked Jeans to liaise with Mountford in relation to the $6m facility, but nothing more. Hill said, in effect, that Jeans had no right to act for Markland House and was doing so on his own initiative. He was aware that Jeans had had some dealings in the Kimberley shares but said that he was not aware at the time that Jeans was directly involved with the Chard/Poltaz mortgages. Mr Mountford gave some support to Mr Hill on this aspect of the matter, describing Jeans as an "asset swapper". It was the fact that, at this time, Jeans was the beneficial shareholder and a director of both Poltaz and Chard, although he said he was holding these entities in a "de facto relationship for Tricontinental". He said, "...we would retain the ownership in trust for Tricontinental .... there was a sort of non-recourse mortgage of property...". In addition, Chard was entitled to a weekly management fee of $1,250 in respect of one of the mortgaged properties.

Mr Jeans rejected Mr Hill's account, claiming that both Hill and Wilkins were aware of his letter to Mountford of 11 April. Further, he noted that his letters were all typed by Hill's secretary. Certainly he kept Wilkins well informed of these developments as evidenced by his memorandum to Wilkins of 10 April 1989.

Mr Hill said the first he knew of the revised proposal was on 14 April when Mountford telephoned and said - "Forget the previous deal. This is the new deal. You've got to now take it or leave it". Mountford then outlined the proposal, which was confirmed by letter the same day. Hill
alleged that Mountford gave him and the board of Markland House one hour in which to accept the new proposal.

The revised proposal involved the provision of two separate facilities, namely:

Facility 1: a facility of $7m for twelve months at prevailing rates with no establishment fee. Security was to be a first registered charge over Markland House's 50% interest in Coogal and assignment of the put option agreement for $7.5m between Essington Securities Ltd ('Essington') and Markland House; and

Facility 2: a facility of $9m for three years at 12% p.a. fixed with no establishment fee. Security was to be a first registered mortgage over Markland House and guarantees of all wholly owned subsidiaries. This facility was to purchase 2.8 million Kimberley shares (at $2 per share) and the Chard/Poltaz mortgages (for $3m).

Mountford said this proposal would be "... subject to Tricontinental directors' approval, which we will endeavour to obtain on Monday next ..." (being 17 April).

Mountford noted that, in connection with facility 2, "... Tricontinental will need to undertake a full review of the group's assets and assess and introduce suitable covenants prior to formalised loan being available". Mountford acknowledged that there was a requirement to draw down $3m of facility 1 on the following Monday, 17 April. This drawdown would be "... permissible subject, of course, to Tricontinental directors' approval", and on the basis that facilities 1 and 2 were accepted on mutually satisfactory terms and that security for facility 1 was in place.

On 16 April 1989 Hill wrote to Mountford setting out the current financial position of Markland House and its subsidiaries. He also visited Isaac that
day and told him, for the first time, of the proposed borrowing of $6m - there was no mention of a $16m facility. On April 17, Isaac said he would not forgo his pre-emptive rights, but he would not object to Markland House mortgaging its Coogal shares for a loan of $3m for six months.

On 17 April 1989, at Tricontinental's office in Melbourne, Mountford met Hill, Jeans and Wilkins to finalise the new deal. No credit submission was then in existence; that was created on 26 April. Agreement was finally reached. Directors' approvals were allegedly obtained from Johns, Moyle, Ryan and Smith. The proposal was incorporated in two letters of offer which were signed and accepted on that day. Isaac provided Tricontinental with a letter consenting to a charge over the Coogal shares for $3m for 180 days. Markland House executed a mortgage of the Coogal shares that day, securing all moneys owing to Tricontinental for an unlimited period of time. Hill left Tricontinental with a cheque for $3m in his hand.

The letter of offer for facility 1 ($7m) superseded the previous agreement of 30 March ($6m). The terms and conditions for both facilities were substantially as set out in paragraph 23 above with the following changes or additions:

Facility 1 ($7m)

- additional security comprising
  
  (i) first registered mortgage debenture over the assets and undertakings of Markland House;
  
  (ii) first registered share mortgage over all the shares held by Markland House in Merchant Capital and Yalfa;
  
  (iii) joint and several guarantees from some entities of the Markland House group; and
  
  (iv) negative pledges from Markland House

- a covenant (among others) that Markland House would not undertake any asset sales in excess of $100,000 without Tricontinental's written consent;
Facility 2 ($9m)

(i) the purpose was stated as being for the provision of working capital as well as for the purchase of the Kimberley shares (for $5.57m) and the Chard/Poltaz mortgages (for $3m);

(ii) the interest rate was reduced from 12% to 11%; and

(iii) additional security and covenant were as for facility 1.

The current buy price (at 19 April) for the Kimberley shares was 75c per share. Accordingly, the market value of the parcel was approximately $2.09m. By paying $5.57m for the shares, Markland House allowed Tricontinental to realise the book value associated with the asset and avoid recording a loss on sale. The value of the Chard/Poltaz mortgages was approximately $700,000 (assuming they could be realised). They secured facilities of $2.97m in the accounts of Tricontinental. Facility 2 enabled Tricontinental to clear those debts without recording a loss. Thus, Tricontinental had lent $9m to avoid recording a loss of $5.75m - so long as the loan did not collapse.

On 21 April 1989, after lengthy negotiations (mainly about the put option) between all parties, including Isaac (who continued to insist on his pre-emptive rights), the balance of documentation was completed and Markland House drew down a further $1.3m on facility 1 and the total of $9m on facility 2. The $9m was used to purchase the Kimberley shares and the Chard/Poltaz mortgages. On the same day one of Coogal’s lawyers noted that "Trico is getting rid of its rubbish". Mr Isaac was also recorded as saying Hill indicated to him (presumably on 21 April) that he "... must draw on Trico facility today - has drawn $3m on Monday - must draw today to obviate a 364 [insolvency] notice".

As noted above, it was not until 26 April 1989 that Ken Mountford and Paul Hue compiled a credit submission for the two facilities. Maddison
On 22 May 1989 Tricontinental repaid to Markland House the $45,000 establishment fee which had been paid on the initial facility of $6m.

D. **Other Matters of Importance**

(a) **Cadalso shareholders' agreement and the agreement of 21 April 1989**

The assignment of the put option agreement between Markland House and Essington purported to stand as security for both facilities. The ability of Tricontinental to realise this security, however, was seriously compromised by the existence of a shareholders' agreement between Cadalso, Coogal and Markland House. In most circumstances the shareholders' agreement would override any attempt by Tricontinental to exercise the put option agreement and give Cadalso the opportunity to purchase the shares at an assessed value. Tricontinental could be placed in a position whereby either it was required to sell the shares to Cadalso for less than the expected $7.5m or it would risk allegations of selling at less than market value if it proceeded with the exercise of the put option, despite having obtained a valuation which indicated that the market value was higher.

Tricontinental's solicitors were aware of the inconsistencies between the provisions of the put option and the shareholders' agreement. When preparing the security documentation, they included a draft Deed of Waiver to be executed by Markland House, Tricontinental, Coogal and Cadalso. Mr Isaac refused to sign this document when it was presented to him on 21 April 1989. As a result of negotiations on that day, Isaac's solicitors sent a letter to Mountford by fax outlining Isaac's requirements. One of the points raised was that the documentation should provide that, if Tricontinental were to exercise its rights on default, it would be required to
enter into a deed of covenant to be bound by the shareholders' agreement. Mountford confirmed he had no problems with these requirements.

34 Due to the shortage of time it was agreed that, rather than attempting to redraft the proposed Deed of Waiver, an irrevocable letter under seal should be executed in its place. A one-page letter agreement was then executed on 21 April 1989 by Markland House, Cadalso, Coogal and Tricontinental ('the agreement of 21 April 1989'). This agreement evidenced the irrevocable consent of Coogal and Cadalso to the sale of the Coogal shares to Essington pursuant to the put option and provided for discharges of security in certain circumstances. It also provided:

"Tricontinental agrees that the provisions of the Shareholders Agreement shall apply in respect of any exercise of Tricontinental's powers on default by Markland under such security documents Tricontinental shall first offer the shares to Cadalso pursuant to Part 6 of the Shareholders Agreement ... and further that if Tricontinental becomes beneficially entitled to ... Markland's Coogal shares on default of Markland it shall enter a Deed of Covenant to be bound by the Shareholders Agreement ... ".

(b) Tricontinental side agreement to finance the put option

In addition to the difficulties caused by the existence of the shareholders' agreement, any attempt to realise the put option security could have been largely self-defeating because Tricontinental had entered into a side agreement to provide the $7.5m to Essington Developments Ltd, or a wholly owned subsidiary, in the event that Tricontinental sought to exercise the put option within the first twelve months. Mountford confirmed this arrangement to Mr John Brimacombe of Corrs Pavey Whiting & Byrne on 21 April 1989, noting that Cadalso's solicitors were "not conversant" with it. Mr Mountford said that he was unable to recall why this information had been kept from Cadalso's solicitors.

In effect, Tricontinental had agreed to finance its own security by providing significant funds to the Essington group, which at this time was already indebted to Tricontinental for more than $150m (see Transaction Reports 3-
5. It seems likely that the difficulties in arranging the guarantee of the put option by Axis and, possibly, some reluctance by Essington to enter into the put agreement were among the factors which led to the delay in completing, and ultimately the abandonment of, the first facility for $6m. Essington must have insisted that there should be funding from Tricontinental if the put option were to be exercised within twelve months.

The put option expired on 30 January 1990, unexercised. Although the receiver appointed to Markland House indicated that the decision not to exercise the option was based on legal advice, the contemporaneous documentation submitted in evidence indicates that the obligation to fund the exercise of the put option formed a major consideration.

(c) Hill’s allegation of duress in relation to the change to the facility

By late June 1989, Markland House was having difficulty meeting bill roll­overs. In August and September 1989, Hill wrote to SBV requesting interest relief on the facilities together with forgiveness of approximately $5m (being the difference between the price at which Markland House acquired the assets from Tricontinental and their actual value at that time). For the first time, Hill raised the allegation that Markland House had been coerced into acquiring these assets from Tricontinental. Hill claimed that, following acceptance of the first facility and payment of the establishment fee of $45,000, the directors of Markland House had made certain commitments and arranged the affairs of the Markland House group accordingly. He said that, following the conversation with Mountford on 14 April 1989 ("take it or leave it"), directors were left with no alternative but to accept the new deal because of the commitments they had made on the basis of the first facility for $6m. Directors also took into account, he said, "a number of verbal implications and inferences that, should [Markland House] accept the facility as proposed, it [Markland House] would have the ongoing support" of Tricontinental. He said that, following agreement at the meeting on 17 April, Mountford said, "Don’t worry,
you've got Trico behind you now", or words to that effect. The giving of such an assurance was corroborated by Mr Jeans.

Mr Hill developed and repeated these allegations at later times. On 19 October 1989, the day on which notice of demand was served on Markland House, Hill wrote to Tricontinental claiming that the facility agreements "... masked the true nature of the underlying transaction and were procured under duress", and further that "Markland House Limited believes that fees were paid or that benefits were provided to certain third parties in respect of this transaction which were not disclosed at the time of the purported agreements nor have been disclosed to it by [Tricontinental] subsequently".

Mountford emphatically denied these suggestions, indicating in a memorandum to Mr Leonard (SBV) on 19 September 1989 that the Kimberley share/asset purchase proposal was initiated by Markland House acting through Tony Jeans who, Mountford said, would have no hesitation in supporting his account.

Mr O'Brien of SBV expressed his opinion, in August 1989, that the $9m facility could be regarded as a "... soft loan, structured to suit both the lender and the borrower, notwithstanding Julian Hill's assertions to the contrary". Around the same time Mr Hunter described the circumstances surrounding the transactions by which Tricontinental acquired the Chard/Poltaz mortgages as complicated, and involving a number of "strange things".

Mr Isaac, in August 1990, expressed the view that:

"... the Agreement executed sought to reflect the special and unusual circumstances surrounding the proposed loan facility, which included the sale of other [Tricontinental] 'problem' assets it held, and the specific requirements of Cadalso to give the consents sought, which were contrary to the provisions of the Shareholders' Agreement, and had the potential of changing Coogal's future".
The circumstances surrounding the change in the facility remain unclear. Mr Mountford suggested that Markland House was experiencing difficulty in negotiating the put option to Tricontinental’s satisfaction. However, it is evident that negotiations as to the put option were still proceeding at the time the facility was changed, and that it was Tricontinental that varied its requirements for the put. It is unlikely that those changes were made at the request of Markland House.

In his evidence to the Commission, Mr Hill again claimed that he had no choice and was coerced into acceptance of the new proposal by Tricontinental. By 14 April 1989, he said, Markland House was in a "pretty desperate situation". Confirming this picture, Hill had also told Isaac that, around this time, ANZ had "pulled the plug" and he needed $3m. However Hill did not maintain the assertion (noted at paragraph 39 above) that a kickback or commission was paid to Jeans in respect of his involvement in the matter. He said Jeans was the only person he had in mind when making this allegation. This was just an assumption on his part, he said, for which he had no evidence, but "logic dictated to me that there had to be a benefit passing, otherwise it would never have been done. ... The only assets that were picked were those that Jeans was intimately involved with".

In his written submission to the Commission, Mr Isaac also cast some doubts on Jean’s role in the matter, alleging an established relationship between Jeans and Tricontinental, through Johns and other senior officers. However these allegations came too late to be investigated and, in any event, little could have been achieved without evidence from Mr Johns, and the matter is peripheral to the Commission’s main concerns.

Mr Jeans denied any wrongdoing, claiming he got nothing at all out of the deal. He said that, in their discussions, Hill had never criticised him over
any aspect of his involvement and that, in fact, there had been no undue pressure put on Markland House.

47 In his evidence, Mr Mountford rejected the claim that Tricontinental put pressure on Markland House. He said the borrower acted quite voluntarily and that it was Jeans who proposed the Kimberley share purchase. Mr Jeans could not say whether he or Mountford made the suggestion. Mountford thought Johns might have "... insisted that the Chard Poltaz be thrown into the pot as well". As to Hill's account of their conversation on 14 April, Mr Mountford conceded he may have indicated an immediate decision was required (because of the need for Markland House to draw down $3m the following week) but he said "...‘take it or leave it’ is not my language".

48 Markland House had an apparently binding agreement pursuant to the letter of offer dated 29 March 1989. Mr Mountford said that, in his opinion, Tricontinental was "committed" to that deal. There were, however, difficulties in completing the arrangements for the put option.

49 The minutes of the meeting of directors of Markland House, held on 20 April, which ratified the transaction, are silent as to the suggestion that Markland House was "forced" to accept the revised proposal.

E. Role of Mr Johns

50 The original request for $6m was within Johns' discretion as managing director, leaving aside possible related exposures. As noted, he made his approval of that facility subject to the approval of other directors.

51 Tricontinental's letter of 14 April 1989 was prepared by Mountford after discussing Jeans' proposals with Mr Johns. He specifically recalled that it was Johns who insisted on the inclusion of the Chard/Poltaz mortgages in
the deal, although he was not certain whether Jeans or Johns raised the topic first.

Johns also negotiated with Mr Malcolm Edwards, the principal of the Essington group, the arrangement whereby Tricontinental would fund the exercise of the put option to Essington if called upon to do so within the first twelve months.

Johns was noted by Maddison as approving the increased facilities on 17 April 1989.

Mr Mountford said in evidence that he believed it was Johns who gave instructions for $3.4m of the $9m facility to be shown on the credit submission as for working capital purposes rather than for its real purpose, namely the purchase of the Chard/Poltaz mortgages from Tricontinental.

F. Role of Other Managers

Mr Mountford

Mr Mountford conducted all negotiations with Markland House. In particular, he developed the revised proposal with Mr Jeans and conducted the crucial meeting at Tricontinental on 17 April 1989. He "reviewed" the financial information presented to him. As the credit submission of 26 April was not prepared until after directors' approval and drawdown, Mountford (not Johns) was the principal source of information within Tricontinental upon which directors could rely in deciding to approve the facilities.

As the senior executive who "had the running" of the matter, Mountford was responsible for obtaining directors' approvals for the facilities. He noted his receipt of the directors' approvals of the first facility ($6m) on 23 March 1989. Following the reaching of agreement with Markland House
on 17 April, he was said to have obtained directors’ approvals for the revised proposal, as noted on the later credit submission.

With Mr Hue, Mountford prepared the credit submission dated 26 April 1989. He signed this submission as recommending the proposal on 2 May 1989, fifteen days after he had facilitated the agreement reached at Tricontinental on 17 April.

From then on, Mr Mountford was closely involved in the monitoring of the loan.

G. Role of Directors

The initial $6m facility was recorded as being approved by Smith, Morton and Carr on 23 March 1989. Mr Smith said in evidence he had no recollection of his approval. Neither Mr Carr nor Mr Morton was examined about their approval of this facility.

The credit submission of 26 April shows that approval for the two facilities of $7m and $9m was given by Moyle, Ryan and Smith to Mountford on 17 April. This was noted by Maddison, probably on 2 May. None of those directors has any recollection of being asked for approval, as recorded, and Mr Smith’s movements on the day in question, as suggested by his diary, seem to make it difficult for him to have been approached.

H. Events After May 1989

(a) Default

By late June 1989 Markland House was experiencing difficulty in meeting bill roll-overs. On 23 and 24 August it failed to meet its bills on maturity. On 29 August Merchant Capital was placed in provisional liquidation. Markland House shares were suspended from trading the same day.
In October 1989, SBV declined a request from Markland House for interest relief and forgiveness of part of the debt. Accordingly, Markland House requested the appointment of a receiver. This was two months after default. Notice of demand was issued and served on Markland House on 19 October. A receiver was appointed by Tricontinental on 24 October 1989.

(b) Impact of receivership upon the Ramuz facility

The appointment of a receiver to Markland House created difficulties for Ramuz in its attempts to arrange the full financing required for the Atcherley hotel development. Tricontinental had indicated a strong desire to participate in, and possibly lead, the syndicated facility. Mezzanine debt financing was the key to the whole project. Following integration with SBV in May 1989, Tricontinental was no longer in a position to take part in any such further funding.

SBV acknowledged that the decision to appoint a receiver to Markland House would have a substantial impact on the Ramuz facility. The future funding of the hotel development was crucial to its success. In fact SBV considered participating in the mezzanine debt financing and obtained in principle credit committee approval to do so, but in the result did not proceed.

The fact that one of Coogal's 50% shareholders was in receivership, and the uncertainty over the eventual ownership of these shares, made it harder for Ramuz to attract financing from other sources in a declining commercial property market. For these reasons, provisional arrangements for the development of the project expired and were not renewed.

In September 1989 SBV arranged for the preparation of an in-house information memorandum which valued the Coogal shares at $11m. Discussions with Isaac showed that he was interested in acquiring the
Coogal shares at near market value, subject to obtaining financial assistance from SBV.

In December 1989, SBV approved a credit submission for $10m to enable Cadalso to purchase the 50% shareholding which Markland House had in Coogal. In addition, SBV approved in principle $25m mezzanine financing for the Atcherley hotel project. When informed of this Isaac decided not to proceed, partly because another potential joint venturer was no longer able to commit to the Atcherley project, and partly because of the general decline in the property industry and the increasing financial pressure to which he was being subjected.

In February 1990, SBV received an offer from a third party to purchase the Coogal shares for $1.5m. The offer was subsequently increased to $2.05m. After some negotiation, SBV determined in March 1990 to accept this offer but, after further negotiations, the sale did not eventuate.

In March 1990 Ramuz failed to meet interest payments. In June 1990, SBV approved an extension of the Ramuz facility to the end of 1990, and again approved the in principle mezzanine debt financing proposal. Notices to pay were issued in November 1990 and the Ramuz facility expired unpaid at the end of December 1990.

(c) Anticipated Loss

Tricontinental is still looking for a purchaser of the 50% parcel of Coogal shares. The Chard/Poltaz mortgages realised approximately $700,000 gross, with a net payment to the receiver of $586,000. After payment of expenses and interest, the anticipated loss on the Markland House facility of $16m is approximately $15.9m. As to the Ramuz facility of $21.3m (drawn down), the development site at Atcherley is currently for sale by tender. Some other assets have been realised for $70,000. The anticipated
loss is approximately $17m. The total loss anticipated on both transactions is just under $33m.

I. Significant Issues Arising
(a) Credit risk analysis - directors’ approval of the first transaction ($6m)

The Mountford memorandum of 22 March 1989 did not suggest any immediate urgency, notwithstanding the liquidity problems faced by the Markland House group. This proposal had not been reviewed or approved by the credit committee. The memorandum contained only the barest essentials and failed to provide any adequate information as to the financial strength of the borrower or its subsidiaries. The submission was characterised by an almost complete absence of credit risk analysis - indeed, the only comment in this vein was negative, indicating that "Hill concedes cashflow tight". Markland House was a new client for Tricontinental. Accordingly directors could not be expected to have had any background knowledge of the borrower. Before the Commission, Mr Mountford conceded that, due to the lack of financial data, directors could not have made a fully informed decision on this proposal. They would have had to base their decision on the takeout - the put option.

Mr Smith, the only director examined as to this matter, said he had no recollection of it. Other directors consistently failed to remember individual transactions, and there was nothing about this one which was likely to have brought it to mind - particularly in the absence of detailed documentation.

Counsel for the managers and directors of Tricontinental other than Johns submitted that detailed financial analysis was probably not required in this case, because of the short-term nature of the facility and the adequacy of the security - in particular the put option. He noted that the put option agreement had to be to the total satisfaction of Tricontinental’s solicitors.
It is not clear whether that total satisfaction could not be achieved, or whether Essington was not prepared to grant the option in any event. However, it seems probable that the first transaction broke down over the failure to negotiate the put option. Because it was never perfected, there seems little advantage in trying to pass judgment on this facility. However, it does provide an example of how the prescribed procedures, such as prior review by the credit committee, were circumvented.

(b) Credit risk analysis - directors' approval of the second transaction ($7m and $9m)

Tricontinental had been experiencing its own liquidity problems for some time. Mr Mountford described 17 April 1989 as a "crisis day" and had spent the preceding weekend working on these problems. He was still working on them on the morning of the 17th, and so he forgot his appointment with Mr Hill and the others and kept them waiting for about two hours. Not surprisingly, by the time he saw them he was under a considerable amount of pressure.

No written credit proposal for the revised facilities had been prepared before 17 April. Negotiations were still very much on foot, and they continued throughout the course of the meeting at Tricontinental. Among other things, the negotiations involved Hill and Mountford speaking at length with Isaac and his advisers in Sydney. Agreement was not reached until at least early in the afternoon of 17 April. Mr Neil Hunter was also involved in drafting letters of offer.

When discussing the approval of the first transaction, Mr Mountford told the Commission that normally some kind of short-form credit memorandum would have been prepared for directors. In relation to the events of 17 April 1989 he said "... I really believe that at no time in Tricontinental did I ever just phone directors cold" and confirmed that he never asked directors to approve a credit submission without a piece of paper in front of
them. However, he has no recollection of having prepared such a
document on this occasion, or of anybody else doing it for him. No such
document has been found by the Commission's investigators or produced to
the Commission by any party. No other document to hand refers to the
existence of any such paper in this case. If one existed, and copies went to
directors, the original could be expected to have contained the handwritten
note of their approvals, signifying what it was they were approving.

The approving directors examined (Moyle, Smith and Ryan) claim to have
no recall of this facility, and each asserted in evidence that he did not
believe he would have approved the proposal.

Both Moyle and Ryan were available to give approvals on the particular
day, Ryan being at Tricontinental's office that afternoon (according to his
diary). Smith's diary indicates he was scheduled for external appointments
during the day and evening but he acknowledged in evidence that it was
possible he could have been reached by telephone.

Mr Mountford also claimed to have no recollection of discussions with the
directors on 17 April and said he could not recall whether directors did
give their approvals to him. He was quite clear, however, that in no
circumstances would he note approvals which he had not obtained. Mr
Mountford said that he would not have allowed Hill to have left on that
day, with Tricontinental's cheque for $3m, without getting approval from
the directors, or having been informed by Johns of the directors' approval.

Both Mr Hill and Mr Jeans recall Mountford leaving the meeting to obtain
approval for the loan from directors. Mr Hill said he certainly
remembered Mountford "... on at least one occasion and possibly two
being absent for some time, on the basis that he was going off to seek
approval ... [he] certainly said at one stage 'I have to go and get Johnsy to
tick off'". Mr Jeans said:
"... I can recall him saying that he had to get it past Johns, and then he had to ring some directors to get the appropriate approval, and I think the delay during the day was the ability of getting the right number of directors, go to ring around the deal and see if they could find the right guys to approve the arrangement, and I guess that was about 5 o'clock when they finished that deal."

Counsel assisting have submitted that approval for the grant of the two facilities totalling $16m was sought by Mountford on 17 April and obtained verbally from Johns, Ryan, Smith and Moyle in the absence of any short-form credit submission. Counsel for the approving directors (other than Johns) contend that it is improbable that the directors, other than Johns, gave their approval without seeing any short-form credit submission. They point to the fact that Mountford himself has said that at no time in Tricontinental did he "phone directors cold". The notation that directors had conveyed their approvals to Mountford was recorded in a note by Maddison some ten days after the event. It is possible that Maddison misheard or misunderstood what he was told. Counsel for the directors further submitted that Johns may have taken it upon himself to tell Mountford the directors had approved the transaction when in fact they had not. Each of the directors was "as certain as he could be that he did not approve the transaction".

A number of other matters arising from the evidence are relevant to the resolution of this question. These include:

(i) the extreme urgency which surrounded the transaction, particularly the need of Markland House for the $3m on 17 April 1989;

(ii) the fact that, in his letter of 14 April 1989, Mountford had gone to some pains to point out to Hill that the revised proposal would be subject to obtaining directors' approval;

(iii) Mr Moyle's belief that the existence of a short-form credit submission would have been noted in his secretary's records, and the absence of any such record;
(iv) the undoubted fact that any dishonest recording of directors' approvals by Mountford (or any other employee) would, if discovered, have resulted in immediate dismissal. There is not the slightest suggestion that Mountford or any other officer could have been motivated by any personal gain in so acting;

(v) any such dishonesty could well have been disclosed when the board ratified the approval at its next meeting;

(vi) the special circumstances surrounding the transaction including -

- the significant size of the facilities;
- the fact that Markland House was a new borrower;
- Tricontinental disposing of its significant non-performing assets - which factor had become Tricontinental's primary incentive for the transaction, or as Mr Mountford put it, the deal became a "risk-reward" transaction, not a normal commercial one; and
- the fact that the proposal may have appealed to directors who saw it as a means of dealing (in part) with Tricontinental's own liquidity crisis at that time;

(vii) evidence that on a number of other occasions directors did give verbal approvals for facilities before the preparation of credit submissions.

Counsel for the directors concurred with the submission that there is no suggestion that either Mountford or Maddison (for whom they also act) was fabricating the approval of directors, and the Commission can see no good reason to suppose that Johns would have done so.

The absence of any evidence from Johns makes it impossible for the Commission to reach any concluded view on this matter. It seems most likely that the directors named did give their approvals, probably by telephone, either to Mountford or to Johns, on the date indicated by Maddison - 17 April 1989 - before Hill left Tricontinental's office with a
cheque for $3m in his hand. But the Commission is unable to make any firm finding to that effect. If this were shown to be the case, the directors are to be criticised for allowing a system to operate which permitted a loan of this size to be approved in this way, and for permitting drawdown without formal documentation and without adequate safeguards.

(c) Merits of the proposal

The revised proposal gave rise to a number of crucial considerations which required careful analysis and consideration by directors. These included the following:

(i) the liquidity crisis Tricontinental was facing, and the need, recognised by some directors at least, to adopt more conservative lending policies;

(ii) the financial position of Markland House in a difficult money market situation;

(iii) the circumstances relating to the purchase by Markland House of assets from Tricontinental at book value well in excess of the disclosed market value;

(iv) the capacity of Markland House to service and repay the facilities; and

(v) the adequacy of the security to support the facility.

It is doubtful whether directors were made aware of the significant differences between the revised facilities and the $6m facility which had been approved less than a month earlier. In fact the transaction had changed from a $6m facility for six months at a commercial interest rate, secured by a guaranteed put option exercisable at $7.5m (and not backed by Tricontinental), to one for $16m for three to four years of which $9m was at a 'soft' interest rate of 11% pa, with no guarantees to the exercise of the put option (which Tricontinental now backed), and additional security only by way of debenture charges and share mortgages over subsidiaries and negative pledge covenants. In particular, directors would have needed to
be satisfied that the change in the essential nature of the facility was in Tricontinental’s best interests.

Mr Mountford acknowledged in evidence that the revised proposal had become a risk/reward related transaction rather than one involving straightforward commercial considerations. It was a very high risk proposal which Mr Mountford now admits he did not have time to assess as thoroughly as he would have wished. He conceded in evidence that the information available to him on 17 April did not provide an adequate basis for a decision.

Mountford actually advanced the proposal knowing of adverse marketplace rumours concerning Markland House, which included the suggestion that they were having trouble balancing their money market book.

As against these considerations, counsel for the other directors and Mountford urged that the loan proposal was entirely reasonable. Leaving aside for the moment the question of security, they submitted that the financial records for Markland House in the previous financial year showed after-tax profits of $2.423m and interest cover 4.1 times interest expense. Estimated proceeds from planned asset sales were $8.49m. Mr Hill gave evidence that he believed that at least $7m could be repaid within six months of the facility being granted. Counsel for the directors summarised Mr Moyle’s evidence to say that, on the figures disclosed by the later credit submission, interest cover was adequate, the profit position was good, market capitalisation was good and there was the added bonus of the put option.

Counsel submitted, by way of summary, that the proposal was a reasonable one because (a) the $7m facility was only for twelve months, (b) security appeared to be adequate, (c) financial statements suggested good future profitability, (d) the lending to security ratio was very favourable - 73.6%,
(e) the transaction would assist the provisioning of bad debts in Tricontinental's books, (f) the overall interest cover of Markland House was 4.1 times interest expense, and (g) there were projected planned asset sales of $8.49m.

They also drew attention to Mountford's calculation of a "downside risk strategy", which brought into account the benefits to Tricontinental from disposing of its non-performing assets, which he estimated at $6.574m. When this was added to the supposedly secure put option of $7.5m, it meant that Tricontinental only had to secure $1.9m from realisation of other Markland House assets in order to show a profit on the deal - even if it had to enforce its security.

As Mr Mountford said in his evidence, "I think it was always acknowledged that it was a high risk transaction. There were high rewards if it worked and it was undertaken with Ian Johns and a full assessment on the basis of what the downside was." He also said, in a perceptive moment, "To some extent I was assessing Hill, his ability ...". This concentration on the person behind the transaction was common to many transactions. While obviously important, it could not be accepted as a substitute for a proper assessment of the particular proposal.

Given this "risk-reward" approach to the matter, avoiding hindsight, and bearing in mind that this was a merchant bank operating at the higher risk end of the market, it is difficult to be strongly critical of Mountford's support for this transaction. Transactions such as this were part of the life-blood of Tricontinental. So far as the directors are concerned, it would seem that, as noted above, they may be criticised for allowing a system to operate which could result in a loan of this size being granted in a very short space of time and without any formal documentation before the loan was approved. The Markland House transaction provides an example of the lack of control exercised by the board to ensure that proper procedures
were both in place and adhered to. However, if it were accepted that such an approval process was permissible, then the directors could not be criticised for approving this particular loan - because the Commission cannot know exactly what the directors were told before they gave their approvals. Indeed the Commission is unable to make a confident finding that such approvals were ever given.

(d) Credit submission - 26 April

This submission post-dated directors' approvals. Apart from serving as an historical record of the transaction, it played no role in the process of credit risk analysis. Nevertheless, it is appropriate to consider some aspects of the submission as they reflect on the transaction as a whole:

(i) The financial information provided relied solely on figures produced by Markland House as to its financial condition and that of its subsidiaries. This information was not subjected to any independent assessment or analysis by Tricontinental. Mountford had told Hill on 14 April that, with regard to the $9m facility, "... Tricontinental will need to undertake a full review of the Group's assets and assess and introduce suitable covenants prior to formalised loan being available". No such full review was undertaken. Tricontinental failed to assess Merchant Capital's assets, its loan book (amounting to $21.7m) or its funding needs. The pro-forma consolidated balance sheet of Merchant Capital and Yalfa indicated liabilities in excess of $30m.

(ii) $3.42m of the $9m facility was stated to be for working capital when in fact most of these funds were to be used to purchase the Chard/Poltaz mortgages. The submission contains no mention whatsoever of the proposal that Tricontinental would dispose of these assets.

(iii) While the put option agreement between Markland House and Essington was referred to as part of the security, nothing was said to indicate that, if called upon in the first twelve months,
Tricontinental would be obliged to finance the put option and thus finance its own security.

(iv) The submission did not refer to the relationship of the Cadalso shareholders' agreement to the exercise of the put option nor did it refer to the agreement of 21 April 1989 or any of Tricontinental's obligations under it.

(v) Although the submission refers to the fact that Markland House was "... selling its non-core and unprofitable assets and requires funds to assist with cash flow needs in the interim", it fails to refer to the serious liquidity problem then faced by Markland House and its subsidiaries. Markland House made no secret of its financial difficulties when seeking assistance from Tricontinental. The initial approach for funding was to "redress a liquidity mismatch". That situation was confirmed by Markland House immediately before drawdown as is reflected in contemporaneous notes taken by Mr Isaac's solicitor. Mountford acknowledged these difficulties both before and after drawdown. In particular, he voiced his concerns to Jeans in telephone conversations on 12 and 14 April, saying that he was concerned about the ability of Markland House to withstand the proposed level of borrowing.

(vi) In this context, no explanation is provided as to why Markland House would have been prepared to purchase the Kimberley shares at $2 per share when the current buy price was 75¢ per share.

(vii) Servicing and repayment was said to be available from cash flow and/or refinance. It was said that the borrower's "... normal operating cash flow is available to service borrowings. [Earnings available for payment of interest] for year ending 30.6.88 [were] $1,912,000 against interest of $464,000, resulting in interest cover of 4.1 times". In fact the interest contemplated on the $7m facility (at 17.5%) was $1.22m and that on the $9m facility (at 11%) was $990,000 per annum, requiring Markland House to find a total of $2.21m per annum to service its interest debt on the facilities
provided. Clearly it could not do this on its normal operating cash flow based on the previous year's figures. Significantly, in less than a month from the date of the submission, Hadley informed Mountford that "... the only regular source of income from Markland is approximately $1.2m p.a. from the Walton Bond receivable financing transaction. Unless assets are realised the client will have difficulty servicing debt. I will monitor account closely and advise on a regular basis".

(viii) Great emphasis was placed on the proposed asset sales by Markland House. In the result these never eventuated. As noted by Mr O'Brien (SBV) on 25 August 1989, there was a huge discrepancy between the book value of the assets and their realisable value.

(ix) Although the submission suggested that the planned asset sales would return $8.49m there was no evaluation provided as to whether these funds would be available to service Tricontinental's loans or whether they would be used by other lenders, particularly those having security over the Merchant Capital assets. No analysis was provided as to the likelihood of completion of these sales.

(x) In its recommendations, the submission incorrectly stated that security offered included "real estate properties valued conservatively at $9.35m by Price Waterhouse".

Considering these deficiencies, it is hardly surprising that Mr Mountford should acknowledge "... a lot of deficiencies in this credit submission too. I probably shouldn't have signed it off as well".

(e) Security for the loan

On 28 April 1989 Mountford informed Hadley that "we do not have a full handle on security position (asset cover), we are losing assets for cash". In August 1989 Hadley and O'Brien noted that Markland House had been experiencing "an acute liquidity problem for the past 6 months or so as a result of calls on its short term money market book".
On 4 August 1989 Mountford noted Markland's "continuing inability to meet projected funds inflow from asset sales/other sources ... with Markland management yesterday telegraphing real concerns as to ability to meet interest rolls later this month we obviously need to take a firmer stance".

A number of specific deficiencies in security were evident:

(i) The difficulties associated with the exercise of the put option agreement, particularly arising from the shareholders' agreement and the agreement by Tricontinental to fund its exercise, have already been noted.

(ii) Tricontinental failed to seek any charges over the actual operating assets of Markland House's subsidiaries - which were in fact pledged to other lenders.

(iii) Although Tricontinental's approval was required for asset sales in excess of $100,000, the proceeds of asset sales need not have been applied to a reduction of Tricontinental facilities. Tricontinental recognised this as a problem as early as 27 April. Tricontinental did not obtain any security over the assets purchased with the $9m facility. The Kimberley shares were disposed of by Markland House within two to three months for approximately $2m. Markland House experienced a substantial loss on disposal of the shares, which may have contributed to its collapse but, in any event, Tricontinental did not obtain the benefit of any of the proceeds of the sale. The futility of the situation was acknowledged by SBV in late August 1989.

(iv) The value of the charge taken over shares in Yalfa was based on the net tangible asset backing of that company, with no evaluation of the actual realisable value of those assets. These shares in fact turned out to be worthless, being written off by Markland House in July 1989.

(v) Tricontinental's security consisted only of a charge over the assets
of Markland House itself and guarantees from various Markland House subsidiaries. The assets of Markland House consisted of shares in those subsidiaries and loans to those subsidiaries. Tricontinental did not take any charge over the actual operating assets of the subsidiaries, and indeed the credit submission contains no information as to whether those assets were pledged as security to other lenders. In fact they were. The lending by Markland House to these subsidiaries also appears to have been on an unsecured basis. Accordingly, when those subsidiaries failed, other lenders enforced their security, leaving Markland House, and thus Tricontinental, with nothing.

(vi) Tricontinental undertook no analysis of the capacity of the subsidiaries to meet their obligations under the guarantees and obtained no security from those subsidiaries in response to their obligation.

(vii) Drawdown of $3m was permitted on 17 April although the consent to the mortgage of the Coogal shares (a pre-condition to drawdown) was not in satisfactory form, being limited by Coogal to $3m for a term of only 180 days.

(viii) Drawdown of the balance of the facilities was permitted on 21 and 27 April despite the limitations in the consent to the mortgage of the Coogal shares, and the failure to comply with other preconditions to drawdown.

On the other hand, it must be noted that the 50% of the issued share capital of Coogal was valued by Price Waterhouse, as at 31 January 1989, at $9.35m. Also, a pro forma balance sheet, as at 31 December 1988, showed that a proposed single entity, made up of Yalfa and Merchant Capital, would have net tangible assets of $11.276m. The value of Markland House’s 65% shareholding would therefore be $7.3m. The market value of the Kimberley shares was said to be over $2m. Thus, at first sight, the value of security appeared reasonable - particularly when the
put option was in place. It was only when more detailed questions were asked, as outlined in the previous paragraph, that the security position began to look less certain.

On this question, as on the general merits of the proposal, it must be remembered that Mountford had to put the arrangement together very quickly, and under considerable pressure from the potential borrower. And we do not know what the directors were told. It is, of course, reasonable to assume that they were given only the broad outlines of the security.

(f) Allegations by Isaac

In his written submission to the Commission, dated 3 April 1992, Mr Isaac is understandably suspicious of the motives of all those who left him out of negotiations until the last moment. However it must be noted that he had to be brought into the picture before finality was reached, because the Coogal shareholders' agreement gave his company pre-emptive rights to Markland House's shares in Coogal. There is no evidence on record to support the allegations of collusion. It seems likely that the intention of the other parties was to finalise all aspects of the transaction among themselves, and then present Isaac with a situation where he would find it difficult not to co-operate.

Mr Isaac has consistently argued that Tricontinental failed to abide by its alleged obligation to take up an equity position in Coogal on default by Markland House. Mr Mountford stated more than once in evidence that he was not fully aware of all the legal implications of the interrelationship between the Cadalso shareholders' agreement and the put option. It does not appear that Mountford was examined directly as to his understanding of the agreement of 21 April 1989 or Tricontinental's position under that agreement if Markland House defaulted. In September 1990, SBV obtained legal advice in relation to the allegations raised by Isaac. For the purposes of this Commission this disposes of the allegation. It is not part of this
Commission's function to attempt to resolve, or even to comment on, possible third party actions against Tricontinental.

(g) Allegations by Hill

Mr Hill was an experienced businessman and former director of a merchant bank. He could have sought to hold Tricontinental to the initial agreement relating to the $6m facility but he did not. He continued to employ Mr Jeans as a consultant following these events. He only made his complaint of unfair pressure or duress when it became obvious that Markland House was in serious financial difficulties and unable to meet its obligations under the loans. No doubt Mr Hill did feel pressured by the serious financial position his company faced, particularly as Tricontinental may well have been seen by him as his last chance for funds.

There were benefits to both Hill and Tricontinental in the revised proposal. In the case of Tricontinental it stood to receive a substantial benefit from the disposal of its non-performing assets. It improved its balance sheet, avoided the need for provisioning and secured a new borrower. Disadvantages faced by Tricontinental included the low fixed interest rate of 11% for the $9m facility, the increased credit risk in the loan to Markland House, the agreement to fund the put option if exercised in the first twelve months, the return of the $45,000 establishment fee, and the agreement not to charge facility fees. In the case of Markland House, it secured urgently needed finance, the possibility of some capital appreciation of Tricontinental's non-performing assets, continuing financial support from Tricontinental and an enhanced prospect of merging with the Essington group. In addition, the Kimberley shares constituted a substantial parcel of 18% of issued shares. Hill acknowledged in evidence that he saw a possibility of dealing profitably with them. Markland House was aware of the true value of the assets it was acquiring and calculated the potential benefits as evidenced by a file note made by Mr Wilkins on 10 April 1989.
Impact upon the Ramuz facility

It is arguable that a firm and prompt decision by SBV to support Coogal, for example by taking up Markland House's equity position in Coogal and giving a firm commitment to the financing, might have enabled the project to proceed and thus permitted SBV to recover, from sale or refinancing, both the funds advanced under the Ramuz facility, and a substantially greater amount than it has from the Markland House facilities.

In his written submissions to the Commission, Mr Isaac drew attention to what he called "the tardy manner and efforts of Tricontinental/SBV and Markland's receiver, Ferrier Hodgson & Co, to sell the 50% Coogal shareholding." He said that he was first approached in August 1989 to see if his company, Cadalso, was interested in purchasing the balance of the Coogal shares. Alternatively, he was asked if he had any objection to the shares being offered to selected and approved potential purchasers. He said that he preferred the latter course, because he needed a "big brother". Tricontinental approached several parties to try to interest them in the shares; some interest was expressed, and further information was sought. It was not until mid-October 1989 that a memorandum of information was made available, shortly before Markland House was placed in receivership by SBV.

In speaking to the receiver, Mr Isaac indicated some interest in purchasing the remaining shares if the funding for the Ramuz project continued to be available. He had no response to this until late December 1989, by which time Coogal's trading bank withdrew any further support for the company until the share position was resolved.

Cadalso decided not to proceed with the share purchase, but introduced another possible buyer before the end of January 1990. It then took SBV until June 1990 to ratify the offer and acceptance. However by this time the economic scene had changed and, eventually, the purchaser withdrew.
So ran Mr Isaac's submission - and no doubt this was how matters appeared to him. However, a study of the SBV files tendered in evidence does not support this summary of events. It is clear that the offer by a third party to purchase the Markland House shares in Coogal was received by SBV, which was interested in the proposal but, in March 1990, made a counter proposal. Negotiations continued in the weeks and months which followed, with the sale of the shares becoming firmly linked to negotiations about the funding of the hotel development. There is nothing in the SBV files to suggest that its officers were dilatory or negligent in the conduct of these complex negotiations. It was no easy decision to risk substantial additional sums in a rather speculative hotel development, in order to try to redeem some of the losses already incurred. It may well have been in SBV's best interest that no further loans were eventually undertaken.

J. Conclusions and Findings

This was a very complex transaction, involving as it did Tricontinental, Hill, Jeans, Essington and Isaac - each having separate interests and objectives. This complexity only serves to highlight the fact that the transaction provided an extreme example of the haste, and totally inadequate documentation, which characterised so many Tricontinental transactions. Because the recordings were so inadequate, and the directors themselves have claimed to have no recollection of the transactions at all, it is impossible for the Commission to make any useful findings.

This is also true of the part played by Mr Johns because, although he was involved in the approval and change of the transaction as explained to him by Mountford, and may have insisted on at least one of the terms of that transaction, his only other significant part in the proceedings seems to have been the arranging of the agreement to fund the put option with Essington. His refusal to give evidence leaves the Commission with insufficient
material before it to pass any judgment upon his part in this particular transaction.

113 The position of Mr Mountford is rather different. In this, as in all other matters, he appeared to do his best to assist the Commission by recounting his knowledge of the transaction to the best of his recollection.

114 Obviously it can be argued, with the benefit of hindsight, that this was a very unwise transaction to enter upon - particularly at a time when Tricontinental was encountering its own liquidity problems. However, the risks inherent in the proposal were compounded by the totally inadequate analysis of the transaction. If Mr Mountford had undertaken a proper analysis of the information available to him on 17 April 1989, many of those problems would have become obvious.

115 It is acknowledged that there was some urgency to this transaction but the urgency only extended as far as the initial $3m drawdown. The haste to proceed with the balance of the transaction, i.e. the transfer of the Kimberley and Chard/Poltaz assets, seems to have come largely from Tricontinental. If further drawdowns had not been permitted until a full analysis had been performed, Tricontinental’s loss on this facility might have been limited to only $3m.

116 Even if it is accepted that there was some urgency to proceed to full drawdown, many of the deficiencies in security were obvious and required, not analysis, but the inclusion of appropriate routine protection for Tricontinental in its letter of offer. This would include taking charges over the operating assets of Markland House subsidiaries (which would then have revealed that these were already charged to other lenders) and a requirement that the assets acquired with the funds drawn down under facility 2 be charged to Tricontinental (which would have ensured that Tricontinental received the $2m paid for the Kimberley shares).
Furthermore, Mountford was aware of the limitation on Isaac's consent to the mortgage of Coogal’s shares. He therefore could and should have sought proper consent before permitting drawdown of anything more than $3m.

There are two aspects of the credit submission which cause the Commission particular concern, although that concern is reduced by reason of the fact that the credit submission was never seen by directors and constituted little more than a note for file. The first point was the absence from that submission of any reference to the Chard/Poltaz mortgages, and the false statement that the money which was in fact needed to pay them out was required as "working capital". Mountford, in his evidence, was confident that this had been a requirement of Johns.

The other significant omission was the fact that, if the put option was exercised within twelve months from the date of the transaction, then Tricontinental would itself provide Essington with the finance for it. Mr Mountford appears to be the only person within Tricontinental, other than Johns, who was aware of the commitment to fund the put option. It seems reasonable to assume that, if this commitment was left out of the credit submission when it came to be drawn up, it would also have been omitted from any oral information supplied to directors when their approvals were sought, if known to Mountford at the time. If so, this was a very serious omission and deserving of condemnation. However, as with other matters mentioned earlier, the evidence as to who said what to whom is so uncertain as to make a clear finding on this issue impossible.

This transaction highlights the fact that Tricontinental entered into high risk transactions with little or no analysis. Although it is not possible, on the evidence before the Commission, to attribute blame precisely to individuals, Tricontinental’s management in general, and Mr Mountford in particular, were clearly at fault in allowing this facility to proceed without
adequate analysis and, whether deliberately or otherwise, without complying with the procedures in place to evaluate such proposals.

120 The Commission, in all the circumstances of this case, and more particularly for general reasons explained in chapters 14 and 23, does not recommend that any charges be brought against Mr Mountford for his part in this transaction.

121 As indicated in the course of the narrative of this transaction, the Commission can find no reliable evidence on which to base any findings of improper conduct, either on the part of Tricontinental in allegedly putting pressure on Mr Hill to commit Markland House to the transaction, or by Mr Jeans in putting together a transaction between Tricontinental and Markland House which appeared, on first inspection, to contain some personal benefit for himself - because of his interest in Chard/Poltaz - and which involved only assets with which he had a connection. The Commission notes that any "advantage" that may have accrued to Mr Jeans appears to relate to the terms on which he originally acquired the assets, not to the terms on which they were passed on to Markland House.

122 Finally, the Commission is not satisfied that there was any negligence on the part of SBV in the way in which it handled this very complex and difficult transaction after integration with Tricontinental in May 1989.
 TRANSACTION REPORT 11

DALLHOLD INVESTMENTS PTY. LTD.

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A. **Background and Summary**

1. **Background**

   Dallhold Investments Pty Ltd (‘Dallhold’) was a proprietary company incorporated in Western Australia in 1969 and the private investment company for Mr Alan Bond and his family. Mr Bond held over 90% of Dallhold’s issued capital.

2. **Summary**

   Tricontinental’s relationship with the Dallhold/Bond group of companies began shortly after the bank’s formation in 1978, and was well established by the mid 1980’s when Mr Johns became managing director.

3. Tricontinental lent $100m (‘facility 1’) to Dallhold in February 1987 to assist Dallhold in subscribing for 64.5m shares (12.18% of issued capital) in the newly formed media company, Bond Media Ltd, following Bond Corporation’s $1b purchase of Mr Kerry Packer’s media interests. The Dallhold facility brought the total exposure of Tricontinental to the Bond group to $226m.

4. The security for the loan was to be those shares with "sufficient other acceptable listed securities" to provide 1.25 times cover.

5. Due to the less than successful float of Bond Media in June 1987, compounded by the October 1987 stock market crash, security for this facility dropped in value, and security was rearranged in November 1987 and July 1988 to include second mortgages of shares and charges over newly acquired gold and mineral interests of the Dallhold group.

6. Tricontinental’s second loan to Dallhold of US$85m (‘facility 2’), originally proposed in late 1988 and endorsed in April 1989, formed part of a syndicated facility of US$200m by HongkongBank, Tricontinental and Wardley Australia Ltd (‘Wardley’). The purpose of the syndicate was to enable Dallhold to refinance and restructure its group borrowings.
Tricontinental’s participation in the syndicate in May 1989 enabled repayment of the first $100m facility (and a smaller $2m facility) but resulted in its replacement with an increased facility of US$85m (approximately $107m due to the US dollar conversion). Dallhold defaulted in October 1989, and Tricontinental’s prospects for recovery of at least part of its facility now seems to depend upon the success of a proposed float of QNJV, expected to occur later this year.

B. Chronology

The chronology of main relevant events is as follows:

1987
29 January Credit submission for $100m facility
4/5 February Directors’ approval and letter of offer from Tricontinental to Dallhold for $100m commercial bill facility
25 February Board noted facility
April Extension of existing facility of $2m
7 May Drawdown of the $100m facility
5 June Dallhold provided shares in Bond Corporation as additional security on the $100m facility
28 July Tricontinental group exposure report showed total exposure to Bond group of $104,201,839
26 October Dallhold letter to Johns proposed to restructure the security around gold float which would retire the current debts owed by Dallhold and Metals Exploration Ltd
30 October Credit submission to amend security for $100m and $2m facilities following Dallhold purchase of St Joe Gold Inc
24 December Memorandum from Johns to directors about restructure of Tricontinental’s securities.
Memorandum enclosed various documents re St Joe Gold valuations

1988
7 January
Tricontinental letter to Dallhold stated that the re-arrangement of the security for the $100m commercial bill facility had been approved

24 March
Fresh security documentation completed

26 May
Dallhold letter to Johns confirmed intention to pay off debts due by Metals Ex by end of July 1988, and noted agreement to extend repayment of $100m facility until at least September 1988

30 May
Credit submission re extension of $100m facility to 30 September 1988 pending flotation of Bond International Gold Inc

8 June
Tricontinental letter to Dallhold notified approval of extension of the $100m facility

21 July
Memorandum from Johns to directors enclosed board paper covering restructure of Tricontinental’s security arrangement for Dallhold

Internal review of the Bond group of companies (34 pages)

July
Security amended to second charge over BIG shares

18 August
Credit submission for extension of $100m facility to 31 July 1989; approved at 24 August board meeting

30 September
Dallhold agreed to let $4m held on deposit be used as top-up security. Johns authorised repayment of $11.5m which had been held on deposit
3 October  Tricontinental letter to Bond in relation to security shortfall in excess of $40m
28 October  Deloitte Haskins & Sells' valuation of the Queensland Nickel Joint Venture of approximately $1.2b
30 November  Johns meets Bond to discuss restructure
19 December  Memorandum from Johns to directors of Tricontinental. Bond sought to rearrange personal borrowings and change security to cash flow being generated by QNJV. Credit submission attached recommended Tricontinental continue $100m facility to Dallhold - MEQ Nickel Pty Ltd
21 December  Tricontinental minutes of board meeting showed approval of Dallhold $100m facility, subject to offering of Bond's personal guarantee. Bond attended board lunch

1989

February  Internal review of the Bond group examining the group's preliminary financial statements for the half year ended 31 December 1988
15 March  Memorandum from Johns to Tricontinental directors set out variations to proposed terms and conditions in relation to the MEQ Nickel refinancing
25 April  Johns' file note set out details of further restructure
26 April  Tricontinental board paper. Managing director's report noted request to switch portion of security from shares to QNJV. Board agreed to change in security
C. Narrative

(a) Dallhold’s first facility

9 Mr Robert Pearce, Dallhold’s managing director, conducted negotiations with Mr Johns for the $100m facility in January 1987. He did not approach any other bank. Johns agreed to the proposal, subject to Dallhold repaying an earlier $35m facility. Johns’ memorandum to Clark made no reference to the asset backing of the issued shares, but noted the proposed issue price and Dallhold’s anticipation of quick profit. This transaction is an example of the board’s approach to lending against shares.

(b) Approval

10 The initial credit submission for facility 1 was approved by Johns together with Ryan, Smith and Moyle on 4 and 5 February 1987 and noted by the board in February 1987. Facility 1 was to have a term of no more than 12 months expiring on 31 May 1988. Drawdown was not to occur until May 1987. It actually occurred on 7 May 1987. Mr Pearce gave evidence that the Bond Media scrip was provided then, and it was assumed for the next three weeks that the issue price would be $1.55. The share cover was to be 1.25 times, a departure from the 1.3 times cover required by guidelines. Mr Pearce gave evidence he had "no great difficulty" in getting Johns to agree to reduced cover.

11 As a condition for the underwriting of the float, Dallhold needed to acquire 12.18% of Bond Media shares, which it gave to Tricontinental as security. There was contemporaneous comment in the business press that the
purchase price was too high and the float was overpriced.

Bond Media was listed on the Australian Stock Exchange on 4 June 1987 at an issue price of $1.55 per share, however the market failed to respond. The shares closed at the end of the day at $1.12.

The next day, when it was seen that the deficiency in cover was $54.7m, Tricontinental requested additional security. Further shares in Bond-related companies were provided. Between 5 and 15 June 1987 the Bond Media share price dropped from $1.10 to $1.01, and Tricontinental again sought top-up security because of a $5m deficiency in cover.

Dallhold continued to service the loan, but received frequent requests for top-up.

In August 1987, when it had become clear that the $100m facility was chronically in default of security covenants, Tricontinental increased its exposure to the Dallhold/Bond group by providing a $165m facility to Metals Exploration Ltd (‘Metals Ex’), a mineral exploration company controlled by Dallhold. The facility enabled Metals Ex to purchase $250m worth of convertible notes in Bond Corporation, which had embarked on a $750m fund raising exercise to support its rapidly increasing borrowings.

By October 1987, Tricontinental had approved loan facilities to companies within the Dallhold group culminating in a peak exposure to the group of $292m, with nearly all security being shares in Bond-related companies. Facilities to the Dallhold group of companies during the 1987-1989 period included those to Dallhold, Windsor Resources Ltd, Metals Exploration Ltd, Gladswood Pty Ltd, Bond International Gold Inc, Heronswood Ltd and Mid-East Minerals N L.
(c) First restructure of security - October 1987-January 1988

In October 1987 Bond Media share prices took a further plunge as a direct result of the stock market crash. To meet the deficiency in Tricontinental's security (at .86 times cover after the crash), Dallhold proposed to restructure its security package with second charges over newly-acquired mineral assets, which would ultimately become the source of repayment for the outstanding Dallhold and Metals Exploration debts. The proposals were set out in a letter from Pearce to Johns dated 26 October 1987. In this letter Pearce said that Dallhold needed the scrip which Tricontinental held for "greater flexibility", which the evidence revealed meant availability to other banks seeking top-up.

HongkongBank was lending Dallhold US$585m to complete the purchase of a majority holding in Mid-East Minerals, the Colosseum mines in California and St Joe Gold Inc, all of which would be combined (with Dallhold's interest in North Kalgurli Mines Ltd) into an international gold float, Bond International Gold ('BIG'). The BIG float was intended to raise in excess of $1.2b.

The security restructure was approved by Johns, Ryan, Rawlins, Smith, Morton and Moyle in early November 1987, subject to certain preconditions being satisfied.

Mr Pearce recalled telling Johns that both the Metals Ex facility (drawn to $144m) and Dallhold's $100m facility would be repaid by the end of February 1988 out of the BIG gold float. Pearce had a number of discussions with Johns about the release of the Bond Media scrip. This scrip was required to meet margin calls from other banks. Mr Pearce considered Johns was qualified to assess the security swap and to make some assessment of what was being offered in exchange for the scrip. Johns informed the board of a planned February repayment date, but may
not have informed the board that the Bond Media scrip was required by Dallhold to meet other margin calls.

Mr Pearce gave evidence of the relationship between Dallhold and Drexel Burnham Lambert ('Drexel') which arose out of the purchase of goldmining interests including St Joe Gold and the Circus mines. The Bond Group had an earlier relationship with Drexel as they had done some underwriting work, including two junk bond issues for Bond Brewing and the Heileman purchase. Drexel managed the BIG float.

The amendment of security was approved in November 1987 by Johns, Rawlins, Moyle and Ryan. Tricontinental's solicitors were instructed to alter security documentation in early January 1988, but it was not until 24 March that such documentation was complete and the Bond Media Ltd and Bond Corporation Holdings Ltd scrip returned to Dallhold. The facility remained in default of agreed security cover during this period.

(d) Extension of facility 1 - May 1988

On 30 May 1988 Johns, Ryan and Carr approved a credit submission to extend the $100m facility for four months to allow for the BIG flotation and sale proceeds to materialise. By this stage, Tricontinental had released the 64.5m Bond Media shares and was totally reliant upon second ranking security over the various mineral assets. The board ratified the extension. Tricontinental's exposure to the Dallhold group at this time was $281m.

Although Johns had received a letter from Pearce in late May, foreshadowing that the BIG float would only yield sufficient funds to repay the majority of the Metals Ex facility and not sufficient to repay the $100m facility, this fact was not set out in the credit submission of 30 May 1988 or, it seems, told to the board at that time.
(e) Second restructure of security - BIG float - July 1988

Documentation for the BIG float and the second restructuring of security was finalised by July 1988. Tricontinental's board was asked, in a July board paper, to endorse the change in Dallhold's security to a second mortgage over 33.3m BIG shares.

To overcome an underwriting shortfall and ensure the successful float of BIG, which Tricontinental needed as a repayment source, Tricontinental agreed in late July to purchase up to US$15m BIG shares. A formal investment banking credit submission dated 9 August 1988 was prepared. The investment banking facility was noted at the August board meeting as having been approved by directors. A contemporaneous minute records that Smith, Moyle, Ryan and Johns gave approval on 27 July. Tricontinental was to have a put option from Mr Bond to expire in six months, on 31 January 1989.

(f) Further extension of facility 1 - August 1988

In August 1988 a credit submission was tabled by Johns at the board meeting. The submission was to extend the $100m facility to 31 July 1989 to enable the loan to be shown as a non-current liability in Dallhold's balance sheet. A side agreement between Tricontinental and Dallhold was to provide that the facility would, in fact, only be extended to 31 March 1989. The credit submission approval sheet showed that the board approved the extension on 24 August 1988, "subject to directors being informed at September board meeting of arrangement with A. Bond".

Mr Ryan gave evidence that Johns informed the August board meeting of a proposed extension to 31 March in principle, with a further review paper to be produced at the next board meeting. He acknowledged Johns may have referred to the fact that Dallhold wanted an extension to the end of July, but was sure a side agreement was not discussed. Mr Ryan said he
would not have agreed to such an arrangement. Neither Smith nor Moyle could recall any reference to a side agreement.

(g) September 1988 board review - extension

In September 1988 the facility was in default of the security covenant of 1.25 times cover. On 21 September 1988, Johns provided Clark with information for the preparation of a review to be presented to the September board meeting. The facility was to be reduced by an amortisation payment of $20m or $30m flowing from the Bond/Bell merger. The board agreed to the extension on 28 September 1988 because Tricontinental's "... exposure to the Bond group had been reduced substantially in recent months and in view of the long standing relationship with Bond group ..."). The reduction referred to was the repayment, from the BIG float, of $US89.5m of the Metals Ex facility.

(h) Release of $11.5m funds on deposit to Dallhold

On 30 September 1988, upon request from Dallhold and with the consent of Johns, Tricontinental released $11.5m cash on deposit to Dallhold, even though a security cover shortfall of $17m existed. By agreement with Dallhold, $4m of the cash on deposit was retained as top-up security. There is no documentary or other evidence that Johns told the directors of this event. He, of course, did not give evidence.

Mr Hunter did not recall any discussions about the release of the $11.5m cash deposit at this time; but Mr Thomas, from Tricontinental's Perth office, wrote to Johns pointing out the security shortfall and asking whether he approved the release.

Mr Cross believed the $11.5m was a Dallhold deposit on Tricontinental's money market which did not belong to Tricontinental. Due to security shortfalls, it had been transferred as security to the $100m facility, but the evidence suggests that Johns and Cross had agreed that only $4m should be
used for this purpose. It is noted that Dallhold had this amount of cash available on deposit with Tricontinental, but was not required by Johns or anyone else to lodge it with a right of set off.

(i) Dallhold's second facility - third restructuring of security

In November 1988 Mr Johns was told that Dallhold was preparing to restructure its group borrowings. The restructure was to rely upon a recent valuation of Dallhold's interest in a nickel processing operation, Queensland Nickel Joint Venture ('QNJV'). In late October 1988 a valuation by Deloitte, Haskins & Sells, ('Deloittes') commissioned by Dallhold, had valued QNJV with a debt free market value of $1.2b. The valuation had been supplied to the Queensland Government in order for it to assess a debt-equity swap. In November 1988 the Queensland Government agreed to convert approximately $190m debt into a 12.5% interest in the venture. It appears it relied upon Deloittes' valuation to justify the debt/equity swap.

Mr Brent James, a chartered accountant with Deloittes' Sydney branch, conducted the valuation and gave evidence to the Commission. Mr James had experience in valuation of resource projects, including coal, gold and petroleum projects. He was told the timetable for preparation of the valuation was only two to three weeks. He visited the plant and examined relevant matters within this time frame.

Mr James told the Commission his appreciation of the valuation was that it was to establish a fair value of the asset for Dallhold to put on their balance sheet, ie fair value of that asset on a debt-free basis. The aim was to carry out a business valuation of the asset which, he noted, was somewhat different from simply valuing the asset. It was submitted by Freehill Hollingdale & Page, solicitors for Deloittes, that the purpose of the valuation changed to assisting Dallhold in the assessment of the proposed equity participation by the Queensland Treasury Corporation
('QTC'), but the method of valuation did not alter with the change of purpose. Deloitte did not consent to the valuation being provided to Tricontinental.

Deloitte did not carry out any independent verification of information provided to them by MEQ Nickel Pty Ltd ('MEQ Nickel') regarding QNJV. MEQ Nickel was a wholly-owned subsidiary of Dallhold. Mr James decided on a discounted cash flow analysis as the correct basis for valuation due to the number of possible variables, adopting 14.75% as a fairly conservative figure. He agreed Deloitte's valuation was dependent upon nickel prices remaining in the US$5 per pound range, stable Australian/US dollar exchange rates, combined with management's ability to source and process imported ore on a cost effective basis.

Mr James said he was unaware that the report was provided to Tricontinental as Dallhold's banker. He was concerned, as it represented a valuation which excluded any question of liabilities. Mr James confirmed the valuation was never intended as a document to support lending. By way of contrast, Mr Cross, who commissioned the valuation, testified that Deloitte were aware and had no difficulty with Johns being provided with a copy of their valuation. Mr Cross agreed that if the valuation was used for a credit submission it would be necessary to draw attention to the fact that Dallhold borrowings were not taken into account.

Johns met Alan Bond on 30 November 1988 to discuss Dallhold's facilities. The memorandum which Johns prepared after the meeting stated that Dallhold was restructuring its securities and that its facility would be reduced to $75m by March 1989. The memorandum also noted that the cash flow generated by QNJV was sufficient to service all Dallhold's debts.
(j) Approval of restructure

On 19 December 1988, a credit submission endorsing the proposed restructure of Dallhold's group borrowings (including those of MEQ Nickel and Mid-East Minerals) was prepared and circulated to all directors. A syndicated facility of $900m was proposed to refinance Dallhold's existing borrowings. Tricontinental's participation was to be $100m, with an initial five-year term and an amortisation schedule. Tricontinental's security for this new facility (proposed to be in the name of MEQ Nickel) was to come from charges over MEQ's assets and cash flow arising from its 87.5% interest in QNJV. Tricontinental's new $100m facility to MEQ Nickel would be used to repay the existing $100m Dallhold facility.

The credit submission outlining this new syndicated facility came before the Tricontinental board on 22 December 1988. After some discussion, the board approved the credit submission, by a majority decision, subject to obtaining a personal guarantee from Mr Bond. Johns was in attendance at the December board meeting together with Carr, Morton, Ryan, Smith and Ziebell. Mr Ryan dissented. Mr Bond joined the board for lunch.

(k) March 1989 amendments

In a memorandum dated 15 March 1989, circulated to Tricontinental directors, Johns reported that the proposed Dallhold syndicate had been altered. The syndicate was now reduced to US$550m to be lead managed by Wardley. Tricontinental's participation was to be a US$85m facility for five years with preconditions and covenants said to enhance Tricontinental’s position. No details of this were provided. Carr, Ryan, Smith, Moyle and Morton telephoned their approval of the revised submission.
(I) April 1989 amendments

One day after a Tricontinental credit submission had been drafted (24 April 1989) to extend a Dallhold $2m facility for two months, Johns recorded a conversation with Cross revealing that Dallhold had reduced its borrowings in the past two months by $36m, principally from the cash flow of MEQ Nickel.

Mr Johns did not record, in any contemporaneous documents examined, whether he inquired why Tricontinental was not a participant in these payouts.

Mr Cross reported that Dallhold's incoming cash flow, from January to April 1989, would total approximately $81m. Due to the high price of nickel, Dallhold would be receiving an average net cash flow of $18m per month from MEQ. Cross told Johns that a number of smaller banks were becoming nervous in view of Bond Corp's share price, and threatening to issue demand notices. Therefore he was asking both Wardley and Tricontinental to restructure their facilities solely against the cash flow of QNJV. Johns told Cross the restructure would be considered by the Tricontinental board.

As concern and pressures were developing rapidly within Tricontinental at this time, the evidence as to what facts were reported on by Mr Johns at the 26 April board meeting is far from clear. The minutes refer to a switch of security from Bond group shares "to nickel production of Queensland Nickel Pty Ltd."

Mr Cross gave evidence that Dallhold could only offer, as security to Tricontinental, a charge over the shares Dallhold held in MEQ Nickel. Standard Chartered Bank had first charge over the actual assets of MEQ Nickel, a fact which was apparently never disclosed by Johns to Tricontinental directors.
Mr Cross explained the reason Dallhold became the syndicate borrower, rather than MEQ Nickel as originally proposed. Standard Chartered Bank would not allow the facility to be put into place directly against MEQ assets, so Mr Cross was forced to revise the proposals and substitute a charge over MEQ shares. The term of the syndicated facility had been reduced from five years to six months due to concern in the market place about Bond Corp and its parent, Dallhold.

The syndicate refinancing was to provide funds to enable repayment of Tricontinental's $100m facility 1. Facility 2 was to be serviced and repaid from the cash flow generated by the joint venture. The facility was in US dollars to match the dominant currency of nickel revenues. HongkongBank had the primary carriage of the discussions as to the nature of the security for the syndicated facility. Tricontinental fell in behind HongkongBank, but on similar terms. Final security for the three syndicate members was a charge over 77.5% of the shares of MEQ Nickel and an assignment of the cash flow stream of MEQ Nickel to Dallhold.

The syndicated facility was to be repaid within six months, from the sale of BIG shares and a 20% selldown of MEQ's interest in QNJV. The likelihood of this occurring within six months does not appear to have been questioned by Johns or the directors.

At the April 1989 board meeting, Johns reported on the request from Cross to rearrange the existing security and to be solely secured directly against MEQ's interest in QNJV. Upon execution of all the documentation by syndicate members, Tricontinental was to discharge previous securities held covering the earlier facilities, except for a remaining cash deposit of $4.45m, which was to be retained under a right of set-off.
Johns had been heavily involved with the ABL proposal and with liquidity problems at this time. He was no doubt working under considerable pressure when he endorsed this alteration.

Tricontinental’s board agreed to this change. All directors attended the meeting.

D. Role of Mr. Johns

(a) As account manager

Mr Johns was account manager for Dallhold and the first point of contact for Mr Pearce, and then his successor, Mr Cross.

(b) First restructure - October 1987

The proposals for the first restructure of security were conveyed by Pearce to Johns in a letter to him dated 26 October 1987. Johns was told by Pearce that the release of scrip held by Tricontinental would give Dallhold greater flexibility with other lenders and was required to meet margin calls from other banks.

(c) Extension - May 1988

Johns, Ryan and Carr approved the extension of the facility in May 1988. Johns was told by Pearce that the BIG float would not yield sufficient funds to repay the Dallhold facility, but this was not set out in the credit submission of 30 May. There is no persuasive evidence that this was conveyed to the board in May 1988, and it probably was not, but it was certainly appreciated by July 1988.

(d) Extension - August 1988 - side agreement

Johns arranged the side agreement in relation to the August 1988 extension which was recorded in the managing director’s report to the board for the meeting of September 1988.
(e) Extension and review - September 1988

Johns gave Clark information for this review.

(f) Release of $11.5m deposit

Johns consented to this request from Dallhold. There is no evidence that he told the board of his decision, and he recorded no explanation of the matter.

(g) Dallhold’s second facility - third restructuring of security

Johns continued as account manager and was told of a third restructuring on 30 November 1988, when he met Bond to discuss Dallhold’s facilities with Tricontinental.

There was no evidence to suggest that Johns had the feasibility of this proposal carefully examined, or put pressure on Dallhold to keep the amortisation payments flowing from the Bond/Bell merger.

Johns continued to be the first point of contact, receiving notification of amendments to the syndicated restructure in March and April 1989, and he endorsed alterations together with other directors.

E. Role of Other Officers or Staff Members

(a) Mr Hunter

Mr Hunter gave evidence that a side agreement, to enable a loan to be shown as a non-recurrent liability on the balance sheet, was most unusual in his experience at Tricontinental. The letter of offer in relation to the extension, which incorporated the substance of the side agreement, was prepared by Mr Hunter’s assistant, Debbie Wall. Mr Hunter believed Tricontinental’s solicitors must have had an input into the letter of offer. This was confirmed by other evidence.
(b) Miss Heffernan

Miss Heffernan's role as securities officer in Perth overseeing the Dallhold account was strictly to monitor security documentation, cover ratios and other administrative functions. She had no authority to assess the adequacy of security or initiate any enforcement action.

(c) Mr Thomas

Mr Thomas was also monitoring the Dallhold cover in Perth and expressed concern at the mounting deficiency as the BIG share value declined to US$8.25m in late September 1988. He queried whether Mr Johns knew of this, and was still willing to release the $11.5m held on deposit. After a chastising telephone call from Mr Bond, about a demand for top-up security being made to a middle-level manager, Mr Johns confirmed the release of the deposit and apologised for the approach.

(d) Mr Stott

Mr Stott's evidence was that he had no direct involvement in matters such as setting the share cover on the first facility. He could not recall any feedback from directors in relation to the restructuring of credit after the crash. This tends to confirm the directors' evidence that Dallhold's proposals for the restructure were conveyed to them by Johns and the relevant credit submissions.

(e) Mr Hue

Mr Hue prepared the board paper for July 1988. He compared the projected issue price of the BIG shares in the valuation provided by Drexel with the net asset backing of the shares as derived from available information. He noted the asset backing was US$11.72m, as against the projected value of US$15-$17m. In making his assessment he noted that, "Proposed new security consisting of BIG shares will only be effective after BIG shares have been listed, a market value established and TCL security value determined". He gave evidence that the risk factors in
relation to the proposed float, which he set out in the board paper, were identified from the documents in the file “just by looking at the figures or by just a reasoning calculation”.

Mr Hue also gave evidence that the most likely explanation of why he failed to incorporate publicly available and relevant information in an internal review for the March 1989 board meeting also prepared by him, was that there was always pressure of time because Dallhold “was Mr Johns’ client”.

F. Role of Directors
(a) Dallhold’s first facility

In early February 1987, Johns, Ryan, Smith and Moyle approved the loan of $100m.

Mr Ryan

Mr Ryan gave evidence that he was unaware that Dallhold’s purchase of 12.18% in Bond Media was a requirement by the underwriters for the float, although he realised the $100m loan was to take up “12 1/2 per cent or some such percentage ... in Bond Media”. He first appreciated the Dallhold facility was under-secured, due to the drop in Bond Media share value, after the share crash in October 1987. He had no recollection of any concern before that date about the Bond Media float not being as successful as anticipated.

Mr Smith

Mr Smith gave evidence he could not recollect “anything specific” in relation to the first credit submission. Mr Smith said he and the board knew that the Bond group was one of Tricontinental’s biggest exposures at the time of granting the $100m loan. He also knew that the price of the Bond Media shares on listing reflected that too much had been paid (by
Bond Media) for the television stations acquired. Mr Smith also gave evidence of being aware of the high gearing of the Bond group.

Mr Moyle

Mr Moyle agreed that he approved the January 1987 credit submission and gave evidence that he was aware that Tricontinental’s exposure to the Bond group was increasing in 1987, and he had become aware of the Bond group’s heavy indebtedness to other banks in 1976 to 1978. His own requirement was that "exposures to the Bond group should always be short-term with clear cut sources of repayment and with watertight documentation". He said that at one time he and Smith discussed the exposure of Tricontinental to the Bond group with Mr Hancock, and he thought that was in relation to the $100m. He was certainly aware that the $100m was to subscribe to a percentage of Bond Media shares exceeding 5%, and he recalled that the decline in value of the Bond Media shares "was very well publicised at the time". When looking at the January 1987 submission, Moyle said he did not enquire about other lenders to the Bond group, even though he expected credit submissions to be self-contained.

(b) First restructuring of security - October 1987-January 1988

Mr Ryan

Mr Ryan recalled board discussion in relation to the submission to swap Bond Corp scrip for second ranking security in gold interests. He considered that, on all the evidence available at the time, it appeared better security was being offered and he believed there was sufficient expertise within Tricontinental to make an assessment about this. He noted also that the substitution of the gold assets was subject to Tricontinental obtaining satisfactory valuations from Drexel and Salomon Brothers. These were being sought by Dallhold. Mr Ryan admitted concern that the substituted security was a second ranking charge (after HongkongBank’s priority as to US$585m), but considered the security was still better than the Bond Media and Bond Corp shares which were falling on the market.
Mr Smith

Mr Smith recalled the assurance from Johns, supported by a report from Salomon's, of confidence in the feasibility of the BIG float. He gave evidence that it was expected at board level that the BIG float would be successful, notwithstanding the economic climate after the crash. He recollected the board's reaction was positive because it appeared the security situation was to be improved. He noted, however, that there was no alternative to the substituted security arrangement.

Mr Smith recalled concern over the Bond Media shares at this time and was aware of the difficulties being experienced by Mr Bond. He believed the repayment of the Metals Ex loan out of the BIG float would have been taken into consideration by the board in extending the Dallhold $100m loan. He also believed the board became aware that repayment of the Dallhold $100m out of the BIG float was unlikely.

Mr Moyle

Mr Moyle said that he was probably aware of Dallhold group's increased borrowings and Bond Corp's purchase of Heileman Brewery in October 1987 for US$1.2b. He believed, on the basis of the valuations of the gold interests, that Tricontinental was improving its position in getting out of security which had not come up to expectations and substituting security where values appeared more favourable. He said the fact that the swap in security was not to take place until the market had established the value of the new shares in BIG was an additional safeguard. In fact, the security swap from the Bond Media and BCHL shares to second charges over the gold assets occurred in late March 1988, whilst the BIG shares did not float until July 1988. (It should be noted that the initial $100m was similarly drawn down before the market established the value of the Bond Media shares.) Subject to suitable valuations from Drexel and Salomon being obtained, Mr Moyle would not have expected the facility to have been referred back to the board.
(c) Extension of facility 1 - May 1988

Ryan, Carr and Johns approved the first extension at the end of May/early June 1988. The reason for the extension was said to be the "pending flotation". Mr Moyle recalled the delays in the BIG float and believed these were reported on by Mr Johns to the board. Mr Moyle was not too concerned about the four months' extension in May 1988 as delays were to be expected.

(d) Second restructuring of security - BIG float, late July 1988

This second restructure had been foreshadowed in earlier submissions and approved by the directors. Johns circulated a board paper outlining the restructure on 21 July 1988. Mr Carr's approval was subject to the security ratio being reinstated. The other oral responses were not recorded.

An internal review of the Bond group was also presented to the directors at this time. Both the internal review and board paper noted that, although Tricontinental's $144m facility to Metals Exploration was to be repaid from proceeds of the BIG float, the outstanding $102m in facilities to Dallhold were now to be repaid through refinancing by 30 September 1988. Tricontinental's lending/security ratio was to be dependent upon the value placed on BIG shares, which were estimated at a value between US$15-17 per share upon flotation. A second charge over Dallhold's 33.3m shareholding in BIG was to become the sole security for Dallhold's outstanding $102m facilities (except for a guarantee by Mr Bond which was attributed a nil value).

Although repayment for the Metals Ex facility was originally to come from redemption of the Bond Corp notes by August 1988, this did not occur, and Dallhold diverted $109.5m proceeds from the BIG float to repay substantially the Metals Ex facility. (Mr Cross confirmed that Metals Ex made a substantial loss in its ultimate disposition of Bond Corp convertible
notes). Thus Tricontinental’s source of repayment for the $100m facility, which had been altered twice, was now totally dependent upon Dallhold producing another repayment proposition.

Security at this time consisted of the second registered share mortgages over 33.3m BIG shares which had floated on the New York Stock Exchange in late July at a price significantly lower than forecast. As at mid-August, the BIG units were trading at US$10.37, well below their issue price of US$12.60 a share. For this reason, additional security consisting of 6.5m Bond Media shares and a second mortgage over 37.3m Mid-East Mineral shares were given. Tricontinental also retained the personal guarantee from Mr Bond.

Mr Moyle said the board was aware that the BIG issue had fallen somewhat below what was expected. However he did not recall any specific board discussion as to the impact of the lower float price.

The presence of board papers, namely the internal review and the restructure board paper concerning the Dallhold group exposures, did not prompt any enforcement action. Tricontinental relied on Dallhold to produce a refinance proposal.

(e) Tricontinental’s purchase of BIG shares

Mr Moyle did not recall Tricontinental’s purchasing shares in BIG and did not recall any discussion of the need to do this in the light of an underwriting shortfall.

(f) August 1988 extension and side agreement

Mr Ryan said that he believed Mr Johns informed the August board meeting on a proposed extension to 31 March in principle, with a further review paper to be produced at the next board meeting. He acknowledged that Johns may have referred to the fact that Dallhold wanted an extension
to the end of July, but was sure a side agreement was not discussed. Mr Ryan said he would not have agreed to such an arrangement. He also said he would be surprised if the credit submission had been approved by the board as it misled those relying on Dallhold’s published accounts, since it did not disclose all current liabilities.

Upon reviewing the credit submission of 18 August 1988, Mr Moyle said that he found the proposed side agreement unusual. He admitted that it was not unusual in commercial agreements to set a date so that a liability would appear non-current, but he had never seen it done in this fashion, by way of a side agreement. Mr Moyle said he could not recall a side agreement being discussed at board level, but in view of the managing director’s report in the September board paper which specifically referred to "a side agreement", he would have expected it to have been discussed.

Mr Pearce acknowledged that the request to extend the facility to July 1989 was made by him to Johns for two reasons:

- so that the $100m borrowing would appear as a non-current liability and make the balance sheet appear better; and
- to facilitate Cross’ accession as Dallhold’s managing director and relieve him of a large borrowing immediately falling due. Pearce stated that Johns would only agree to the extension if a side agreement limiting the extension to March 1989 was incorporated.

Counsel for the directors submit that it is open to the Commission to find the directors for whom they appear were not aware of, and did not approve, the credit submission of 18 August 1988 in so far as it refers to a side agreement. Counsel assisting relied on Mr Moyle’s evidence that the matter in all probability would have been discussed because it appeared in the managing director’s report.
As a precondition to the extension, Dallhold was to satisfy Tricontinental fully of its means for refinancing upon expiration of the facility in March 1989. By this stage Tricontinental had received US$89.5m in partial repayment of the Metals Ex facility. A further US$19m was to come by the end of August. (In fact this was received in October 1988.) Tricontinental agreed to refinance the $10m residue of Metals Ex’s debt for a maximum of six months.

The remainder of the US$287m proceeds of the BIG float went to National Australia Bank and HongkongBank. By apportioning the limited surplus from the BIG float to repayment of the Metals Ex facility, Tricontinental’s $100m facility became totally dependent upon new schemes of repayment devised by Dallhold.

Extension of the $100m facility was approved by all the directors at the August 1988 board meeting, subject to their being informed at the September board meeting of a formal timetable with Mr Bond for the facility repayment.

(g) September 1988 board review - extension

Following requests for additional security cover in September 1988, Dallhold provided top-up security with additional Bond Media and BCHL shares. As requested, at the September board meeting the managing director’s report contained a report on Dallhold which anticipated that Dallhold’s investments, the Greenvale Nickel refinery and the proposed Bell/Bond merger would produce sufficient cash flow to Dallhold in 1988-89 to repay most of its current borrowings, including Tricontinental’s facilities. (By this time Bond Corp, in which Dallhold had a 54.2% interest, had acquired approximately 70% of the Bell Group Ltd.)

The board paper proposed that, from the funds Dallhold would receive from the Bond/Bell merger, either $20m or $30m would be used in
reducing its debt to Tricontinental by December 1988. The remaining outstanding debt was to be repaid by 31 March 1989 from asset sales and/or refinance. Following this report, the Tricontinental board unanimously approved the facility’s extension to March 1989.

Mr Pearce said that he had some discussions with Mr Johns concerning possible repayment of the Dallhold facility out of Bell Resources’ "cash box" and explained how this was to occur, but Mr Moyle did not recollect Johns mentioning whether this would provide a source for partial repayment of the $100m facility. Mr Moyle’s view of the Bond acquisition of Bell was that it would add cash flow and cash resources to the Dallhold group and improve its position overall.

Mr Cross acknowledged that the $20m to $30m amortisation was not made. It was his understanding that the amortisation arrangements were overtaken by events in December concerning the restructure of the $900m syndicate. Mr Cross pointed out that approval for Tricontinental’s $100m participation in the syndicate (21 December 1988) was received before the date of the scheduled amortisation (31 December 1988).

It is possible that the $100m facility could have been reduced to $70-$80m had Mr Johns or the directors insisted upon the amortisation payment being met before agreeing to restructure the entire facility.

(h)  Restructure - third amendment of security - December 1988
This was approved at the December 1988 meeting by Johns, Carr, Morton, Smith and Ziebell. Mr Ryan dissented.

Mr Ryan said he did not approve the credit submission as he had had enough of Mr Bond and thought Dallhold could obtain its money elsewhere. He thought it was "going to the well once too often", and that if the security was as good as suggested, Dallhold could try its luck
elsewhere. Tricontinental valued MEQ's 87.5% interest in QNJV at $1.05b, accepting at face value Deloittes' valuation. Mr Ryan did not recall seeing the Deloittes' valuation. It was not attached to the credit submission although a lengthy summary of it was included in the submission, which noted that it was conducted on a debt free basis.

Mr Smith said that Mr Ryan was always concerned about Tricontinental's exposure to the Bond group, however he himself had faith in the security Tricontinental held and, in particular, the personal guarantee of Mr Bond, which he thought was not available to others. Mr Smith said the opportunity to swap security from second mortgages over the BIG shares to security over the QNJV was viewed by the board favourably, as the BIG shares were dropping in value and the Queensland nickel venture was seen as a very valuable asset.

Mr Smith was questioned about QNJV and whether any consideration was given at board level to the facts that nickel prices might fluctuate or that ore deposits supplying the venture only had three years' life. Mr Smith said he would have expected the credit analyst to have made a judgment on these matters. He was aware that the credit submission put to the board accepted at face value the Deloittes' debt-free valuation of $1.2b. He noted that the submission stated the security being offered was a charge over MEQ's assets including the cash flow. Mr Smith expected the cash flow from the mine to service the loan and also to reduce it progressively. Later events caused the security to be altered so that Tricontinental's charge was only over MEQ Nickel shares, as prior charges existed over the assets.

(i) March 1989 amendment

This amendment was approved by Carr, Ryan, Smith, Morton and Moyle on the basis of a memorandum submitted by Johns. Mr Ryan remembered discussion at the March 1989 board meeting, on the managing director's
report of an internal review of all major companies within the Bond group. The Lonrho reports, which were very critical of the Bond group and its financial status (claiming Bond Corp to be insolvent), were also discussed and a cause of concern. However Mr Ryan noted there were other brokers putting out predictions different from Lonrho's. The internal review noted Dallhold's liabilities increased by $348m from June to December 1988 and totalled $886m. (Thus the need for Dallhold to refinance $900m in borrowings.) Mr Ryan reversed his earlier stance and endorsed later changes to the facility. He said in evidence that it was a "no choice situation", and noted that the terms had been slightly improved. The facility's term, however, was still for five years, which was not in line with the directors' stated objective to keep the Bond facilities short-term.

(j) April 1989 amendment

This amendment was presented orally by Mr Johns and approved by the directors at the board meeting. Mr Ryan said that he was now not clear as to what was recorded in the minutes, and intended in April 1989, by the request to switch a portion of Tricontinental's security from shares in Bond Corp and Bond Media to the nickel production of Queensland mines, although he and the board agreed to the change. He said he first became aware that the security was not a first registered debenture charge over all the assets of MEQ Nickel, but rather security over its shares, when Mr Moyle alerted him to the fact that the security wasn't what they thought it was, and that Standard Chartered Bank had a charge over the QNJV cash flows ahead of Tricontinental.

Mr Moyle did not recall discussion at the April 1989 meeting concerning the restructured security. His impression had always been that Tricontinental had security over the cash flow operations at MEQ Nickel. It was a surprise to him when he later found out that the security was over MEQ shares, because that did not accord with his recollection. He did not discover this until SBV had taken over the management of Tricontinental.
G. Events after May 1989

Tricontinental records show the Dallhold $100m facility 1 as matured and repaid on 3 May 1989. Due to the conversion to US$, a $2m surplus was created and given to Dallhold rather than applied to reduction of the new outstanding balance of US$85m.

Soon after the US$85m facility was drawn down, Tricontinental merged with State Bank of Victoria (‘SBV’) and management of the loan was transferred to SBV’s corporate lending division. An SBV credit submission, reviewing the Dallhold group facilities and exposure in late July 1989, repeated substantially the earlier analysis in Tricontinental’s review papers.

By accepting Tricontinental’s last letter of offer, dated 28 April 1989, Dallhold undertook to sell its interest in BIG, and to procure a sale of 20% of its interest in QNJV, by 30 September 1989. An audit report for the year ended 30 June 1989 determined that there was no need to make provision for the Dallhold facility as security was adequate and the loan was being serviced.

Due to a fall in the price of nickel and the apparent inability of Dallhold to sell its interests in QNJV to effect repayment, Dallhold defaulted on facility 2 as at 31 October 1989. Prospects for at least partial recovery now depend upon the success of a proposed float of QNJV, expected to occur later this year.

Following Dallhold’s inability to repay Tricontinental’s US$85m facility in October 1989, the syndicate was restructured in February 1990. Tricontinental agreed to participate, through Tricontinental Australia Ltd (‘TAL’), in a US$300m refinancing facility with Hongkong Bank and Bank of New Zealand. TAL’s new facility incorporated the existing US$85m
outstanding plus interest due but unpaid at the date of participation in the syndicate, which turned out to be US$87,377m. A credit submission, dated 16 February 1990, was approved by Tricontinental’s credit committee under urgency delegation and later ratified by the Tricontinental directors, Hancock, Ironmonger, Smith, Morton, Baker, Moyle, Clendenin and Renard. No evidence was led at the Royal Commission on the merits or disadvantages of participating in yet another refinance syndicate.

Although the term of the revised syndicate facility executed in February 1990 was to be two years, in July 1991 the position had deteriorated to the extent that HongkongBank, BNZ and Tricontinental moved against Dallhold to secure their US$300m exposure. The syndicate was unsuccessful in forcing Dallhold to find a buyer for MEQ’s interest in QNJV. The only interest payment received from the refinancing was in November 1990. The banks obtained a judgment from the NSW Supreme Court in September 1991 that the syndicate facility was due and payable.

H. Expert Evidence
(a) First facility

Mr Weaving gave expert evidence about each of Dallhold’s facilities. He criticised the approval of the first facility because the value of the shares could not be determined until they were listed and it would have been necessary, he said, for a banker either "to put in place measures whereby no funds were to be drawn down until a price was established for the shares", or "to provide that there was other adequate security available should the security ratios not be met upon listing". He noted also that, to meet normal lending criteria, more information was needed in the credit submission - especially as the lending involved 100% financing and the security represented heavy reliance on the Bond group.

Counsel for the directors seek to rely on the presence of underwriters by way of justification for the directors’ approval of the first facility. Mr
Pearce gave evidence that the underwriters insisted on Dallhold's acquisition of the 12.18% parcel before they would agree to a commitment.

(b) First facility - first restructure - November 1987-January 1988

Mr Weaving did not agree that security taken after October 1987 was better than the security which Tricontinental held at the time of the stock market crash. He said he would not have released first charges over Australian shares (Bond Media and Bond Corp) to take second charges over off-shore gold interests.

Mr Weaving pointed out that security over offshore mineral assets could be difficult to enforce, and was subject to foreign influences such as exchange rates, downturn in commodity prices and lack of control over cash flows.

Finally, counsel for the directors submit in substance that Mr Weaving's assessment of the security swap was inadequate, as he did not appear to emphasise in his evidence the precondition that a value be established for the BIG shares before release of existing security. But counsel assisting submit that it would have been impossible for Tricontinental to retain the second ranking charges it held over the gold assets as these gold assets had to be on-sold into Bond International Gold so that the float could occur. In fact, the second ranking charges were discharged on 26 July 1988 and BIG floated on the New York Stock Exchange on 28 July 1988.

(c) Second facility - third restructuring of security

Mr Weaving considered that the first registered debenture charge over the assets of MEQ Nickel, even if it had been acquired, would not have strengthened Tricontinental's security, because the only assets of MEQ Nickel were its plant, equipment and shares in QNJV. It was the joint venture that held the real operating assets, and those assets had been pledged to Standard Chartered Bank in priority to Tricontinental. He
pointed out that Tricontinental should have had details of Standard Chartered Bank’s arrangements, as that bank had assumed over $800m in debt in relation to the project and naturally had first security over the assets.

115 Mr Weaving’s assessment of the nickel project was that virtually all MEQ had was plant and equipment to process imported ore. He also noted that the exchange risk on the total operation was very high.

116 Counsel for the directors criticise Mr Weaving’s comments because he did not refer to certain items of security including:

(i) assignment of cashflow strength in the joint venture;
(ii) assignment of MEQ shares of sale contracts in the joint venture; and
(iii) the personal guarantee of Alan Bond.

(d) Prudential considerations

117 Mr Weaving noted that the total exposure to the Bond group at the time of the first credit submission, 29 January 1987, was $226m, representing 2.2 times Tricontinental’s capital base and 32% of SBV’s capital base of $700m as at June 1987. There was no disagreement that the exposure of Tricontinental to the Bond group at October 1987 was $292m.

I. Significant Issues

118 The Commission’s examination of this transaction has involved consideration of a number of significant matters. These include:

(i) the adequacy of the board policy on lending against shares;
(ii) the adequacy of security;
(iii) quality of credit analysis;
(iv) departures from guidelines;
(v) prudential considerations;
(vi) the adequacy of monitoring;
(vii) inadequate account control;

(viii) Dallhold's alleged failure to keep accounting records which correctly recorded the transactions and financial position of the company.

(ix) alleged offences under s229(2) of the Companies Code against Johns, Ryan, Smith and Moyle arising out of the approval of the January 1987 credit submission;

(a) Adequacy of board policy on lending against shares

Counsel assisting submit that this transaction was an example demonstrating the absence of a prudent board policy on lending against shares.

They also submit that, in so far as the directors had no reasonable and prudent policy to guide them in relation to lending against shares, and in particular shares yet to be listed, there was an onus on each of them to assess the following matters, among others, when approving the first credit submission:

(i) the capacity of Dallhold to service and repay the loan;

(ii) the realisable value of the Bond Media shares taken over time;

(iii) the realisable value of any substitute security.

(b) Security

Counsel for the directors submit that it was not necessary to have a policy about lending against shares which went beyond security cover and lending against no more than 5% of the issued capital. They content that Tricontinental's policy was adequate and directors were not bound by it in any event.

Counsel assisting argue that the first credit submission considered in detail, dated 29 January 1987, was of most importance, because it was this approval to lend $100m which was the crucial cause of ultimate loss. They submit that the money was lent on imprudent and unreasonable
security, and constituted an example of "name lending". Counsel for the directors submit that they were entitled to rely on their commercial judgment, that Bond would arrange security cover if it were needed and that there was no substantive breach of security cover before the stock market crash of October 1987. Counsel assisting, in reply, submit that a $28.2m deficiency existed immediately after the float, and was followed by repeated shortfalls as the Bond Media shares continued to fall in value. Over 20.7m Bond Corp shares were provided between June and October 1987.

(c) Credit analysis

Counsel assisting submit that the directors' assessment, in February 1987, of Dallhold's capacity to service and repay the loan, was deficient in the following respects:

(i) Dallhold was a proprietary limited company. The directors should have required it to provide information on other borrowings, together with details of security arrangements. This is particularly true of Mr Moyle who was aware of the Bond group's level of indebtedness to the banks from 1976;

(ii) there was no independent analysis of projected cash flow;

(iii) Tricontinental's security was entirely dependent on the viability of the group;

(iv) Dallhold contributed no equity.

Counsel assisting also submit that the directors' assessment of the realisable value of Bond Media shares was the most critical issue, because the directors accepted 64.5m shares as primary security for the $100m exposure before the value of the 12.18% holding was tested in the marketplace. They argue that a pro-forma balance sheet was insufficient information to satisfy directors that the valuation of media assets underlying the shares was accurate. They submit there was no independent valuation of those assets, and there were contemporaneous claims
published that the issue was overpriced. Counsel for the directors describe these contemporaneous reports as anecdotal and not probative. Counsel assisting also submit that the directors should have insisted on identified realisable security before drawdown. They contend that it was neither reasonable nor prudent to lend the $100m against a promise that, if the issue price was not maintained, Dallhold would then provide other security sufficient to meet the security covenant of 1.25 times cover.

Counsel for the directors submit that the transaction was a commercial one, chiefly because it was anticipated by Dallhold executives, the underwriters of the float and Tricontinental that Dallhold would receive a substantial profit from the float. Security also appeared adequate, and the pro-forma balance sheet was acceptable. They point out that it was not possible to determine the market value before drawdown, and the security covenant contemplated that action would be taken if the value of the shares dropped.

They further submit that the stock market crash alone was the cause of the problems that Tricontinental faced over its Dallhold exposure.

(d) Departures from guidelines

Counsel assisting note that 1.3 times cover was required by the guidelines. 1.25 times cover was accepted in the January 1987 credit submission and 1.25 times was substituted in April 1987 for 1.75 times cover relating to an earlier $2m facility. Counsel for the directors submit 1.25 times was reasonable cover in early 1987. Counsel assisting also note that the share parcel accepted as security represented 12.18% of Bond Media shares, which was out of keeping with a decision of a board meeting a few weeks later, to the effect that security exposure should not exceed 5% of issued capital.

(e) Prudential considerations

Counsel assisting point out that Tricontinental's exposure to the Bond
group at its height in October 1987, was $292m. Even if SBV's capital base is calculated by reference to the Reserve Bank's capital adequacy guidelines of 1988, this represented 32% of SBV's capital base of June 1987.

(f) Adequacy of monitoring

Counsel assisting submit that there were many warning signs about the Dallhold facility suggesting doubtful recoverability, especially after the October 1987 crash. In particular, they refer to frequent changes in purpose, security or repayment sources and in substance assert that the directors abrogated their responsibility by relying always on Dallhold's assessments and Mr Johns' endorsements as to whether or not a security swap was in the interests of Tricontinental, without proper inquiry or independent valuation. Counsel for the directors submit in substance that every change in purpose or repayment source and every switch in security was justifiable, and that the Tricontinental directors were justified in relying on information put before them in agreeing, in particular, to changes in security.

(g) Inadequate account control

Counsel for the directors note that monthly shortfalls in security cover for Dallhold were not so reported to the board in the problem loan reports. They also submit that Ryan and Moyle believed that the Bond Corporation and Bond Media shares were not to be released until the BIG shares had been issued and a market price created. Counsel assisting note that the credit submission provided otherwise.

There was evidence that Johns released $11.5m held on deposit at Tricontinental by Dallhold at a time when there was a security deficiency of the order of $17.26m (September 1988). Counsel for the directors note Mr Smith's evidence that this fact should have been told to the board, and argue that this was especially so as the Dallhold facility was under constant
review by the board. There was also evidence before the Commission that Johns agreed to the extension of the facility in May 1988 before approval by directors.

Counsel for the directors also refer to a number of changes between approvals and implementation of facilities. They submit that some of the differences between the facility originally approved and that provided were fundamental, namely the change in borrowing entity, the waiving of Bond’s guarantee and the change in security, from a charge over operating assets of the nickel mine to a charge over shares in a company which held an interest in the joint venture which operated the mine.

(b) Dallhold’s accounting records

Counsel assisting submit that Dallhold failed to keep correct accounting records.

Mr Pearce admitted approaching Johns in August 1988 to extend the Dallhold facility to July 1989 so that it could appear as a non-current liability in Dallhold’s balance sheet. He stated he did this for two reasons; to make the balance sheet look better and to assist Mr Cross in his transition phase. He negotiated with Johns to have a side agreement limiting the extension to March 1989. Johns informed both Stott and the directors of the fact of a side agreement, the reason for it being so that the facility could be presented as a non-current liability in the 1987/1988 annual report.

In submissions made on behalf of Mr Pearce it is argued that the evidence does not support adverse findings sought by counsel assisting - specifically that Pearce and Dallhold breached s267(1) of the Companies Code and that those matters should be referred to the Australian Securities Commission for further investigation.
(i) Alleged offences

Counsel assisting allege the commission of certain offences under s229 of the Companies Code arising out of the conduct of the directors.

J. Conclusions and Findings

This was a very large loan which should have received most careful attention from directors. The Commission has no reason to doubt that they did give attention to the material put before them; but that was deficient in several important ways. It provided no information on Dallhold’s other borrowings, no independent valuation of the media assets underlying the security, and no details of alternative security. Thus, acting on this inadequate information, the directors were guilty of a series of errors of judgment.

The most serious of these errors, in the view of the Commission, was to lend against the security of a large parcel of shares which were not yet on the market. This was done without any independent assessment of the value of the assets which those shares represented. Nor was any advice sought as to the likely price which the shares would achieve on the open market.

Given these uncertainties, one might have expected that there would be a firm arrangement in place for alternative security if the shares proved inadequate. In fact, there seems to have been no discussion between directors as to what steps might be taken in that eventuality. There seems to have been a general acceptance that, somehow, Mr Bond would find alternative security and the matter could safely be left to him. This appears to have been a classic case of ‘name’ lending based upon a conviction that the borrowing group was so large, with interests in so many diverse fields, that it must be able to find the funds to repay the loan somehow. This conviction was reinforced, in an important way, by the personal guarantee which was to be obtained from Mr Bond.
Apart from this basic weakness in the analysis of credit risk, the credit submission lacked any information about Dallhold's lines of credit with other lenders. As events were to show, the Bond group was heavily indebted to other creditors which held better security than anything which Tricontinental was able to achieve. It must be remembered, of course, that Dallhold itself was a proprietary limited company, financially dependent on Bond Corporation Holdings Limited for its normal income. It was contributing no equity to the purchase of Bond Media shares.

The times cover called for by the credit submission was 1.25. Tricontinental's guidelines called for 1.3 times, but it seems that the borrower had no difficulty in persuading Mr Johns to reduce that level. In view of the speculative element in the float, and the general feeling in the industry that Bond had paid a very high price for the Packer interests, this would seem to have been a very high price for the Packer interests, this would seem to have been a case where prudence would have called for an increased cover rather than a reduction.

All these criticisms must be considered against the background that this loan took Tricontinental's exposure to the Bond group to over 32% of SBV's capital base.

So far as the monitoring of this transaction is concerned, the Commission believes there is some substance in the criticisms of counsel assisting. The various changes which took place in the purpose of the loan, the security for it and the proposed sources of repayment were all based upon proposals from the borrower with the apparently uncritical endorsement of Mr Johns. Tricontinental never sought its own independent advice, even though it was venturing into areas in which neither management nor directors had any particular expertise. These included the value of overseas gold mines and of the nickel joint venture with the Queensland Government. Any valuations which were seen came from the borrower and had been obtained for its purposes.
On the other hand, the Commission does not feel that the question of monitoring looms very large in this transaction. The fault lay in the terms of the original transaction and, from that point onwards, Tricontinental was virtually in the hands of its borrower. A more aggressive style of monitoring might have produced some improved results, but this can only be a matter for speculation.

So far as further investigations or criminal proceedings are concerned, the Commission does not believe that any of the allegations made against Mr Johns or the directors in this matter is sufficiently clear-cut to warrant further action. While it is reasonably clear now that this was a very foolish transaction for Tricontinental to undertake, the various aspects of it which lead to that conclusion are not clear beyond doubt. To defeat criminal charges, those concerned would only have to show that, at the time when they committed themselves, they had a genuine belief, on reasonable grounds, that the Bond Media float would be successful. The Commission has only the credit submission to work from and does not know what further information or opinions Johns may have passed to directors at the time when they gave their approvals. He himself would no doubt say that he was persuaded to support the loan by cogent arguments from his friend Mr Pearce.

Finally, the Commission agrees with Mr Ryan that the so-called side agreement was improper and should never have been suggested by Pearce or Johns or agreed to by directors - as it seems to have been. Although no director could remember discussing it, it was referred to in the managing director's written report to the September 1988 board meeting. However the matter is not one of great moment in the annals of either Tricontinental or Dallhold. It does not merit further attention.
TRANSACTION REPORT 12 - THE GOLDBERG GROUP

PARKSTON LTD
ENTRAD LTD
ROXBURY HOLDINGS PTY LTD

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A. **Background and Summary**

(a) **The Goldberg group**

The Goldberg group, headed by Mr Abraham Goldberg, was well known and well regarded within the Australian business community. The group's main interest was textile manufacturing but, in addition, it was involved in the provision of industrial catering services, oil and gas exploration and property investment.

There were over 180 companies and trusts within the group, most of which shared common directors and executives. However, they were all controlled one way or another by Mr Goldberg, who played an active role in the day-to-day management of the business.

The group structure was extremely complex, with a high level of intercompany lending and shareholding and financial interdependency. Between 1987 and 1990, the group was in a state of constant flux as it attempted to rationalise and restructure its holdings.

Almost all companies in the group were private entities. The few remaining public companies were almost wholly owned by other Goldberg corporations. Mr John Durlacher, the company secretary, confirmed that there was virtually no trading of Goldberg shares on the stock exchange. He indicated that any shares which became available on the market were purchased by the group in its ultimate effort to privatise.

The group was supported by over thirty financial institutions in Australia, its major lenders being ANZ, Citibank and Westpac. Mr Durlacher said that Tricontinental was within the list of the group's top ten lenders.

Although Mr Durlacher said that Mr Goldberg had, over 20 years, built up a "track record of conservatism", he also said that the group's business philosophy was to be always fully borrowed. The annual interest expense
was about $220m - $240m, and the yearly shortfall, after cash flow from operations, rental and interest income, was somewhere in the $100m - $125m range.

(b) Group/banker relationship

The quality and the incidence of contact which the group shared with its bankers varied markedly. Mr Durlacher described Citibank and ANZ, for example, as having established a close and demanding relationship with the group, Citibank wanting to monitor its activities on a monthly or bi-monthly basis. Tricontinental, on the other hand, was "one of the less demanding banks", co-operative and non-intrusive. He added that Citibank started to demand repayment of its facility of some $62m in about December 1990 (one month before the collapse of the group), but there was no money with which to make the repayment.

The group continued to pay its interest bills as and when they fell due. This factor, coupled with the repute it enjoyed in the market place, apparently led many financiers into a false sense of security as to the safety of their loans.

There were telling signs, however, that all was not well, particularly after the stock market crash in October 1987 which, according to Durlacher, had a significant effect on the group. The 1988 annual returns for major group entities demonstrated that the financial health of the group had deteriorated markedly. In fact, the Roxbury Holdings Pty Ltd accounts for that year revealed that, unless group support was received, the company was insolvent. Durlacher said that most banks, including Tricontinental, paid little or no attention to this important source of information.

(c) Goldberg group collapse

In January 1990 the Goldberg group collapsed. For many, including Tricontinental directors and management, this event came as a surprise.
While it is unnecessary for the Commission to reach concluded views as to the precise causes of the group's failure, a number of publicly known developments certainly contributed to its demise:

(i) First, in October 1988 Goldberg's main operating arm, the Linter group, attempted to take over the Tootal group, a large UK-based textile manufacturer. This move failed, but it led to a significant increase in the group's level of debt ($250m) which potentially threatened the group's assets as it sought to service this extra commitment.

(ii) Next, in June 1989 (following Tricontinental's integration with SBV), the group succeeded in a $400m takeover of Brick and Pipe Industries. It was then necessary to sell off non-core assets quickly to repay debt. However, as it turned out, this could not be done in a timely fashion.

(iii) In August 1989, the group sought to take over Industrial Equity Limited ('IEL'). It needed to raise $1.8 billion for this move to succeed. The market was wary, however, and the effort failed, incurring a $50m loss to the group.

(iv) The Brick and Pipe and IEL manoeuvres provoked a good deal of adverse publicity for the group.

(v) In December 1989, three key executives (Mr Durlacher, Mr Ron Deans and Ms Katy Boskovitz) resigned their executive positions with the group.

On 17 January 1990, Mr Goldberg informed all of the group's bankers that there was concern as to the group's ability to service its external debt levels. He attributed this situation to:

- high interest rates;
- the unsatisfactory price expected from the proposed sale of Brick and Pipe Industries; and
- the failure of the takeover bid for IEL.
In the same month, an accountant's review of the Linter group concluded that it was insolvent. A receiver and manager was appointed. The failure of the pivotal Linter group had a domino effect upon other companies in the group. By the middle of 1990, receivers and managers or liquidators had been appointed to other major group entities.

In a report to creditors, one of these liquidators stated that the overall group deficit was understood to be more than $500m and may have been significantly greater, depending on the asset realisations achieved. He said that the group "... appears to have been very highly geared, made heavy losses and paid excessive amounts for acquisitions both in Australia and in the United States of America. It appears that the Goldberg Group was unable to service its level of accumulated debt".

The collapse of the Linter group coincided with default of interest payments on Tricontinental's facilities.

Mr Goldberg no longer lives in Australia and his whereabouts are unknown to the Commission. Thus he could not be called as a witness. Mr Durlacher said he believed Mr Goldberg now moves between Poland and USA. ASC warrants have been issued for his arrest on charges not related to the transactions before the Commission.

(d) General summary

Tricontinental lent extensively to the Goldberg group between 1986 and 1989. The Commission has examined in detail three particular group borrowers to whom a total of $82m was provided. These were:

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

These borrowers were very closely related and financially interdependent. The failure of the Linter group precipitated the collapse of the borrowers.
The anticipated loss in respect of these three transactions is approximately $47m.

Roxbury Holdings was a private investment company dealing in property and shares. It held a controlling interest in Parkston between July 1986 (71%) and October 1989 (99%). Parkston was a publicly listed company with investments in its subsidiary, Entrad Corporation Limited ("Entrad Corporation"), which in turn (through various trusts) wholly owned Entrad, a private company. Entrad's subsidiaries (such as the Linter group, AFCO Industrial Services Group Pty Ltd ("AFCO") and American Frontier Exploration Inc) controlled the operating businesses of the group.

**B. Transactions Generally**

(a) Issues relating to all three facilities

Specific issues relating to the facilities provided to Parkston, Entrad and Roxbury Holdings are dealt with in discrete sections of this report. However, a number of matters relating to all three facilities may be conveniently dealt with at this point.

First, although each of the directors who were examined could remember the Goldberg group and the interdependency of entities within the group, they had no independent recollection of the specific transactions. In assessing credit proposals, directors placed emphasis on a number of different matters, including:

(i) Tricontinental's significant group exposure;

(ii) Mr Johns' close understanding of, and their own confidence in, the group;

(iii) the group was a valued client and had support from other large banking houses; and

(iv) the group was a major force in the Australian textile industry and conservative in its approach.
Secondly, in addition to annual reports, Mr Durlacher said the Goldberg group annually provided its bankers (including Tricontinental) with analyses of the group's financial statements and structures. This material probably would have been received by Mr Johns or Mr Hunter and forwarded to Mr Clark or Mr Maddison in the credit division. Neither Maddison, Mountford nor Hunter could recall receiving any such material relating to the borrowers examined. According to Maddison, such documents were stored in Tricontinental's library, available to be analysed and reported upon if and when the facility was annually reviewed, or a later credit submission was to be compiled. He explained that it would have been unmanageable to analyse this material upon receipt by Tricontinental, as most companies had a balance date of 30 June and supplied their accounts in September. Hunter said the account manager, or his delegate in the credit division, was responsible for annual reviews. In this context it is important to note that Maddison said annual reviews were generally not up-to-date and in 1988 there was a back-log. He also said that, when annual reviews were completed, little notice was taken of them by senior executives such as Johns or Mountford, because of lack of time.

The borrowers were obliged by the terms of the letters of offer to provide Tricontinental with financial information, including any financial details which Tricontinental may have reasonably sought, on a timely basis. On 23 June 1988 Tricontinental asked for the 1987 annual report for Roxbury Holdings. This suggests that these accounts had not in fact been received by Tricontinental. There was apparently no follow up to this request. Again, in December 1989 following a request, Mr Durlacher supplied the Roxbury Holdings accounts for 1988 to SBV. Although the Tricontinental files contained the 1988 annual returns for each of the three borrowers, it is not clear when these returns were first placed on file. The letter of offer also allowed Tricontinental to withdraw, terminate or suspend the facility if any changes occurred in the borrower's financial position which adversely affected its ability to repay. The fact that Linter sought to take over
Tootal, thereby increasing the group's level of debt by $250m in October 1988, was a matter of some importance which should have been known by Tricontinental.

Thirdly, while Parkston and Entrad Corporation were publicly listed companies, in fact less than 5% of their shares were held by the public. A number of companies and unit trusts stood between those entities and the operating subsidiaries. Thus the public accounts and reports which they produced did not deal with the performance of the subsidiaries which held the true operating assets of the group.

Finally, no annual internal reviews of the three borrowers have been found in Tricontinental's files for the years 1986 to 1989. Tricontinental's credit procedures manual stipulated that these were required to be produced annually (unless a recent comprehensive credit submission concerning the borrower substituted for the review). The lending officer (account manager) was supposed to obtain timely information from the borrower and send this on to the credit division, which would then produce the review. Had they been compiled in 1988, following publication of the annual returns, it is alleged that such reviews would have disclosed serious financial problems for the borrowers and the group as a whole. The board may have been forced to take remedial action to protect Tricontinental's interests. The directors had no recollection of having seen the borrowers' accounts during 1988. Ryan said that, having now looked at the 1988 returns, "they would cause you to have some doubts".

(b) Counsel's general submissions
Counsel assisting submit that Tricontinental received annually, or should have obtained, copies of the financial reports for Roxbury Holdings, Entrad and Parkston. This is supported by Durlacher's evidence that these reports were sent to all major lenders. Counsel submit that, in 1988 particularly, these reports showed a significant deterioration in the financial position of
the borrowers. Counsel argue that, at Tricontinental, there appeared to be almost complete ignorance of what was happening to these borrowers, that the facilities were not monitored, and no annual reviews have been found. Counsel submit that it was therefore hardly surprising that the collapse of the group came as a complete surprise to Tricontinental's directors and management.

Counsel assisting submit further that the directors and management appear to have been lulled into a false sense of security concerning the strength of the Goldberg group and the safety of Tricontinental's loans. Counsel submit a number of factors contributed to this alleged state, including:

(i) the close business relationship which existed between Johns and Goldberg;

(ii) the fact that Johns was the account manager of the facilities and often negotiated directly with Goldberg;

(iii) the good reputation which the group enjoyed throughout the business community;

(iv) the fact that the group was backed by other major trading banks; and

(v) the group's continuing ability to meet interest payments up until its collapse in January 1990.

Generally, counsel assisting submit that a number of matters peculiar to Tricontinental significantly contributed to its loss. Counsel rely on the following:

(i) inadequate evaluation of credit risk, including insufficient emphasis being placed upon the interdependence of group entities and a lack of independent assessment of information provided by the borrowers;

(ii) excessive group exposure;

(iii) breaches of guidelines (as to share security cover exceeding 5% of issued capital, and percentage cover for real property);
(iv) a serious failure to monitor the borrowers' progress, particularly in light of the deterioration of the group's financial worth from 1988 onwards;

(v) a failure to compile internal annual reviews;

(vi) a failure to monitor and enforce covenants prohibiting disposal of operating assets without the consent of Tricontinental;

(vii) a failure of management to report adequately to the board; and

(viii) a failure of directors to supervise management properly, and to ensure that established systems operated effectively.

Counsel assisting submit further that the directors had ultimate responsibility for supervising management and ensuring that appropriate systems were in place and operating. While this principle was conceded, the directors argued in evidence that they were entitled to assume, in the absence of an adverse report, that all was well with the borrower. This involved, as well, the assumption on their part that the borrower was being properly monitored and that annual reviews were being conducted. For example, Rawlins relied on the assumption that the group and Johns were in a close working relationship and he assumed if there were any problems Johns would alert the board. Similarly, Mr Ryan said he expected the account manager to monitor the borrower's affairs regularly, that annual reviews would have been completed on a timely basis and that any deterioration in an account would be reported to the board. Ryan also said that Johns was never questioned generally by the board as to the system of monitoring. Not surprisingly, Mr Smith and Mr Carr conceded that the complicated mix of companies involved, and the size of the exposures, called for very close monitoring.

Counsel for the directors (other than Johns) and management contend that Tricontinental would have received not only the accounts of the group companies, but also the analyses of those accounts undertaken by the group for the benefit of its bankers. Counsel refer to Mr Durlacher's evidence
that Tricontinental was on the "mailing list of banks" which received yearly and half yearly accounts together with the group's analyses of those accounts. Counsel note that these analyses have not been tendered before the Commission. The Commission understands that this was because no such documents were found in the relevant Tricontinental files obtained by the Commission. In the absence of this material, counsel for the directors submit that it cannot be determined whether any of the alleged shortcomings in Tricontinental's analysis and monitoring caused or contributed to Tricontinental's loss in respect of those facilities. Counsel submit that, in the absence of a full enquiry into the Goldberg group, and an understanding of the performance of the group as a whole, no conclusive findings can be made by the Commission in respect of the causative effect of any action taken by Tricontinental's directors or officers.

Counsel for the directors agree with counsel assisting that companies within the group were interdependent and that the fortunes of one company had an impact on the entire group. They submit that the corollaries of this proposition are:

(i) that the success of one group entity would also affect the other members of the group; and

(ii) if one company within the group were to fail, the group would only fail if it were not able to absorb, on a cumulative basis, the loss sustained by that company's failure.

Counsel observe that some 30 other lenders appear to have either not identified or not acted upon the allegedly declining financial position of Parkston and Roxbury Holdings, and they submit that any shortcomings of monitoring cannot be regarded as being the cause of Tricontinental's loss.

Counsel for the directors submit that, even if the Commission finds there was a decline in the financial position of the group and, in particular, Parkston, Entrad and Roxbury Holdings, it cannot be satisfied that Tricontinental failed to conduct its annual review, nor that such a review
would have caused it to call up its loans to the Goldberg group. In this connection, counsel make the following observations:

(i) vigilant monitoring may not have assisted Tricontinental or caused it to take any action other than that which it did;

(ii) there were financial analyses said to have been provided to Tricontinental, together with the accounts of the companies forming part of the group. The analyses have not been produced and, in their absence, it is simply not possible to decide whether additional monitoring was required; and

(iii) by reason of the interdependence of the group, each facility cannot be dealt with in isolation but must be considered as part of an overall review of the Goldberg group.

Counsel for the directors submit that it was entirely proper for directors, having approved procedures for the monitoring of facilities and arranged for internal auditors to review those procedures, to assume that, in the absence of information to the contrary, the procedures were being complied with. This was particularly the case where the account manager for the facility was the managing director, who had direct access to the board.

As to the reasons for the failure of the Goldberg group, counsel for the directors and management observe that no expert evidence has been called about the reasons for the group's collapse. Counsel note that the three reasons provided by Goldberg in his letter of 17 January 1990 concerning the problems of the group (see paragraph 11 above), arose after SBV's absorption of Tricontinental. Similarly, the Brick & Pipe takeover, and the bid for IEL, post-dated integration. Counsel submit that there is ample evidence before the Commission in support of the view that events leading to the demise of the Goldberg group occurred after SBV's absorption of Tricontinental.
As to counsel assisting's submission that Tricontinental's directors and management appear to have been lulled into a false sense of security, counsel for the directors observe that Tricontinental was only one of many lenders to the group which were surprised at the losses. Directors were entitled to rely on the matters referred to in para 25 above.

C. The Parkston Transaction
(a) Summary

In April 1987, Parkston borrowed $50m from Tricontinental to finance its takeover of Entrad Corporation. Half the facility ($25m) was repaid in November 1987. The Parkston accounts for 1988 revealed an operating loss of $4m and a loss on extraordinary items of almost $8m. This development was apparently not noted at Tricontinental. Between September 1988 and March 1989, interest payments were late. While still within the term of the loan, the balance of the facility ($25m) was repaid just before integration with SBV. This sum was then redrawn a few days later without reference to the SBV credit committee or board. Interest payments were made until January 1990 when the Goldberg group collapsed. A provisional liquidator was appointed to Parkston a short time later. As the loan was secured by shares in another group entity, security proved worthless and the anticipated loss is the whole of the facility balance of $25m.

(b) Chronology

The chronology of relevant events is as follows:

1987

14 April Credit submission for $50m
16-22 April Directors approved the submission (Johns, Ryan, Smith and Carr)
27 May Approval ratified by the board. Parkston provided $54.5m worth of Entrad Corporation shares as security
1 June $50m drawn down
16 November $25m repaid
14 December Tricontinental received, as security, certificate for 38 million Entrad Corporation shares (worth approximately $57m) in the name of Parkston

1989
19 May Repayment of the Parkston ($25m) and the Roxbury Holdings ($22m) facilities
5 June Parkston and Roxbury Holdings redrew $25m and $22m facilities, respectively

1990
19 January Parkston suspended from trading on the ASX
2 February Parkston facility in default
14 March Mr Sherlock of Coopers & Lybrand appointed provisional liquidator
18 June Mr Sherlock appointed liquidator of Parkston
3 October Parkston delisted from ASX for failure to pay annual listing fees

(c) Narrative

In April 1987, Parkston announced a takeover offer for Entrad Corporation, offering two Parkston shares plus $3 cash for every five Entrad Corporation shares. This offer was successful, and by July 1988 Parkston held 99% of Entrad Corporation.

In April 1987, Johns, Ryan, Smith and Carr approved the grant of a $50m facility to Parkston, so as to finance this takeover. The approval of this facility resulted in a total exposure by Tricontinental to the group of more than $167m.

According to the credit submission dated 14 April 1987, half of the facility ($25m) was to be repaid within six months. The facility was to be secured
by a first registered share mortgage over all the issued share capital of Entrad Corporation (which was then valued at approximately $155m). Ultimately only half of the issued share capital of Entrad Corporation was taken as security.

The facility was fully drawn down on 1 June 1987. $25m was repaid on 16 November 1987.

Entrad Corporation shares had been thinly traded. The October 1987 share market crash did not affect their price. On 7 October the market price per share was $1.40, while on 29 October, it had gone up to $1.50 per share. Throughout the relevant time these shares gave a security cover over the facility of approximately $57m.

Between September 1988 and March 1989 Parkston was late in making its interest payments.

The facility was due to expire on 30 January 1992. On 19 May 1989, just before integration with SBV, Parkston repaid the facility balance of $25m. Roxbury Holdings similarly repaid its $22m facility. Tricontinental/SBV permitted Parkston and Roxbury Holdings to redraw these sums very shortly afterwards, on 5 June.

Following the collapse of the Linter group, on 19 January 1990, Parkston and Entrad Corporation were suspended from trading on Australian Stock Exchange Limited ('ASX'). A provisional liquidator was appointed for Parkston on 14 March and appointed liquidator on 18 June 1990. With the collapse of the Goldberg group the security for the facility was considered worthless. The anticipated loss is the whole facility balance of $25m.
(d) Role of Mr Johns

Mr Johns was the Parkston account manager. He proposed the credit submission (as he did for the Roxbury Holdings and Entrad submissions). He negotiated with the borrower. Mr Durlacher recalled these negotiations. He said that, although Johns did not say that approval was a fait accompli, he did indicate his belief that the board would approve the proposals and that the loan would be forthcoming. In an urgent memorandum of 10 April 1987, Johns provided the essential information necessary to compile the credit submission. He also noted that, after the takeover, Parkston would have approximately 35,000,000 shares on issue, with NTA increasing from $2.90 to $3.40 per share. He approved the credit submission on 15 April.

Following approval of the credit submission by directors, the borrower requested several minor changes to terms and conditions, favourable to itself. These were approved by Mr Johns without apparent reference to the board. He also agreed, at the client's request, to extend for a few weeks the date for repayment of the first $25m.

(e) Role of other managers

As noted, the facility balance of $25m was repaid on 19 May 1989. This was within the term of the loan. Mr Hunter accepted this repayment on the basis, requested by the client, that the Parkston facility would not be cancelled. Following integration, on 5 June 1989, this facility was redrawn. The same process happened with the Roxbury Holdings facility of $22m.

(f) Role of other directors

Apart from Johns, the directors who approved the facility were Ryan, Smith and Carr. The general matters taken into account by them are referred to at para 19 above. After approving the submission, and noting it
at the next board meeting, it would appear these directors had no other involvement with this transaction.

(g) Significant issues

The Commission's examination of this transaction has given rise to a consideration of a number of significant issues. These include:

(i) the quality of credit risk analysis;
(ii) the apparent departure from the guideline limiting security exposure to any one company to 5% of that company's issued share capital;
(iii) the failure to take the full security cover approved by directors;
(iv) the borrower's breach of an asset covenant;
(v) the alleged failure of the monitoring process, particularly involving the 1988 financial reports;
(vi) the repayment and redrawing of the facility; and
(vii) the alleged breach of the Companies (Victoria) Code ('the Code') by Mr Johns.

(b) Quality of credit risk analysis

The approval of this facility brought the total Goldberg group exposure to approximately $167m. The interdependence of the entities within the group meant that very careful analysis of the proposal was required.

When considering the April 1987 credit submission, the latest financial documents which the directors considered were Parkston's unaudited financial statements for the half year ending 31 December 1986. Although pre-tax profit for the 6 months to December 1986 was noted to be a little over $1m, the directors were specifically told that a detailed profit and loss statement for the interim period had not been provided. The recent sale of approximately $70m worth of assets within Entrad Corporation was noted. Significantly, the directors were told that Entrad Corporation's net profit before tax was below expectation as a result of the continued burden of high interest rates.
The credit submission failed to deal at all with the question of the borrower's (or the group's) current liabilities to other major financial institutions. Counsel assisting submit this was an important omission, especially as the directors knew, or should have known, the group was indebted to many other lenders for large sums.

Counsel assisting submit that the approving directors, Johns, Ryan, Smith and Carr failed adequately to assess credit risk in that, among other things:

(i) excessive group exposure was permitted;
(ii) insufficient weight was given to the position of the borrower in the group, bearing in mind that the failure of one group entity could lead to the collapse of the borrower and the group as a whole; and
(iii) it was proposed that 100% of the issued capital in Entrad Corporation be taken as security - an extraordinary departure from the guideline permitting no more than 5% of issued capital of any particular company be taken as security.

Accordingly, counsel submit Johns, Ryan, Smith and Carr demonstrated a lack of commercial judgment in reaching the decision to approve the Parkston credit submission.

Counsel for the directors deny any failure of commercial judgment and submit that it was open to the directors to approve the facility. Among other things, they rely on the following matters:

(i) there was adequate security;
(ii) there was adequate capacity to service the facility (which proved to be the case);
(iii) Tricontinental received an establishment fee of $0.25m for the transaction;
(iv) Parkston's profits for the 12 months to 30 June 1986 were $1.78m, whereas in the 6 months to 31 December 1986 they were $1.08m, reflecting an improved profit; and
(v) the Goldberg group appeared to be in a sound financial position.
(i) Alleged breach of 5% of issued capital guideline

As noted, the credit submission stated that security for the $50m facility was to be a first registered share mortgage over the whole of the issued share capital of Entrad Corporation. One month before this facility was approved, the board agreed that, in view of the sustained bull market and potential volatility, the sum of Tricontinental’s security exposure to any one company should not exceed 5% of that company’s issued share capital. It would seem the rationale for this guideline lay in the difficulty which might be encountered in seeking to realise a substantial share parcel within a short time frame. The guideline did indicate, however, that there could be exceptions to the 5% limit, takeovers being cited as one example. However, in the circumstances, counsel assisting submit there was an impermissible departure from the 5% guideline.

In evidence, directors suggested that because the facility financed the Entrad Corporation takeover, this constituted an exception to the 5% guideline. For instance, Mr Carr suggested one justification may have been that security was to cover the whole entity, thus ensuring total control. Counsel assisting submit the position requires further analysis. The takeover was essentially of another group entity, not an external corporation. If Parkston could not repay its loan (because it had failed), counsel argue it was highly probable Entrad Corporation would be in serious difficulty and the security would be worthless. This is in fact what happened. Mr Carr recognised this as a valid consideration.

Although nominally a public company, in reality Entrad Corporation was almost wholly controlled by Goldberg group entities. Its shares were thinly traded and, in these circumstances, counsel assisting submit the sale of a substantial parcel of its shares could not be guaranteed on the open market. Mr Ryan agreed with this general proposition, although he believed the board was justified in departing from the 5% guideline because the facility would enable restructuring to occur, which would in turn strengthen the
Goldberg group. However it was true that the value of the security still depended on the continuing financial strength of the group as a whole, not its structure.

57 Mr Smith maintained that the guideline was to be observed by management, but could be departed from by the board. He was comforted by the value of Entrad Corporation’s shares (at $2 per share) although he conceded there was not much trading in them because they were substantially held by the group. He agreed that a small parcel could be traded more easily than a large parcel but, he said, the latter might be valuable as a strategic holding.

58 Mr Hunter agreed with counsel assisting that the inter-relationship between the group companies, and the fact that only a very small percentage of the shares were held by the public, increased the difficulties associated with selling a 50% parcel of Entrad Corporation shares.

59 Counsel assisting submit that the position would have been quite different had the takeover target been an external entity, financially independent from Parkston.

(j) Failure to take security cover approved by directors

60 On 27 May 1987, Parkston provided security of 27,264,865 Entrad Corporation shares, then worth approximately $54.5m. The $50m facility was fully drawn on 1 June 1987. Half the facility ($25m) was repaid on 16 November. However, the full security on the facility (100% of Entrad Corporation shares), as contemplated by the credit submission and required by the letter of offer, was never in Tricontinental’s hands. It was not until 14 December 1987 that Tricontinental recorded on its security schedule that it had received scrip for 38m Entrad Corporation shares - amounting to 50% of the issued share capital.
Counsel assisting submit that, no doubt, the directors were concerned to ensure that there was adequate security even if the share price dropped significantly, and no adequate explanation has been given as to why the required share cover was not obtained. They submit this condition should have been complied with, or management should have sought the directors’ approval to reduce the security parcel if there was good reason for doing so.

Counsel assisting submit that Mr Hunter, as the officer in charge of the securities division, failed to ensure that the full security (as stipulated by the letter of offer) was in place before drawdown. Counsel submit that, in so acting, Mr Hunter was negligent in the discharge of his duties.

Counsel for Mr Hunter reject the submission that he was negligent. They submit that, at all stages, the security taken was adequate to cover Tricontinental’s exposure. Given that, until the $25m was repaid, the brokers had instructions to issue all the scrip to Tricontinental, and Mr Hunter was relying on that degree of control, the Commission does not find his conduct unreasonable.

(k) Breach of asset covenant

In accepting the $50m facility, Parkston agreed that during the term of the facility it would not, without Tricontinental’s prior written consent, dispose of or further encumber any assets of Entrad Corporation in excess of $500,000. This covenant was designed to protect the underlying value of Tricontinental’s security, and to ensure that the operating assets which ultimately supported the market value of Entrad Corporation shares would remain within Tricontinental’s control.

It will be recalled that the financial strength of Entrad Corporation lay in its investment in its wholly owned subsidiary, Entrad Limited which, in turn, controlled the operating assets of the group. Any significant dealing
in respect of these assets would impact on the financial position of Entrad Corporation. Counsel assisting submit the financial statements for the year ended 30 June 1988 of Entrad Limited were (or should have been) available to Tricontinental. These revealed that there had been dispositions of assets worth $10.4m namely:

- on 1 July 1987 the Sterling Clothing Company business was transferred to Pelaco Australia Limited; and
- on 1 November 1987 the Pelaco, Exacto, Sterling, Zora and Toronto businesses were sold to the Linter group. In addition, certain trademarks owned by subsidiary companies were also sold.

Parkston reported the same asset sales in its 1988 return. Counsel assisting submit that apparently this asset covenant was breached by the borrower and not monitored by Tricontinental. Counsel for the directors accept that there may have been a breach of this covenant, but say that the account manager, Johns, was entirely responsible for its monitoring. In fact, Johns had been informed by Entrad Corporation of these sales in a letter of October 1987 which purported to explain their effect. There is no evidence that this information was analysed, reported to the board or considered as indicating a breach of covenant.

(I) Alleged failure to monitor 1988 financial reports

Pursuant to the terms and conditions of the letter of offer, Parkston was obliged to provide Tricontinental with half-yearly and audited yearly accounts. Tricontinental could, at its option, withdraw, terminate or suspend the facility to Parkston if any change occurred in Parkston’s financial position "... which adversely affects in any material way (Parkston's) ability to meet any drawdowns under the facility provided ...". Counsel assisting submit this was a curiously worded provision, particularly the use of the word "drawdowns"; perhaps the words 'repayment of' are to be implied after 'meet'. The directors believed that the clause was designed to enable Tricontinental further to protect its investment or realise
its security in the event that there was a significant deterioration in the financial health of the borrower.

Mr Ryan said in evidence that he did not need to read any of the Goldberg group accounts for 1988 as he assumed normal monitoring was being carried out. He said that, had he known of the asset sales, he would have wanted an explanation. Mr Smith also said that, had he known of the transfer of these important operating assets, he would have asked Mr Johns to make enquiries and report back to him.

No internal annual review of the Parkston facility has been found, and counsel assisting submit that the Commission should be satisfied none was compiled following approval of the facility in April 1987. No up-dated credit submission substituted for the required annual review. Parkston's accounts for 1988 revealed an operating loss of almost $4m and a loss on extraordinary items of almost $8m. Counsel assisting argue that such a deterioration in the financial position of the borrower should have been appreciated by Tricontinental and the board, and that a prudent banker would (at least) have made appropriate inquiries to see that the loan was still safe.

On this point, the Commission notes the evidence of Mr Durlacher that "...the majority of banks, as far as I'm concerned, did not do a proper and thorough review of the group as they should have". He included Tricontinental in the majority.

Counsel assisting submit that the directors wrongly assumed that appropriate monitoring was taking place and that annual reviews were being conducted. Counsel submit the board failed properly to supervise the account manager (Mr Johns) so as to satisfy itself that the system of monitoring was operating effectively.
Counsel for the directors refer to their general submissions, as to what closer monitoring would have revealed, in relation to the Roxbury Holdings transaction (paragraphs 203 to 205 below). Counsel submit that the necessity to prepare an annual review did not arise, based on Tricontinental's internal procedures, because credit submissions were regularly being prepared for some entity in the group, and so no criticism ought to be made of any member of the credit division.

As to the alleged deterioration in the financial position of Parkston, counsel for the directors submit that it is not relevant that Parkston's financial strength may have diminished. To the extent that it is relevant, such a situation must be put in the context of the group's financial strength as a whole, the fact that other entities of the group would support Parkston, and the fact that other group entities had a significant improvement in their financial position.

(m) Repayment and redrawing of facility
By letter of 19 May 1989, Mr Durlacher repaid the $25m facility to Parkston and the $22m facility to Roxbury Holdings. The repayments were made apparently to avoid unnecessary interest payments. In his letter, Durlacher referred to a discussion he had with Mr Hunter and said, "...we ask that the facilities not be cancelled at this stage and confirm that Parkston Limited and Roxbury Holdings Pty Ltd will pay unused facility fees in relation to the unused portion of the facilities". Hunter replied by letter of 1 June 1989 (after integration), confirming that the two facilities were available and that they could be drawn down on the giving of three days notice. Both facilities were fully redrawn on 5 June 1989.
Mr Durlacher recalled his discussion with Hunter concerning this repayment and said it did not include any reference to, or inquiry from, Mr Hunter as to the financial position of the group as a whole. Hunter said he could not recall this discussion.

Counsel assisting submit that Hunter allowed these facilities to be redrawn without any discussion with Durlacher as to the group’s financial position and without confirmation of the purpose for which the monies would be used. Counsel argue that by this time the purpose for redrawing would or might differ from that originally proposed.

Before the facilities were redrawn, and following integration with SBV, the reconstituted Tricontinental board resolved on 30 May 1989 that:

"All loan approvals regardless of whether initiated by Tricontinental employees or to be provided by Tricontinental would be submitted to the State Bank of Victoria credit committee or board, as appropriate. No further new lending would be undertaken by Tricontinental without such approvals which will require the prior endorsement of the board".

Hunter did not refer the matter to the SBV credit committee or board. He maintained he did not need to obtain approval for the facilities to be redrawn because they were still current and securities were in order. He said he was unaware of any deterioration in the borrower’s position.

Mr Hunter said that, following integration, he had been made aware that all new lending proposals were to be channelled through SBV. But he said this was not new lending. Mr Mountford said that the resolution concerning new lending would have been made known generally, but that there was a certain flexibility in the way it was applied. In this context, counsel assisting note Mountford’s concession that Tricontinental could have declared a default after the facilities were repaid due to the borrower’s financial deterioration.
Mr Carr considered that the redrawing amounted to new lending of which the board should have been informed. In his view, Hunter should at least have obtained approval from some executive officer or the credit committee.

Mr Ryan took the view that there was no requirement for reference back to the board; however, in the circumstances of recent integration and the board’s resolution, any loan being redrawn should have been subjected to close investigation as to the purpose and the security.

Counsel assisting note that the period immediately following integration was one of great urgency and confusion for Tricontinental and SBV directors and management. This atmosphere may have contributed to the failure of management to consider properly the proposal for a redrawing of the facilities. Nevertheless they submit that, in spite of any assurance given to the borrower about redrawing, Mr Hunter was obliged to refer the matter back to the SBV credit committee or board for consideration and approval and, in failing to do so, he was negligent in the discharge of his duties. Counsel assisting submit that, in the circumstances then prevailing (including the fact that Roxbury Holdings was insolvent), Tricontinental would have been fully justified in refusing to allow the facilities to be redrawn.

Counsel for Hunter submit that he was not expected to know the financial position of the borrower and, in fact, he sought the approval of a superior officer, who consented to the release of the funds to Parkston and Roxbury Holdings. The basis for this assertion appears to be Mr Mountford’s evidence that Hunter was not prone to stepping outside his authority, but it must be noted that Hunter himself stated that he could not recall with certainty discussing the re-drawing of the facility with anyone at Tricontinental. Counsel also submit that the repayment of the $47m shows that the group was not in a poor financial state as at 19 May 1989.
(n) Alleged breach of the Companies Code by Mr Johns

Counsel assisting submit that, in addition to his involvement as an approving director (referred to at paragraphs 49 to 53 above), as the account manager, Mr Johns:

(i) failed to monitor and enforce the asset covenant or to detect its breach;

(ii) failed to monitor the facility by obtaining and analysing Parkston’s annual reports and those of other group borrowers;

(iii) failed to compile annual reviews; and

(iv) failed to report to the board the significant financial deterioration of the borrower, and other group borrowers, which had been disclosed in the 1988 returns.

Alternatively, Johns failed to supervise properly the officer to whom he delegated the performance of these duties. Accordingly, counsel assisting submit he failed to exercise a reasonable degree of care and diligence contrary to s229(2) of the Code.

Counsel for the directors and management agree with counsel assisting that Mr Johns was responsible for monitoring compliance with the asset covenant and was negligent in failing to do so (paragraphs 64 to 66 above). In this context counsel for the directors observe that:

(i) while the credit area accepted responsibility for the monitoring of Johns’ accounts, it did not purport to usurp his role as account manager;

(ii) there is no evidence that the securities division failed to monitor relevant share prices; and

(iii) Johns was responsible for informing the board of the purpose of the restructure and its intended effect. The Goldberg group restructure necessitated the transfer of assets with a value exceeding $0.5m from the Entrad group of companies.
The Goldberg empire was constructed in a very complex way, and any credit submission relating to a loan to a particular entity called for careful analysis, not only of that entity but also of related parts of the empire. This need for careful analysis became even greater as total exposures to the Goldberg group exceeded $150m.

In this case the Commission is satisfied that the analysis was deficient, particularly in its description of the relationship between the various entities with which Parkston was involved. However, it is by no means clear that a more detailed or critical credit analysis would have produced any different result in the present case. In view of the reputation of the group at the time, it seems quite likely that the directors would have approved this facility in any event.

The next point of criticism of this transaction relates to the security proposed. This was intended to be the entire issued capital of Entrad Corporation. This security was proposed by management and accepted by directors without any consideration of the implications - in particular, what the issued capital would be worth if the security ever had to be called upon. The proposal seems to have been accepted by directors without any consideration of the guideline which they had only just adopted, limiting share security to 5% of issued capital. They may have been able to justify this as a special case, permitting a departure from their self-imposed rule. But any careful discussion should have raised the obvious question as to what the value of the security would be if it were ever called upon. This was the basic flaw in the transaction which, in the Commission's view, should have been foreseen.

On the other hand, the Commission does not see any great significance in the fact that, ultimately, only 50% of the issued capital was taken as security. This, in theory, should have been sufficient to give good
coverage - were it not for the basic weakness already referred to. Two points, however, do need to be made about this matter. The first is that the account manager, Mr Johns, should not have taken it upon himself to halve the security determined by directors. He could hardly have known what importance they attached to it, and the matter should certainly have been referred back to the board. The second point is that the Commission accepts the submission of counsel for Mr Hunter that he cannot properly be blamed for the security accepted. He would not have accepted a halving of security without the direction or, at least, the approval of the managing director.

There was, in this case, a clear breach of the usual asset preservation covenant. Certain valuable assets of the Entrad Corporation were transferred out of Parkston's reach to other entities in the Goldberg group. It was Mr Johns' responsibility, as account manager, to monitor this transaction; and he clearly knew of these events, which were brought to his notice by letter and disclosed in the group's financial returns. In the view of the Commission, he should either have taken action or, at least, reported the matter to his board.

This was not the only matter which should have been picked up by proper monitoring. There were a number of issues in the 1988 reports in particular, which ought to have led to fairly close questioning of the borrower. Mr Durlacher's comments about the poor quality of review by most banks, including Tricontinental, are very relevant. However, when considering whether better monitoring would have produced different results, it is necessary to remember also Mr Durlacher's evidence about Citibank, representatives of which met officers of the Goldberg group at regular intervals and put detailed questions to them. In spite of this process, Citibank only became alarmed about its exposure to the group a month before the collapse - too late to take any effective action. Before leaving this matter, the Commission accepts the submission on behalf of
directors that they were entitled to assume that transactions within his personal control would be properly monitored by the managing director, or by some other person appointed by him to the task. In the absence of any word from him to the contrary, they were entitled to assume that all was well with the transaction.

One of the key issues in this transaction is the conduct of Mr Hunter in accepting repayment of the loan on the understanding that it could soon be redrawn, and then, after integration, permitting the redrawal without further question. This was, in the Commission's view, a remarkable step for Mr Hunter to take, given his usual aversion to accepting responsibility, and also the extraordinary circumstances of the weeks immediately following integration. However, although it finds his actions to have been extremely ill-advised in light of the general direction which he had received, the Commission is not satisfied that he exceeded his authority. In this connexion it notes the evidence of Mr Mountford and Mr Ryan; see paras 79 and 81 above. It would obviously have been far more sensible to have referred the matter to the new account manager - presumably Mr Mountford - or to the SBV credit committee. This question is dealt with in the context of Mr Hunter's general performance in paras 14.237-238 and 14.368 in vol 2.

Finally, in relation to this transaction, the Commission must consider whether there is sufficient evidence to warrant any action being taken against Mr Johns for a breach of s229(2) of the Code. The substance of the allegation against him is that he failed to monitor this transaction properly, if at all. In the absence of any evidence from him, it is difficult for the Commission to reach any firm conclusion as to the extent of his personal responsibility. The Commission accepts that the transaction was not well monitored and that, as account manager and managing director, he must accept the primary responsibility. However, in view of the fact that Tricontinental was only one of some 30 financial institutions which failed
to appreciate what was happening to the Goldberg group, the Commission does not feel that this is an appropriate case for action to be taken.

E. The Entrad Transaction

(a) Summary

In September 1987, Entrad borrowed $10m from Tricontinental to refinance part of an existing facility of $20m which Tricontinental had made available to another group entity. Directors considered a submission to approve the facility to Entrad Corporation (Entrad's parent). Consequently, in approving the facility, they could not have considered Entrad's financial position as a potential borrower. Initially, security was to be Entrad's debenture stock, but this was later changed to a mortgage over real property. Neither of the significant changes in borrower or security was referred to the board for its reconsideration. Following the stock market crash in October 1987, the facility remained seriously undersecured ($2.85m on $10m) for about six weeks until temporary substituted security could be put in place. Interest was paid on the facility until early 1990 when, like Parkston, Entrad failed as a result of the group collapse. A receiver and manager was appointed in February 1990. The extent of the loss will depend upon the sale of the real estate security. Provision has been made for $72,000.

(b) Chronology

The chronology of relevant events is as follows:

1987

9 September Credit submission for $10m commercial bill facility to Entrad Corporation and $960,000 investment banking facility

15-17 September Submission approved by directors (Johns, Ryan, Rawlins and Carr)

29 September Borrower changed from Entrad Corporation to Entrad and letter of offer sent
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30 September  Letter of offer accepted. Entrad provided scrip for 3m ordinary shares in AFP Investment Corporation Ltd as temporary security

1 October    Drawdown of $10m

20 October   Stock market crash (security valued at $2.85m)

28 October   Facility noted by the board (in name of Entrad Corporation)

1 December   Substitute temporary security (Entrad Corporation shares) valued at $15m.

7 December   LJ Hooker $12.5m property valuation (Five Docks).

1988

14 April     Entrad share security replaced by Five Docks property mortgage

1990

19 January   Entrad Corporation suspended from trading on the ASX

26 January   Entrad facility in default

9 February   Mr Anderson of KPMG Peat Marwick appointed receiver and manager.

(c) Narrative

A credit submission dated 9 September 1987 proposed the grant of a $10m facility to Entrad Corporation (to be distinguished from its wholly owned subsidiary, Entrad). The purpose of the facility was to refinance part of an existing $20m facility in favour of Homfray Carpets Pty Ltd, another of the Goldberg group entities. Repayment of the facility was to come from either refinancing or cash flow.

The submission also incorporated an earlier approval to purchase shares worth $960,000 in Entrad Corporation, as part of Tricontinental's investment banking portfolio.
The $10m facility was to be secured by "debenture stock issued by Entrad Limited to the value of 110% of the facility amount", the value for security purposes being said to be $11m. In fact it was already pledged as security for existing facilities.

Directors were provided with financial details of the proposed borrower, Entrad Corporation. These were the 1986 audited figures. Entrad Corporation's profitability was noted to be below expectations as a result of "the continued burden of high interest rates". This warning proved to be timely, considering that the interest rate on the facility increased from 13.25% in October 1987 to 20.32% in January 1990.

The facility was recommended (by Johns and Maddison) on the basis of the continuing profitability of the borrower. The submission suggested that provision of the facility would not involve an increase in Tricontinental's total exposure to the Goldberg group. This was contradicted by another section of the submission which stated that, "The overall effect of restructuring the Pochette, Roxbury and Homfray facilities involves an increase of $4m in TCL exposure to the Goldberg Group".

Default in interest payments occurred on 26 January 1990. Shortly afterwards, on 9 February, Mr Anderson of KPMG Peat Marwick was appointed receiver and manager of Entrad. The anticipated loss on this facility is approximately $2m. There is the possibility of quite substantial recovery from the sale of the Five Docks property, which was valued at $7.5m-$8m.

(d) Changes to the proposal approved by directors

On 29 September 1987 the borrower changed. Mr Hunter advised Mr Maddison that the facility was to be made available to Entrad not Entrad Corporation. Hunter noted that this change had been confirmed with Johns. No other directors were consulted as to this important alteration.
The letter of offer dated 29 September 1987 to Entrad incorporated another significant alteration. A different security was substituted, namely:

- first registered third party mortgage by Parkston over real property at Five Dock, New South Wales; and/or
- "first registered share mortgage over shares in publicly listed Australian companies acceptable to Tricontinental".

While Johns was aware of this alteration, again it had not been presented to or approved by other directors. In the event, of course, it proved to be a fortunate variation.

The facility was also subject to a covenant which had not been considered or approved by directors, namely, that the market value of shares and/or investment properties constituting security was to provide security cover, based on Tricontinental's valuation, of at least 1.33 times the amount drawn down under the facility. The minimum valuation for the Five Docks property was to be $12.5m.

Full drawdown occurred on 1 October 1987.

The facility (still shown under the original borrower's name, Entrad Corporation, although the change had been made a month earlier) was noted by the board at its meeting on 28 October. The board was not informed of the change of borrower or security or of the fact that security then failed to comply with the 1.33 times covenant. In fact, at this time, substitute security amounted to only $2.85m (see next para). Mr Johns was present at this meeting.

(e) Security

Pending the registration of the mortgage over the Five Docks property (which was delayed), Entrad provided temporary security of 3,000,000 AFP Investment Corporation Limited shares. As at 13 October the value of this parcel was $11.70m ($3.90 p.s.). Following the stock market
crash, as at 30 October, the value of the parcel had decreased significantly to $2.85m (95c p.s.) breaching the 1.33 times cover covenant.

On 1 December, Entrad provided substitute temporary security being 10,000,000 shares in Entrad Corporation. This parcel was valued at $15m ($1.50 p.s.). The Five Docks property was valued on 7 December at $12.5m. A mortgage over this property replaced the Entrad Corporation shares as security on 14 April 1988.

(f) Investment banking - evaluation reports of takeover targets

On 2 June 1987 Mr Johns sent invoices to Entrad Corporation for a total of $1m. Tricontinental's claim was said to be for fees owing for three evaluation reports, as to possible takeover targets, compiled by Tricontinental on behalf of Entrad Corporation. The invoices requested payment before 30 June. A further invoice for fees of $270,000 for another report was sent by Johns to Mr Durlacher on 29 September 1988. The four reports were produced to the Commission.

In fact these reports were not produced for Entrad Corporation, as suggested by the invoices. Nor were they produced at the request of Mr Goldberg or any of his companies. None of the proposed takeovers was pursued by the Goldberg group. These reports were prepared at the initiative of Tricontinental's corporate services division for "prospective purchasers" (except for one which was initiated by the proposed takeover subject itself). The contents of the reports are principally derived from publicly available information, they are incomplete and lack analysis (particularly any directed towards the interests of the Goldberg group).

In evidence, Mr Durlacher said he recalled these invoices and that the companies concerned were not takeover targets of interest to the group. He said he thought the fees were excessive and that he personally would
not have paid them, but he did, because he was so directed by Mr Goldberg.

On 10 June 1987, apparently in response to the three invoices sent on 2 June, Entrad paid $1m to Tricontinental. This payment was credited to the investment banking division as being part payment of holding costs in respect of shares held by Tricontinental in Plymouth Resources N.L. (‘Plymouth’) and Cornwall Petroleum Corporation N.L. (‘Cornwall’). These shares were listed in category A of Tricontinental’s investment banking portfolio, that is, those shares held in Tricontinental’s name on behalf of a client.

Tricontinental and Entrad International Pty Ltd (‘Entrad International’) (a wholly owned subsidiary of Entrad Corporation) were the two largest shareholders in Plymouth and Cornwall between September 1986 and June 1987. Between them they held cumulative shareholdings in each instance in excess of 20%. Tricontinental and Entrad International lodged substantial shareholder notices in respect of their Plymouth and Cornwall holdings. However, these notices did not disclose any association between Tricontinental and Entrad International.

(g) Role of Mr Johns

As with the Parkston matter, Johns negotiated this transaction. He was co-author of the credit submission. He confirmed the change of borrower. According to Hunter, the change of security would have been approved by Johns and this was apparent from his signing the letter of offer. Johns also managed the Entrad investment banking portfolio.

(h) Role of other managers

Mr Hunter played a significant role in pursuing security top-up from the borrower.
(i) **Role of other directors**

Ryan, Rawlins and Carr approved the credit submission on 16 and 17 September 1987. This appears to have been their only involvement (other than formally noting the facility at the October board meeting.) Mr Rawlins resigned from the Tricontinental board in April 1988.

(j) **Significant issues**

The Commission's examination of this transaction has involved consideration of a number of significant matters. These include:

(i) the quality of credit risk analysis;
(ii) departures from the terms and conditions approved by directors;
(iii) inadequacy of security cover;
(iv) the alleged failure of the monitoring process involving the 1988 financial reports;
(v) the significance of the evaluation reports; and
(vi) alleged breaches of the Code by Mr Johns.

(k) **Quality of credit risk analysis**

Clearly, directors proceeded on the basis that they were considering Entrad Corporation as the borrower, not Entrad Limited. Accordingly they had no information before them as to the actual borrower. However the credit submission did not even contain the most recently available financial information for the proposed borrower. It provided the June 1986 audited figures for Entrad Corporation whereas counsel assisting submit the December 1986 figures (at least) and the provisional June 1987 figures should have been provided. There was some reference to December 1986 figures in the submission, but they were not set out.

Mr Rawlins assumed, when considering the credit submissions, that the financial statements provided were the latest available; but he conceded in evidence that more up-to-date information must have been obtainable. Mr Maddison, the credit analyst, was unable to provide a satisfactory
explanation as to why the accounts to December 1986 were not provided. He said, however, that the half-yearly accounts required by the ASX contained very little information.

120 Directors were told of other related exposures to the Goldberg group and, significantly, of Entrad Corporation's below-expected profitability as a result of "... the continued burden of high interest rates ...".

121 Mr Ryan agreed that the submission may not have been read as closely as usual because it indicated that approval of the facility would not result in an increase in Tricontinental's exposure to the Goldberg group.

122 Counsel assisting submit that the approving directors, Johns, Ryan, Carr and Rawlins, failed adequately to assess credit risk in that, among other things:

(i) excessive group exposure was permitted;
(ii) insufficient weight was given to the position of the borrower in the group, considering that the failure of one group entity could lead to the collapse of the borrower and the group as a whole; and
(iii) they failed to require the production of up-to-date financial information.

Accordingly, counsel assisting submit Johns, Ryan, Rawlins and Carr demonstrated a lack of commercial judgment in reaching the decision to approve the Entrad Corporation credit submission.

123 Counsel for the directors note that the half yearly accounts as at 31 December 1986 were not put in evidence before the Commission. Counsel argue that these accounts form the basis for the conclusions expressed in the credit submission and, accordingly, their absence necessarily detracts from the conclusions which are open to be found by the Commission in respect of the analysis performed by directors and officers.
Counsel for the directors submit further that it is apparent Tricontinental received not only the accounts of the Goldberg group of companies, but also the analyses of these accounts undertaken by the group for the benefit of its bankers. These analyses have not been produced to the Commission (because they were not contained within the relevant Tricontinental files when obtained by the Commission) and counsel submit that it would be important to examine them in assessing the credit decision of the directors and officers.

Counsel for the directors argue that there was a sound basis for directors approving this transaction in the form proposed in the credit submission. They rely upon the following considerations:

(i) the facility enabled a major borrower to re-organise and rationalise its affairs;
(ii) the borrower's servicing capacity was said to be 11.9 times its servicing requirements;
(iii) there was a good existing relationship between Tricontinental and the Goldberg group;
(iv) there was no increase in exposure to the Goldberg group;
(v) there had been a substantial improvement in Entrad Corporation's ratio of net assets to net liabilities;
(vi) adequate security was proposed for the facility; and
(vii) based on the most recent financial information, Entrad Corporation appeared to be in good financial health.

On this basis it is submitted it was appropriate for directors to approve the proposed facility.

Counsel for the directors and management also submit that, as Johns was the account manager, he was obliged to analyse the proposal critically. In this context, counsel submit the role of the credit and securities division was supportive, but supplementary, to Johns.
127 Counsel for the directors submit that, even if the Commission were to find that there were some shortcomings in Tricontinental's analysis of its facility to Entrad, further analysis may not have prevented Tricontinental from sustaining a loss. Counsel observe that the reasons for the group's failure predominantly emerged after May 1989, and that certainly before that time none of the 30 lenders to the group detected its imminent failure. Thus any further analysis undertaken by Tricontinental was unlikely to have prevented Tricontinental sustaining the loss that it did.

128 Counsel for the directors finally submit there has been no lack of commercial judgment by approving directors; but, assuming there was, they submit this is a far cry from being negligent.

(I) Departures from terms and conditions approved by directors

129 As noted, both the identity of the borrower and the security were altered without reference to or approval from the board. Presumably these changes were initiated at the request of the borrower. The change in borrower was confirmed by Johns and he signed the letter of offer with the altered security.

130 Counsel for the directors submit the change in name of the borrower is more than a mere technicality and agree that the financial information provided to the directors did not relate to the actual borrower.

131 The senior managers involved with the facility, Hunter and Maddison, did not consider it was necessary for the board to reconsider the change of borrower. Each thought it was a matter for Johns as to whether the security was changed. Counsel for Hunter and Maddison submit that, in this matter, managers were acting under the direction of Johns.

132 By contrast, the three approving directors, Carr, Ryan and Rawlins, all believed that these alterations should have been referred to the board for
further consideration. Counsel assisting submit this view is undoubtedly the correct one.

(m) Inadequacy of security cover

Full drawdown of the facility occurred on 1 October 1987. The value of any shares or investment property securing the facility was to provide a security value of at least 1.33 times the amount drawn down. Counsel assisting submit this covenant was seriously breached following the stock market crash. The initial cover of $11.70m (cover of 1.17 times in any event, not 1.33), fell to $2.85m thus providing cover of only .28 times. No top-up security was obtained by management until 1 December 1987, when the 10,000,000 Entrad Corporation shares (valued at $15m) were substituted. This security remained adequate until the Five Docks property was substituted in April 1988.

Mr Hunter claimed that it was up to the account manager (Johns) to obtain adequate top-up security or to instruct him (Hunter) to do this. Counsel assisting submit that it is clear Hunter played a significant role in communicating with the borrower. Mr Durlacher confirmed this and Mr Hunter himself said he could recall chasing Mr Durlacher for top-up security on a regular basis until it got to the stage that "the well was empty". Counsel assisting submit that this cannot have been the case immediately after the stock market crash because, ultimately, Mr Hunter obtained the substitute temporary security (10 million Entrad Corporation shares) in December 1987. Counsel's submission implies that Mr Hunter did not try hard enough. For example, at no stage was it suggested to the borrower that Tricontinental would foreclose on the loan if it didn't immediately supply the appropriate security cover.

A mortgage over the Five Docks property was finally provided as security in April 1988. It was valued at $12.5m. This was less than the minimum $13.33m security which was required by the covenant.
Counsel assisting submit that, as the officer in charge of the securities division, Mr Hunter was responsible for ensuring that security requirements were met. Counsel argue there was a serious deficiency in security following the stock market crash which was allowed to continue for a substantial period. Accordingly, counsel submit Mr Hunter was negligent in the discharge of his duties.

In essence, counsel for Mr Hunter submit that there is insufficient evidence to make any determination on this point and that, in any event, the delay in obtaining top-up may well have been reasonable and explicable given the requirements facing Hunter after the stock market crash.

In addition to the general matters raised, counsel for Mr Hunter rely on the following:

(i) it was up to Johns to obtain adequate security top-up or to instruct Hunter to do this;

(ii) it cannot be said that Hunter had prime responsibility to obtain security top-up just because he may have chased up Durlacher;

(iii) it is unlikely Johns would have wanted Hunter to have contacted a borrower for top-up security without some form of instruction;

(iv) without the evidence of Johns it cannot be concluded that Hunter was negligent; and

(v) it cannot be assumed that Hunter did not do everything possible to obtain top-up, if and when he was instructed to do so.

(n) Alleged failure to monitor the 1988 financial reports

No internal annual review of the Entrad facility has been found and counsel assisting submit that the Commission should be satisfied none was compiled following approval of the facility in September 1987, and that no up-dated credit submission substituted for the required annual review.
Counsel assisting submit the 1988 accounts for Entrad Limited revealed at least two matters which should have been of concern to Tricontinental management and directors:

(i) First, a number of real assets, namely the businesses involved in manufacturing and marketing of textiles, were sold to related companies and replaced by notional assets such as inter-company loans. These sales are referred to at paragraph 65 above. Counsel assisting submit this development threatened to undermine Tricontinental’s security. In this connexion it should be noted that Entrad had purchased a 50% interest in the Linter group and, further, that in October 1987 (well before the 1988 return was published) Entrad wrote to Johns informing him of these developments and outlining the supposed advantages to the group.

(ii) Secondly, a dividend of $9.5m was paid to Goldberg private entities, although Entrad only reported an operating profit after tax of $3m. Counsel assisting submit that Tricontinental’s concern should have been that the group was diverting funds from a company to which it had an exposure and over which it had some control, to another entity over which it had no control at all.

Counsel assisting submit directors wrongly assumed that appropriate monitoring was taking place and that annual reviews were being conducted. Counsel submit the board failed properly to supervise the account manager, Johns, so as to satisfy itself that the system of monitoring was operating effectively. Counsel repeat their submissions outlined at paragraphs 24, 25 and 27 above. In all the circumstances, however, counsel do not submit this failure amounts to conduct contrary to s229(2) of the Code.

Counsel for the directors note that, in contrast to the alleged shortcomings of the financial position of Parkston and Roxbury Holdings (as at June 1988), no such allegation is made concerning Entrad. As to the two
specific matters raised by counsel assisting concerning the 1988 accounts at paragraph 140 above, counsel observe:

(i) the transfer of assets was a matter well known to Johns as he was familiar with the group's rationalisation progress;
(ii) Johns did not report the transfer to the board;
(iii) the interdependence of the group meant that Entrad's inability to meet any obligation would be met by other group entities; and
(iv) the transfer of assets was to other Goldberg companies to which Tricontinental was exposed and for which it had security.

(o) Evaluation reports

As to the invoices for the takeover evaluation reports, counsel assisting submit the fees claimed were grossly excessive and that they were false documents created by Mr Johns for a "fraudulent purpose", namely to conceal the fact that Entrad Corporation paid fees to Tricontinental for 'warehousing' shares owned by Entrad International. Accordingly, counsel assisting submit Mr Johns failed to act honestly in the exercise of his powers and the discharge of his duties contrary to s229(1)(b) of the Code.

Counsel assisting submit further that Tricontinental and Entrad International were "associates" for the purposes of the relevant Companies Codes and that they should have qualified the substantial shareholder notices which were lodged. Accordingly, counsel submit that this matter should be referred to the ASC for further investigation to determine whether there have been breaches of other provisions of the Codes, particularly concerning the substantial shareholder notices and the 20% shareholdings. A further aspect of any suggested inquiry concerns whether there has been any defrauding of the revenue through improper taxation claims made by Tricontinental (as to how it dealt with its income) or any other taxpayer (such as Entrad Corporation falsely using the invoices to support deductions claimed).
Alleged breach of Companies Code by Mr Johns

Counsel assisting submit that, in addition to his involvement as an approving director (referred to at paragraphs 118 to 122 above), as the account manager, Mr Johns:

(i) failed to refer the change of borrower and security back to other approving directors for further consideration;

(ii) failed to monitor the facility by obtaining and analysing Entrad’s annual reports and those of other group borrowers;

(iii) failed to have annual reviews compiled; and

(iv) failed to report to the board the significant financial deterioration of the borrower and other group borrowers which had been disclosed in the 1988 returns.

Alternatively, counsel submit, Mr Johns failed properly to supervise the officer to whom he delegated the performance of these duties. Accordingly, they submit Mr Johns failed to exercise a reasonable degree of care and diligence contrary to s229(2) of the Code.

Conclusions and Findings - Entrad

As with the Parkston transaction, the Commission again finds that the quality of the credit risk analysis for the Entrad transaction was deficient. The position is complicated by the fact that the borrower approved by the managing director was not the borrower which appeared in the credit submission and, therefore, there was no financial information provided about Entrad Limited, the ultimate borrower. But, even if Entrad Corporation had remained the borrower, the credit submission would have left much to be desired. The comments made about the Parkston transaction in para 86 above are equally true in the present case and need not be repeated. But, here again, it must be conceded that a more professional analysis of the credit risk might not have changed the outcome. The basic weakness of the proposal again lay in the extent of Tricontinental’s exposure to the group, and in the dubious quality of the security proposed.
Fortunately for Tricontinental, in this case the security was changed by the managing director from shares to real estate. It was, in the Commission's view, quite wrong of him to take this step without first consulting the board - or at least the approving directors. Even if he was satisfied that neither the change in the identity of the borrower, nor the substitution of a different form of security, would have troubled directors, he should certainly have informed them of both at the earliest opportunity. There is no suggestion, in this or a number of other transactions reviewed by the Commission, that he either consulted fellow directors or notified them of such changes.

The mortgage taken by way of security has been criticised as falling below the 'times cover' prescribed by the letter of offer. However, the difference is slight and, in the totality of Tricontinental's problems, does not warrant further consideration.

The Commission takes the same view of the criticism made of Mr Hunter's efforts to obtain top-up security in the period before the real estate mortgage was achieved. There is insufficient evidence on which to base any criticism of his efforts.

The same may be said of Mr Hunter's role in the monitoring process. This was essentially Johns' responsibility as account manager, and he knew of the matters referred to in para 140(i) above and should have known of those in para 140(ii). In the Commission's view he should have taken action or, at least, reported these matters to the board.

With regard to the evaluation reports, for which Mr Goldberg paid Tricontinental grossly inflated amounts, the Commission is hampered by not having had evidence from either of the two men concerned, Goldberg and Johns. It seems that no-one else knows the truth behind these payments, although it is very likely that they had a purpose connected with
the warehousing of shares by Tricontinental on behalf of Mr Goldberg. In all the circumstances, and particularly the absence of Mr Goldberg from the country, the Commission is reluctant to recommend any further enquiries or actions on this issue. The matter is a comparatively minor one in the scale of corporate misdeeds, and difficulties of proof would obviously be considerable. No harm was done to Tricontinental.

For similar reasons of difficulties of proof, the Commission feels that this is not a case for any action against Mr Johns, under s229(2) of the Code, for the deficient monitoring of the transaction.

G. The Roxbury Holdings Transaction

(a) Summary

In April 1986 Roxbury Holdings obtained a $20m facility. This was increased to $26.5m in September of the same year. In September 1987 the facility was reduced to $22m. An existing $6.5m facility was deleted, $20m was to be used to refinance an existing facility to another group entity and $2m was provided for the borrower’s working capital purposes. Security was intended to be a first registered debenture charge over all the assets and undertakings of Roxbury Holdings. Unknown to Tricontinental, another lender (ANZ) had registered a mortgage debenture over those assets and undertakings in 1978, which had not been discharged. Tricontinental’s solicitors appear to have failed to discover this - or to inform Tricontinental accordingly. Effectively the facility was wholly unsecured throughout the term of the loan. Roxbury Holdings’ accounts for 1988 revealed a significant deterioration in its financial position. In fact the borrower was insolvent. This situation was apparently not monitored at Tricontinental. As with Parkston, the whole of the facility ($22m) was repaid while the loan was still current and just before integration with SBV. Shortly afterwards this sum was redrawn without reference to the SBV credit committee or board. Interest payments were met up until January 1990, when the Goldberg group collapsed. A receiver
and manager was appointed in February 1990. The anticipated loss is the whole of the facility of $22m.

(b) Chronology

The chronology of relevant events is as follows:

1978
13 September ANZ charge no. 33283 created over all the assets and undertakings of Roxbury Holdings
25 September ANZ charge registered

1986
28 April Credit submission for $20m facility.
27 June Tricontinental charge no. 57720 created over all the assets and undertakings of Roxbury Holdings
11 August Tricontinental charge registered
26 September Facility increased to $26.5m with the same security

1987
10 September Credit submission for $22m facility
15 September to
17 September Submission approved by directors (Johns, Ryan, Carr and Rawlins)
28 October Roxbury Holdings facility noted by the board

1988
2 November Full drawdown of $22m

1989
19 May Repayment of the Parkston ($25m) and the Roxbury Holdings ($22m) facilities
5 June Parkston and Roxbury Holdings facilities redrawn
3 November Last rollover
1990
9 February Mr Anderson of KPMG Peat Marwick appointed receiver and manager
14 March Mr Sherlock of Coopers & Lybrand appointed provisional liquidator
18 June Mr Sherlock appointed liquidator.

(c) Narrative
155 In April 1986 Roxbury Holdings obtained a $20m facility from Tricontinental. This facility was increased to $26.5m on 26 September of the same year.

156 Twelve months later, in September 1987, the facility was reduced to $22m. It was this facility which was the subject of examination by the Commission. The purpose of the $22m facility was to refinance an existing $20m facility to another group entity (Pochette Nominees Pty Ltd) and to provide Roxbury Holdings with an additional $2m for working capital. The credit submission was dated 10 September 1987.

157 Security was to be:

- a first registered debenture charge over all the assets and undertakings of Roxbury Holdings; and
- joint and several guarantees of Mr Abraham Goldberg and his associated companies and trusts. These were attributed no value for security purposes. Mr Goldberg's net worth was estimated at $45.2m as at 30 September 1983.

158 Repayment of the principal was to come from cash flow and/or refinancing. Servicing was to come from cash flow.

159 The facility was considered by directors in conjunction with the $10m facility to Entrad Limited. The directors who approved the submission
were Johns, Ryan, Carr and Rawlins. Only two members of the credit committee had recommended the proposal before the directors gave their approvals.

In September 1987 the facility was partly drawn down ($17.5m). It was fully drawn down by September 1988. On 19 May 1989 the full facility ($22m) was repaid along with that which had been made available to Parkston ($25m). Both facilities were then redrawn on 5 June following integration.

Interest payments were met until January 1990. Following the collapse of the group, on 9 February 1990 Mr Anderson of KPMG Peat Marwick was appointed receiver and manager. He concluded that Roxbury Holdings was insolvent and on 14 March 1990 Mr Sherlock of Coopers & Lybrand was appointed provisional liquidator. The purported security proved to be non-existent and the anticipated loss is the whole of the facility of $22m.

(d) Failure to obtain primary security

The primary security over the facility was to be a first registered debenture charge over all the assets and undertakings of Roxbury Holdings. The borrower's major assets were in fact properties which, in the September 1986 credit submission, were valued at $21.63m.

Guarantees of Mr. Goldberg and his associated companies and trusts were attributed no value for security purposes. Counsel assisting submit the reference to Mr Goldberg's net worth was hopelessly out of date (the figure of $45.2m was as at 30 September 1983) and that in any event the guarantees were only as strong or as weak as the group itself.

In fact the primary security specified in the credit submission was not obtained. The facility remained effectively unsecured for the whole period
of the loan. The circumstances in which this situation arose can be dealt with briefly.

165 Following approval of the April 1986 facility ($20m), Tricontinental appointed the Melbourne solicitors firm of Cooper Korbl & Co ('the solicitors') to act on its behalf in respect of this facility. On 1 July 1986 the solicitors became the merged firm of Holding Redlich & Cooper Korbl. This partnership dissolved on 30 November 1986.

166 The security proposed was a first registered debenture change over all the assets and undertakings of Roxbury Holdings. On 27 June 1986 the solicitors filed and had stamped charge no. 57720. This charge was in fact a second ranking registered charge as a debenture charge (no. 33283) had been created in favour of ANZ on 13 September 1978 over all the assets and undertakings of Roxbury Holdings (formerly Cleckheaton Limited) and had not been discharged.

167 The solicitors' file concerning the April 1986 facility has been examined by the Commission. It provides no evidence that the required search, which would have disclosed the ANZ charge, was conducted.

168 On 26 September 1986 the facility was increased to $26.5m. The security still included a first registered debenture charge over all the assets and undertakings of Roxbury Holdings, valued at $21.63m. In September 1987, the facility was reduced to $22m. Once again the security on the facility was to include the same debenture charge. The same solicitors were appointed to act on Tricontinental's behalf. The solicitors' file in respect of this particular aspect of the transaction indicates that a company search of Roxbury Holdings was completed on 2 November 1987. However, there is no record of the solicitors notifying Tricontinental of the results of that search.
Mr Durlacher said in evidence that he was not aware of ANZ's first ranking position at the time the facility was obtained from Tricontinental. Had he realised this was the position, alternative security would readily have been found. He said that his general understanding was that ANZ only had mortgages over limited property. Mr Ryan said that he would have expected the securities division to confirm that Tricontinental had a first registered debenture charge on the basis of an assurance obtained from its solicitors. Mr Hunter stated that Tricontinental relied on its solicitors to make searches for securities and depended on their advice that the appropriate security was held. However the solicitors provided no advice to Tricontinental that they had registered a first ranking charge. Had the earlier charge been brought to Tricontinental's attention, Hunter said Tricontinental would have either required different security or sought the release of the earlier ranking security before funds were advanced.

The value of the various properties held by Roxbury Holdings at April 1990 was approximately $50.6m. These properties secured loans to ANZ and AEFC of $57.8m. Accordingly, Tricontinental has been unable to recover any moneys pursuant to its second ranking charge.

(e) Role of Mr Johns

As with the Parkston and Entrad transactions, Mr Johns negotiated and proposed the facility. He was the account manager for this transaction.

(f) Role of other managers

Mr Hunter was involved as head of the securities division, particularly in ensuring that Tricontinental held the appropriate security. He also permitted the borrower to redraw the facility after it had been repaid.
(g) Role of directors

Ryan, Carr and Rawlins approved the submission on 16-17 September 1987. Apart from the formal noting of the facility at the board, they appear to have had no other involvement.

(h) Significant Issues

The Commission's examination of this transaction has involved consideration of a number of significant issues. These include:

(i) the quality of credit risk analysis;

(ii) the failure to obtain primary security;

(iii) the alleged failure of the monitoring process involving the 1988 financial reports;

(iv) the repayment and redrawing of the facility; and

(v) the alleged breach of the Code by Mr Johns.

(i) Quality of credit risk analysis

Counsel assisting submit the credit submission of 10 September 1987 contained a lack of information concerning the financial position of the borrower. The financial information consisted only of unaudited figures for the years to June 1985 and June 1986 and the half year to December 1986. Even this limited information was not presented adequately - for example, the commentary in the submission stated that total tangible assets increased from $174.8m in June 1985 to $229.3m in June 1986, without mentioning the December 1986 figures, which demonstrated that total tangible assets had declined to $208.8m.

Other deficiencies suggested by counsel assisting were that:

(i) no projected cash flow figures were provided, despite the assertion that servicing was to come from cash flow. The projected group earnings before income tax (EBIT) for 1986/87 were said to be $16.79m (excluding any dividends from the group's 12,700,000 Entrad Corporation shares). The December 1986 figures indicated
that loans amounted to approximately $120m. At an average interest rate of 13.5% the group was required to find approximately $16m to service these loans, almost all of its projected EBIT. In fact, the 1987 annual return indicated that EBIT was $4.26m while the net interest cost on the $22m facility was $4.312m;

(ii) no analysis of the assets and undertakings of Roxbury Holdings was provided. Counsel argue such an analysis would have demonstrated the existence of inter-company loans, the value of which depended upon the performance of the operating assets controlled by Entrad Limited.

Counsel assisting note also that the credit submission did show that profit and loss reserve increased from accumulated losses of $8m (June 1986) to $43m (Dec 1986). In addition, sale of assets resulted in an extraordinary loss of $19m in the half year to December 1986.

Related exposures to other entities within the group were noted in the submission. Approval of this facility brought the total exposure of the group to $133m.

The approval of directors (including Johns, Ryan and Carr) for the previous facility of $26.5m in September 1986 was conditional upon a covenant that, during the term of the facility, the net tangible asset backing of Roxbury Holdings' shares was to be maintained at a level which would ensure a debenture value acceptable to Tricontinental. If that value fell, the facility was to be reduced and/or additional security provided. The September 1987 credit submission noted that, following the sale of all of Roxbury Holdings' stock and debtors, the requirement for debenture covenants attaching to the first registered debenture charge had been removed. It listed five covenants, including the one concerning net tangible asset backing. The deletion of these covenants was one of the purposes of the credit submission. The reason for the removal of the net
tangible asset backing covenant was not explained to the Commission. The operating assets sold were replaced by inter-company loans which would not necessarily be recoverable. In evidence, Mr Carr expressed his belief that the covenant relating to net tangible asset backing should have been retained. Counsel assisting argue that the absence of this covenant enabled Roxbury Holdings to run down the level of its assets and thus affect the value of security provided.

Counsel assisting submit that the approving directors, Johns, Ryan, Carr and Rawlins, failed adequately to assess credit risk in that, among other things:
(i) excessive group exposure was permitted;
(ii) insufficient weight was given to the position of the borrower, since the failure of one group entity could lead to the collapse of the borrower and the group as a whole; and
(iii) insufficient emphasis was placed on the borrower's ability to service interest payments.

Accordingly, counsel assisting submit Johns, Ryan, Carr and Rawlins demonstrated a lack of commercial judgment in reaching the decision to approve the Roxbury Holdings credit submission.

Counsel for the directors note that the credit submission of 10 September 1987 was related to earlier submissions in April and September 1986. They submit that a consideration of the September 1987 facility is irrelevant as it is necessary first to hear evidence in respect of, and then consider, the credit submission of September 1986. In the absence of such enquiry, they submit the Commission is not able to make any finding in respect of the approval of the $22m facility in September 1987. Nevertheless, in dealing with the September 1987 facility, counsel submit that the servicing capacity of Roxbury Holdings was adequate.
Counsel for the directors submit once again that the absence of the analyses provided by the Goldberg group to Tricontinental (presumably covering Roxbury Holdings) is an important consideration, particularly as this document might have provided substantial additional comfort for Tricontinental; see para 28 above.

Counsel for the directors submit that there was a sound rationale for directors approving the transaction. Among other things, counsel rely on the following matters - adequate servicing capacity, net reduction in Tricontinental's exposure to Roxbury Holdings, the appearance of adequate security, an increase in the borrower's net worth (of $20m) from June 1986 to December 1986, a reduction in debt (from $129m in June 1986 to $85m in December 1986) and recent financial information which recorded an improvement in Roxbury Holdings' financial position.

(j) Failure to obtain primary security

Counsel assisting submit that the solicitors' file relating to the April 1986 facility reveals that they failed to conduct the appropriate company search. Alternatively, if the solicitors did conduct the appropriate company search, they failed to inform Tricontinental that it could not register a first mortgage debenture over all the assets and undertakings of Roxbury Holdings, as contemplated by the letter of offer dated 8 May 1986.

As to the September 1987 facility, counsel assisting submit that, if conducted properly, this search would have revealed Tricontinental's second ranking behind ANZ.

Counsel assisting submit it is significant that a note in the 1988 annual accounts under the heading 'contingent liabilities', states that the borrower had entered into a guarantee by way of a cross-deed of covenant executed in favour of the ANZ Banking Group so as to secure loans and advances (worth $62.5m) made to related and associated entities. Counsel submit a
careful reading of the accounts, and particularly this note, should have raised questions as to whether this security might rank ahead of the first registered mortgage which Tricontinental supposedly held.

187 Counsel assisting submit that, as the officer in charge of the securities division, Mr Hunter was responsible for seeing that security requirements were met. Before drawdown he failed to obtain positive advice from the solicitors that the required primary security was in place. Accordingly, counsel assisting submit, as an officer of Tricontinental, Mr Hunter failed to exercise a reasonable degree of care and diligence contrary to s229(2) of the Code.

188 Counsel assisting submit the solicitors Holding Redlich & Cooper Korbl appear to have been negligent in failing to ascertain the existence of the first ranking charge in favour of ANZ or, if they did ascertain this fact, they appear to have been negligent in failing to so inform Tricontinental. It should be noted that due to shortness of time the two solicitors handling the matter were not called to give evidence before the Commission (although their responses to inquiries from officers of the Commission are summarised in a report received by the Commission). Counsel assisting submit this issue is one which should be pursued by Tricontinental.

189 Counsel for directors and management note that, in his evidence, Mr Hunter said that it was the solicitors' responsibility at all times to conduct searches of the companies over which Tricontinental was obtaining security. As to the solicitors' file, counsel submit that it contains no evidence that a search was conducted of Roxbury Holdings to identify any prior charges. Further, that the invoice for work rendered from the solicitors to Tricontinental reveals no fee has been charged for a search. Counsel submit that it is probable the solicitors failed to conduct a search at the Corporate Affairs office to ensure there was no prior charge over the assets and undertakings of Roxbury Holdings.
Counsel for Mr Hunter submit that he cannot be blamed for the solicitors' omission to search. Counsel argue that Hunter was entitled to assume the solicitors would abide by the terms (either express or implied) of their retainer which included that the solicitors were to prepare the security documents necessary to give Tricontinental a first registered mortgage debenture. As the requirement of a search for a first registered mortgage is such an obvious requirement for the satisfactory preparation of a mortgage debenture, counsel submit Hunter could properly assume that a first registered mortgage debenture was obtained. Accordingly, counsel submit there is no basis upon which the Commission can find Hunter acted negligently. They submit that, as account manager, Mr Johns was responsible for establishing which assets were pledged as security to other lenders and that he clearly failed to identify that certain assets were secured in priority to Tricontinental's charge.

The Commission has received separate written submissions on behalf of solicitors Holding Redlich, and of Cooper Korbl & Co. The Commission has been informed by the solicitors acting on behalf of Cooper Korbl & Co and Holding Redlich that these submissions have been prepared without the benefit of sighting Tricontinental's files in relation to the Roxbury Holdings facilities. As at 9 April 1992 a request to review these files had been refused by Tricontinental's solicitors. The two firms merged on 1 July 1986 when the new partnership of Holding Redlich & Cooper Korbl commenced. That partnership was dissolved on 30 November 1986.

Holding Redlich submit there is no substance in any allegations of negligence against the partners of that firm. They contend that:

(i) the first alleged act of negligence occurred during the period April to June 1986, before the merger commenced;

(ii) the second alleged act of negligence occurred in September 1987, long after the partnership had been dissolved; and
(iii) there are no other acts of negligence alleged against the firm of Holding Redlich & Cooper Korbl during the term of the partnership from 1 July 1986 to 30 November 1986.

In these circumstances Holding Redlich submit that the Commission should make no findings against either the firm Holding Redlich or the firm Holding Redlich & Cooper Korbl. It is to be noted that the facility was increased from $20m to $26.5m on 26 September 1986 secured, in part, by a first registered debenture charge over all the assets and undertakings of Roxbury Holdings (valued at $21.63m). Furthermore, the merged firm corresponded with Tricontinental, particularly on 1 September 1986, concerning the very issue of this security.

The solicitors for Cooper Korbl & Co submit that the file relating to the April 1986 facility does not reveal that the solicitors failed to conduct a search of the Corporate Affairs Office records relating to Roxbury Holdings. All that can be said from the file is that there is nothing to show that a search was completed. It is further submitted that:

(i) the solicitor who handled the April 1986 facility believed that a search was completed;

(ii) urgent searches were often requested without a file memorandum (thus the absence from the file of any memorandum requesting a search or any search papers does not indicate that a search was not conducted);

(iii) the absence from the solicitors' account of any reference to a search is explicable on the basis that the firms merged on 30 June 1986, that there were many problems with the consolidation of the accounting records of the two firms, that the firms then "demerged" on 30 November 1986 and the account for the April 1986 facility was not rendered until 2 June 1987;

(iv) as an experienced securities lawyer, the existence and significance of the ANZ charge would have been immediately apparent to the solicitor from his inspection of the microfiche records;
(v) the solicitor would have spoken to someone at Tricontinental about the ANZ charge, probably Mr Hunter; and

(vi) it must have been indicated to the solicitor that Tricontinental was not concerned about the ANZ charge.

194 The solicitors for Cooper Korbl & Co also submit that it is quite possible Mr Hunter referred the ANZ charge to Mr Johns and was told that it was not a problem or would be brought into account at a later stage.

195 They submit further that their clients believe that they did inform Tricontinental of the results of the search conducted on 2 November 1987. The solicitor handling the matter believes that he spoke to either Mr Hunter or Mr David Dyring about the ANZ charge. The solicitor does not recall either Hunter or Dyring saying that the ANZ charge was a problem. It is accepted that there was no correspondence on the solicitors' file confirming to Tricontinental the existence of the ANZ charge. It is submitted there was no particular need for a confirming letter given that Tricontinental's charge was registered more than a year earlier and that Tricontinental did not require any change to the security. Cooper Korbl & Co deny that:

(i) they were negligent in failing to ascertain the existence of the ANZ charge;

(ii) they were negligent in failing to inform Tricontinental; and

(iii) Tricontinental suffered loss.

It is submitted that, had Tricontinental obtained a first ranking charge, it would have been worthless in any event, as the ANZ bank derived nothing from its charge because Roxbury Holdings was insolvent by 1988.

(k) Failure to monitor 1988 financial reports

196 On 23 June 1988, Mr Venner of Tricontinental wrote to Mr Durlacher indicating that a condition of the facility was that annual reports be forwarded "... so that a review may be undertaken". He requested that the 1987 accounts (not the 1988 accounts) be forwarded as soon as possible.
No record of a response to this request has been found.

197 No internal annual review of the Roxbury Holdings facility has been found by the Commission, and counsel assisting submit that the Commission should be satisfied none was compiled following approval of the facility in September 1987. There was no up-dated credit submission to substitute for the required annual review. Counsel assisting submit that the 1988 accounts confirmed that the borrower’s financial health had deteriorated so significantly that Tricontinental's intervention was imperative.

198 The 1988 accounts for Roxbury Holdings revealed:

(i) An extraordinary loss of $70m. This loss arose principally from a provision for uncollectable loans (amounting to $61m) owed to Roxbury Holdings by related Goldberg group companies, which apparently could not honour their debts. Counsel assisting submit this fact alone should have indicated potential liquidity problems within the group and have caused concern not only to Tricontinental but to all lenders to the group;

(ii) An operating loss of $4.3m. Counsel assisting argue this result called into question the ability of the borrower to service debt;

(iii) A dividend paid of $2.7m, the recipients of which would appear to have been companies controlled by Mr Goldberg. Counsel assisting contend no dividend should have been paid, given the losses recorded;

(iv) As a result of write-downs and extraordinary losses, net assets moved from a surplus of $51m in June 1987 to a deficiency of almost $33m in June 1988. This included total accumulated losses by the company of $145m.

On these figures the company was insolvent, a conclusion both Mr Durlacher and Mr Ryan agreed with.

199 The auditors' report as to these figures included only a minor qualification
in respect of accounting for depreciation. There was no qualification to the accounts in respect of the company’s ability to continue as a going concern or at least to do so dependent on the support of the Goldberg group.

None of the Tricontinental directors or management personnel who gave evidence could recall reading the Roxbury Holdings accounts for 1988. Mr Ryan said these results would have caused him considerable concern as a manager, let alone as a director. He conceded that the return showed clearly a significant deterioration in the financial health of the borrower and he said he would have expected to have been informed of this. Mr Carr also conceded that there had been a deterioration in the financial position of the borrower.

Counsel assisting submit the account manager, Mr Johns, and/or his delegate in the credit division, had an obligation to obtain and analyse these crucial returns for 1988. As a result of the failure to do so, the Tricontinental board was not alerted to the serious difficulties faced by the borrower.

Counsel assisting also submit that directors wrongly assumed that appropriate monitoring was taking place and that annual reviews were being conducted. Counsel submit the board failed properly to supervise the account manager, Mr Johns, so as to satisfy itself that the system of monitoring was operating effectively. Counsel repeat their submissions outlined at paragraphs 24, 25 and 27 above. In all the circumstances, however, counsel again do not submit this failure amounts to conduct contrary to s229(2) of the Code.

Counsel for the directors and management submit a number of relevant factors need to be considered in respect of the alleged servicing difficulties and declining asset position. They are that:

(i) the June 1988 accounts were not signed until 8 November 1988.
This provided Tricontinental with approximately six months before integration to obtain and analyse this information, prepare an internal review and recommend a reduced exposure to the group;

(ii) the group continued to service its loans and provide what appeared to be adequate security as well as maintaining other banking support throughout this time;

(iii) there may have been sound reasons for accumulating a negative asset position in one company and enabling it to sustain a loss for taxation purposes; and

(iv) given the interdependence of the group, the perceived alteration of Roxbury Holdings’ position has not been shown to be relevant to the group overall (other group entities substantially improved their position in or about 1988).

Counsel for directors note further that the pivotal Linter group had, from June 1986 to March 1988, improved its net asset position by approximately $80m and its net profit after tax from $7.4m to $36.6m, along with other improvements in its general financial position. These figures were provided in the credit submission of 3 November 1988 for Gibraltar Factors Pty Ltd ('Gibraltar Factors'). Counsel argue, in effect, that the Linter group had acquired some of the financial benefits which had been lost by Roxbury Holdings. Accordingly, counsel submit, it was reasonable for Tricontinental to expect that the Linter group would continue to service Roxbury Holdings’ exposure to Tricontinental. Similarly, counsel note improvements in another group entity, AFCO, an Entrad subsidiary.

In summary, counsel for the directors submit that the AFCO, Gibraltar Factors and Linter group credit submissions reveal:

(i) AFCO had provided ample security for its facility and had a strong servicing capacity, suggesting that Roxbury Holdings’ decline was either an aberration or an intentional transfer of losses to one company;

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other parts of the group enjoyed a massive net asset growth, and profit increased during the identical period in which it is alleged that the group was faltering; and

because of the group's interdependence it was reasonable to expect that each subsidiary's obligations would be catered for by the other companies within the group.

Accordingly, counsel submit that there was no net asset deficiency or difficulty in servicing the Roxbury Holdings' facility or, alternatively, that there is insufficient evidence to make contrary findings. Counsel submit that it is open to the Commission to find that there was a significant restructure of the Goldberg group, resulting in a transfer of assets and profitability to certain group entities to the detriment of others. Counsel further submit that there is no evidence whatsoever that, as at June 1988, there was a decline in the group's position. In addition to the credit submissions which directors received and which have been examined by the Commission, directors received a number of other submissions concerning other group entities which have not been considered during the course of evidence.

(i) Repayment and redrawing of facility

As already noted, Mr Durlacher repaid the Roxbury Holdings and Parkston facilities on 19 May 1989. These facilities were redrew on 5 June 1989. These matters are dealt with at paras 74 to 83 above.

(m) Alleged breach of Companies Code by Mr Johns

Counsel assisting submit that, in addition to his involvement as an approving director, as the account manager, Mr Johns:

(i) failed to monitor the facility by obtaining and analysing the annual reports for Roxbury Holdings and those of other group borrowers;

(ii) failed to compile annual reviews; and

(iii) failed to report to the board the significant financial deterioration of the borrower and other group borrowers which were disclosed in the
1988 returns.

Alternatively, Mr Johns failed to supervise the officer to whom he delegated the performance of these duties. Accordingly, counsel assisting submit Mr Johns failed to exercise a reasonable degree of care and diligence contrary to s229(2) of the Code.

H. Conclusions and Findings - Roxbury Holdings

In this, as in the other two transactions already dealt with, the Commission is satisfied that the credit risk analysis was of poor quality. In particular, in the present case, there was an inadequate consideration of the cash flow of the borrower and its ability to meet interest payments from that source. However, as pointed out earlier, the group was highly complex and it might have been possible for payments to have come from some related entity. Bearing in mind that this facility had its origins in April 1986, the Commission is unable to say that a more thorough credit analysis would necessarily have produced any different result.

The great weakness of this transaction was the failure to obtain primary security. Everyone concerned, including it seems Mr Durlacher, believed that there was in place a first registered debenture charge over the assets and undertakings of the borrower. In truth, however, such a charge had been held for many years by another financial institution.

It would seem, on the documentary evidence before the Commission, that the fault may well have lain with the solicitors acting for Tricontinental in this matter. However, the Commission is not able to make such a finding in the absence of oral evidence from all relevant witnesses. The Commission did not believe that it was appropriate for it to undertake such a detailed enquiry, particularly in view of the likely circumstance that even the first registered charge proved worthless - as the firm of solicitors most directly concerned, Cooper Korbl & Co, now alleges.
211 Once again, as in the two earlier transactions, the Commission is satisfied that this facility was poorly monitored. In particular it seems that, from the company's own financial returns for 1988, it can be established that Roxbury Holdings was then insolvent. It can be argued that this may not have been particularly significant, because the group was so interlocked that a weakness in one area may have been compensated for by a strength elsewhere, and the group as a whole may have been able to meet its commitments. This, however, does not excuse the fact that no searching questions were asked, and nothing was brought to the notice of the board. Nevertheless, the Commission cannot be satisfied that a closer monitoring would have produced a better result. There were over 30 financial institutions lending to the Goldberg group and at least a few of them, according to Mr Durlacher, were prepared to put some effort into their monitoring task and to ask awkward questions. In spite of this, it seems, none of them foresaw the group's total collapse in January 1990. The earliest suspicions seem only to have arisen a few weeks earlier.

212 The repayment and redrawing of this facility took place in parallel with the Parkston facility dealt with earlier. The comments made in para 92 apply again.

213 Finally, the Commission can only repeat what it has said in relation to the two earlier transactions about the suggestion that action should be taken against Mr Johns under the provisions of the Code for the poor quality of his monitoring. As explained earlier, the Commission does not believe any such action would be appropriate.
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A. **Background and Summary**

1 Tricontinental provided financial accommodation to the Hersfield group of companies ('Herscu group'), which was effectively owned and controlled by Mr George Herscu ('Herscu') and his family. The Herscu group comprised two separate groups of companies, namely the GSH group and the HDC group. There was no direct corporate relationship between these two groups, except that both were controlled by interests associated with Herscu. The GSH group of companies was established in 1985 for the sole purpose of acquiring shares in Hooker Corporation Ltd ('Hooker'). The HDC group owned and operated several commercial properties, mainly shopping centres.

2 Tricontinental provided financial accommodation to two companies within the GSH group, namely $30m to GSH Investments Pty Ltd ('GSH Investments') and $10m to GSH Finance Pty Ltd ('GSH Finance'), and $7.5m to one company within the HDC group, Hersfield Development Corporation Pty Ltd ('Hersfield'). Tricontinental has lost about $40m on these facilities.

3 GSH Investments was an exempt proprietary company which acted as trustee of the GSH Investment Trust, a discretionary trust, the beneficiaries of which included the children of George Herscu. GSH Investments was the effective holding company of the GSH group. The GSH Investments Trust was the beneficial owner of all the shares in GSH Securities Pty Ltd ('GSH Securities') which in turn owned shares in GSH Finance.

4 GSH Finance, also an exempt proprietary company (which eventually became a wholly-owned subsidiary of GSH Securities), owned shares in subsidiaries and in Hooker. The wholly-owned subsidiaries also held shares in Hooker. In September 1986, GSH Finance held 27% of Hooker
and its wholly-owned subsidiaries collectively held 19.2%. The other major asset of GSH Finance was 100% of the units in the Herscu Watts Chimside Unit Trust which owned a number of shopping centres located in Victoria and Queensland.

Hersfield was the trustee of the George Herscu Family Trust No. 9. Hersfield had invested in a number of commercial properties, one of which was the Monash Homemakers Centre, a small commercial property in the eastern suburbs of Melbourne. In November 1983, Tricontinental had provided a facility to Hersfield of $4.5m secured by way of a mortgage over the Centre. In mid-1988 the security on the Hersfield facility was cross-collateralised at the request of Tricontinental with the GSH Finance facility and later the GSH Investments facility.

**B. Chronology**

The chronology of relevant events is as follows:

- **November 1983** Approval of $4.5m facility to Hersfield
- **July 1985** Increase in Hersfield facility to $7.5m
- **July 1986** Approval of Hersfield facility of $10m by Johns, Ryan and Moyle
- **July 1986** Letter of offer to GSH Finance for $10m facility
- **August 1986** Drawdown of $10m on GSH Finance facility
- **September 1986** Approval of GSH Investments facility of $30m by Johns, Ryan and Carr
- **October 1986** Extension and amendment of the GSH Investments facility approved by Johns, Carr and Rawlins
- **9 December 1986** Drawdown of $14.5m on GSH Investments
- **11 December 1986** Drawdown of $1m on GSH Investments
- **18 December 1986** Drawdown of $2.5m on GSH Investments
- **18 March 1987** Internal review of GSH Investments
- **7 April 1987** Letter requesting additional security margin of
$345,896 on GSH Investments and $181,714 on GSH Finance

8 April 1987 Letter enclosing additional security lodged in satisfaction of security margin

29 June 1987 Drawdown of $12m on GSH Investments

2 July 1987 Urgent fax requesting additional margin of $540,300 on GSH Investments

22 December 1987 Letter notifying security shortfall of $21m on GSH Investments and $8m on GSH Finance and requesting firm arrangements be made in relation to the security shortfall

3 February 1988 Memo Johns to Moyle enclosing credit submission for $100m to support privatisation bid for Herscu

8 February 1988 Letter Moyle to Johns refusing support for the privatisation bid

25 February 1988 Letter to Herscu advising of security shortfall of $7.9m on GSH Finance facility and indicating no extension of facility until satisfied

7 April 1988 Approval of extension on GSH Finance facility to 31 October 1989 by Johns, Smith, Ryan and Carr

27 June 1988 Johns requests preparation of credit submissions to extend GSH Investments and GSH Finance facilities by 2½ years and to provide a letter of credit option on GSH Finance facility

8 July 1988 Memo stating Carr had declined credit submissions for GSH Investments and GSH Finance without giving a reason

14 July 1988 Memo Johns to Ryan, Moyle and Carr re-submitting credit proposals for GSH Investments and GSH Finance

22 July 1988 Memo Johns to Clark stating Carr and Moyle have approved extensions of facilities to GSH Investments
and GSH Finance and indicating his understanding that Ryan had also approved

20 September 1988  Issue of standby letter of credit in favour of Zurich for $10m on GSH Finance facility

5 October 1988  Credit submission to increase facility to GSH Investments by $1m to cover dividend payments on the preference share issue

12 October 1988  Memorandum from Johns to Smith, Ryan, Moyle, Morton, Carr and Ziebell enclosing credit submission in respect of increase of facility to GSH Investments to $31m

14 October 1988  Carr approved subject to an unconditional guarantee from MGICA or FAI

October 1988  Approval of increase in facility to GSH Investments by Smith, Carr and Morton

2 December 1988  Issue of standby letter of credit in favour of Challenge Bank for $14,406,876 on GSH Investments facility

3 February 1989  Issue of standby letter of credit in favour of Amayco for $16,467,726 on GSH Investments facility

10 March 1989  Letter to Herscu advising of security shortfall on GSH Investments and GSH Finance and requesting rectification

10 April 1989  Meeting between Johns and George and Jeffrey Herscu

6 July 1989  Notice of demand on GSH Investments, GSH Finance and Hersfield

11 July 1989  Resignation of Herscu as CEO of Hooker

26 July 1989  Appointment of provisional liquidator to Hooker

27 July 1989  Suspension of trading of Hooker shares by ASX

28 July 1989  Appointment of receiver to Hersfield

1 August 1989  Demand by Challenge Bank under letter of credit and
payment of $14,389,538.46

4 August 1989  Recommendation by SBV officers that provision for doubtful debts be raised to $38m in respect of GSH Finance, GSH Investments and Hersfield facilities

17 August 1989  Receipt of $900,000 from FAI

31 August 1989  Demand by Amayco under letter of credit and payment of $16,467,726

25 September 1989  Demand by Zurich under letter of credit and payment of $10,040,514

22 November 1989  Appointment of liquidator to GSH Finance

23 November 1989  Appointment of liquidator to GSH Investments and Hersfield

December 1989  Hooker shares delisted on ASX

15 January 1990  Problem loan report making specific provision of $35m re facilities to Herscu group

30 June 1990  Problem loan report making specific provision of $35m and notional specific provision as at 31 December 1989 of $4m

9 July 1990  George Herscu and Sheila Herscu declared bankrupt

16 July 1990  Liquidator of GSH Investments advises no assets realised

3 August 1990  Liquidator of Hooker proposes scheme of arrangement

10 August 1990  Liquidator of GSH Finance advises no recovery to date

30 September 1990  Problem loan report indicating $37,302,000 claimed on government and $6,198,000 as a notional specific provision

29 October 1990  Proof of Debt filed in respect of bankruptcy of George and Sheila Herscu

Late 1991  Sale of Monash Homemakers Centre for $4.25m
C. Narrative

(a) GSH Investments facility

In September 1986, Tricontinental granted a $30m facility to GSH Investments for the purpose of purchasing shares in Woolworths Limited up to a total value of $30m, to be secured by a share mortgage over Woolworths Limited shares. This facility, although approved by the directors, was not drawn down and was later superseded by a further facility approved in October 1986. No drawdown occurred because the proposed bid for Woolworths did not proceed. Although no purpose for the October facility was set out in the credit submission, the letter of offer stated that the purpose was to purchase "ordinary shares in publicly listed Australian companies". Hooker share scrip was to constitute the main security for the loan. It was a precondition to the approval of the October facility that Tricontinental's $12m Hooker investment banking facility be fully repaid before drawdown. The October 1986 facility was due to expire on 31 October 1989.

In December 1986, $18m was drawn down on the facility, notwithstanding that the Tricontinental investment banking facility of $12m to Hooker had not been repaid. The investment banking facility was repaid in early July 1988, shortly after the final drawdown on this facility.

In March 1987 there was an internal review of the facility which reached a favourable conclusion because the security cover stood at 1.35 times. However Mr Clark noted, "Would be useful to have June '86 [Profit and Loss Accounts] and 86/87 cash flow projections given high gearing and accumulated losses". (Gearing was shown as 206%). Mr Clark's note produced no apparent response.

As a result of the stock market crash on 20 October 1987, the value of the Hooker shares dropped by some 64%, putting the facility in immediate default of the security covenant. This default, unremedied, was reported to
the board in November 1987 and again in February 1988. In July 1988, the Tricontinental board approved a further extension of the $30m facility until 31 December 1990.

In October 1988, the Tricontinental board approved an increase in the facility to $31m and a change in the nature of the facility to a letter of credit, to support a preference share issue to be undertaken by GSH Equities Pty Ltd (another company in the GSH group of companies). The increase in the facility by $1m was to cover the dividend payment due on the preference share issues, and was to be secured by a guarantee from Mortgage Guarantee Insurance Corporation of Australia Ltd (‘MGICA’) or FAI Insurance Ltd (‘FAI’) of at least $1m plus costs and interest. A guarantee of $900,000 was in fact received from FAI.

On 2 December 1988, the bill facility was partially converted by the issue of a letter of credit in favour of Challenge Bank Ltd for $14,406,876 and was fully converted to a letter of credit on 3 February 1989 by the issue of a letter of credit in favour of Amayco Ltd in the sum of $16,467,726.

On 6 July 1989, notice of demand was served on GSH Investments, and the outstanding facilities to the Herscu group were placed on the list of non-accrual loans provided to directors.

As a result of default under the terms of the preference share issue, Tricontinental was obliged to make full payment under the letters of credit in August 1989. On payment of these amounts the facility, to the extent of the payments, was treated as a cash advance. Tricontinental recovered the sum of $900,000 from FAI under its guarantee.

Interest was paid on the $30m facility from September 1986 until conversion of facilities into letters of credit. Interest accrued once payment
was made under letters of credit to Challenge Bank and Amayco. The accrual of interest was suspended as from 1 August 1989.

The first action to enforce the security occurred in July 1989 when a notice of demand was served.

(b) GSH Finance facility

In July 1986, Tricontinental directors approved a $10m facility to Hersfield for the purpose of providing Hersfield with additional working capital and to assist in refinancing existing borrowings. The facility was to be secured by a first registered share mortgage over shares in Hooker. A letter of offer was later sent by Tricontinental to GSH Finance and not Hersfield but, apart from this change of borrower, it was in the terms approved by the directors.

In August 1986 $10m was drawn down on the facility.

As a result of the stock market crash in October 1987, the value of the Hooker shares dropped by some 64%, placing the facility in immediate default of the security covenant. This was reported to the board in November 1987 and again in February 1988.

In April 1988, the Tricontinental board approved a further extension of the facility until 31 October 1989, and amended the security so that security for the Hersfield facility (namely the Monash Homemakers Centre) was cross-collateralised to this facility.

In July 1988, the board approved a further extension of the facility until 31 December 1990, and an amendment of the facility to incorporate a letter of credit option to support a possible preference share issue to be undertaken by Hersfield and/or GSH Equities.
On 20 September 1988 the bill facility was converted by the issue of a letter of credit in favour of Zurich Australia Life Insurance Ltd (‘Zurich’) for $10m.

On 6 July 1989 notice of demand was served on GSH Finance and the facilities to the Herscu group were placed on the list of non-accrual loans.

As a result of default under the terms of the preference share issue, Tricontinental was obliged to make full payment under the letter of credit in September 1989. On payment of that amount, the facility was treated as a cash advance.

Interest was paid in respect of the $10m facility from July 1986 until conversion of the facility into a letter of credit. Interest accrued once payment was made under the letter of credit in September 1989.

The first action to enforce the security occurred in July 1989 when a notice of demand was served.

(c) Hersfield facility

The only relevance of the facility given to Hersfield is because of its relationship to the GSH Investments and the GSH Finance facilities as a result of the cross-collateralisation of the security, effected in 1988.

This facility was provided to Hersfield in November 1983, for $4.5m. This was later increased to $7.5m, with an extended expiry date to 30 November 1990. It was secured by first registered mortgage over the Monash Homemakers Shopping Centre, joint and several guarantees and a first registered mortgage debenture over Hersfield.
In mid-1988, the security on the Hersfield facility was cross-collateralised, at the request of Tricontinental, with the GSH Finance facility and later the GSH Investments facility.

On 6 July 1989 a notice of demand was served on Hersfield and the facilities to the Herscu group were placed on the list of non-accrual loans.

The security on the Hersfield facility (Monash Homemakers Centre) has been realised; but it has left a shortfall of $4.25m.

D. Role of Mr Johns in GSH Investments Facility
(a) Approval of facilities

Mr Johns was, the account manager and the facility was a margin lending transaction.

Approval of facility: September 1986
Mr Johns was as usual, a director who approved the facility. Although the credit submission included financial information concerning the Herscu group on a consolidated basis, it did not include any financial information relating to GSH Investments, nor did it disclose that GSH Investments was trustee of the GSH Investments Trust. It did, however, include an analysis of the value of Woolworths shares.

Extension and amendment of facility: October 1986
Johns was the first director to approve the extension and amendment of the facility. Although some out-of-date financial information was included in the credit submission, none of it related to the GSH group. Further, no distinction was drawn between the Hersfield group and the GSH group, nor did the credit submission disclose that GSH Investments was trustee of the GSH Investments Trust. There was no detailed, up-to-date analysis of the prospective share value of Hooker shares, which were to constitute the main security.
Facility extension: July 1988

Johns was, again, one of the directors who approved the facility - some two weeks before Moyle and Carr. Ryan's date of approval is not recorded. Financial information concerning the consolidated position of the Herscu group of companies and trusts for the years ended 1986 and 1987, together with the balance sheet, profit and loss statement and financial ratios for Hooker for the 1986 and 1987 years, were included in the credit submission. Although the purpose of the credit submission was to extend the facility until 31 December 1990, it contained little analysis of the future prospects for Hooker in light of the share market crash in October 1987.

Facility increase: October 1988

Johns was still the account manager, although Mr Kenshole's name appeared on the credit submission and Johns does not appear to have approved the credit submission. Attached to the credit submission was the balance sheet of the Herscu group of companies and trusts for the years ended 30 June 1986 and 1987. There was no financial analysis of GSH Investments or the future prospects of Hooker.

(b) Conduct as account manager

On 7 April 1987, Johns asked Jeffrey Herscu for an additional security margin of $345,196 which was lodged on the following day.

On 15 April 1987, Johns agreed to amend the extension fee from $75,000 to $50,000.

On 2 July 1987, Johns requested further security cover of $540,300, due to the fall in the Hooker share price.

On 22 October 1987, Johns wrote to Herscu requesting specific reasons for a proposed restructure of the facilities by transferring the $30m GSH Investment facility to GSH Finance.
On 22 December 1987, Johns again wrote to Herscu notifying him of a security shortfall of $21,092,112 and requesting that firm arrangements be made in relation to the security shortfall.

On 3 February 1988, Johns sent a credit submission to Moyle, asking approval for $100m to support the privatisation bid by Herscu. Moyle declined the request by letter of 8 February.

On 27 June 1988, Johns directed, in effect, that a credit submission be prepared to extend the facility for 14 months, to December 1990.

On 6 July 1988, Johns declined a request to increase the facility by $1m.

On 14 July 1988, Johns wrote to Ryan, Moyle and Carr resubmitting the credit submission for their approval. Mr Carr at least had previously declined to approve it.

On 22 July 1988, Johns informed Clark that Carr and Moyle had approved the amendment and extension of the facility and that it was his understanding that Ryan had also approved.

On 12 October 1988, Johns wrote to Smith, Ryan, Moyle, Morton, Carr and Ziebell, enclosing a credit submission to increase the facility by $1m to $31m.

On 10 March 1989, Johns wrote to Herscu telling him of a security shortfall of approximately $18.9m, and saying that it was essential to sit down and discuss the shortfall which had existed for many months.

On or about 10 April 1989, Johns recorded in a file note a meeting with George and Jeffrey Herscu at which George Herscu said that "Hooker was travelling extremely well". He acknowledged the security shortfall and
advised that he was "arranging various put options over a number of his personal assets in order to satisfy banks of their real value".

On 24 May 1989, Johns provided Mountford with correspondence exchanged between himself and Herscu concerning the facility.

E. **Role of Mr Johns in GSH Finance Facility**

Johns was account manager for GSH Finance and the facility was a margin lending transaction.

(a) **Approval of facilities**

Facility in name of Hersfield $10m - July 1986

Johns approved the facility as a director. Included in the credit submission was a balance sheet of Hersfield for the years ended 30 June 1983/84/85. The credit submission identified the borrower as a corporate trustee. Reference is made to an operating loss for the 1985 financial year. The credit submission also records a fall in share premium of $114.2m, which was only partially offset by an 80% increase in the asset revaluation reserve. There is no analysis of the value of Hooker shares - even though Hooker shares were to constitute the main security for the facility. In fact the letter of offer was addressed to GSH Finance Pty Ltd, for which no information had been given in the submission.

Extension of facility - March 1987

Mr Johns approved the extension as a director. Included in the credit submission was the unaudited balance sheet of the Herscu group of companies for the year ended 30 June 1986 and the balance sheet for Hersfield for the years ended 30 June 1983, 1984 and 1985.

Amendment and extension of facility - April 1988

Johns again was one of the directors who approved the amendment and
extension of the facility. The credit submission this time included financial information concerning the Herscu group, trusts and Hooker. Although it referred to a privatisation bid by Herscu on 7 March 1988, no suggestion was made as to how the success or otherwise of the bid would affect the security held, even though the bid was due to close on 19 April 1988 and the submission proposed a 19 month extension. It was recommended by Stott, as a member of the credit committee, but his approval was subject to a condition that the facility be immediately repayable if the privatisation bid was successful.

**Amendment and extension of facility - July 1988**

Johns once more approved the amendment and extension of the facility. Financial information relating to the Herscu group, trusts and Hooker was included in the credit submission. The information was a reproduction of figures included in financial documents, with no critical analysis of the long-term prospects of the borrower or the security. The effect of approving the submission was to extend the facility for 14 months from the existing expiry date.

(b) **Conduct as account manager**

In April 1987, Johns requested $181,714 be lodged by GSH Finance in satisfaction of a security shortfall.

On 22 December 1987, Johns told Herscu of a security shortfall of $8,420,000 and asked that firm arrangements be made in relation to the security cover.

On 25 February 1988, Johns informed Jeffrey Herscu of a security cover deficiency of approximately $7.9m and said that Tricontinental would not extend the facility unless its security position was rectified.

From this point onwards, the GSH Investments and GSH Finance facilities
were largely dealt with together, as one $40m facility. Thus on 27 June 1988, Johns directed that a credit submission be prepared; see para 39 above.

On 14 July 1988, Johns resubmitted a credit submission; see para 41 above.

On 22 July 1988, Johns sent a memo to Clark; see para 42 above.

In March 1989, Johns told Herscu of a security shortfall of $7.6m; see para 44 above.

In April 1989, Johns met George and Jeffrey Herscu; see para 45 above.

F. Role of Directors in GSH Investments Transaction  
(a) Approval of facilities  
Initial facility: September 1986  
Approval was given by Ryan and Carr. The approval of Ryan was subject to "sighting an unconditional take-out".  
Amendment and extension of facility: October 1986  
Approval was given by Rawlins and Carr on 9 October 1986. Ryan was not asked to approve this facility as he was on holidays. Although Carr had no specific recollection of approving individual facilities to the GSH group, he gave evidence that he would have discussed the credit submission with at least Johns and Rawlins and would have received information concerning the submission, particularly about the purpose of the funds.

Facility extension: June 1988  
Carr, Moyle and Ryan approved the extension of the facility. Moyle initially questioned the reason for the extension in view of the security shortfall, but he did not recall actually declining to approve the extension at
that stage. After a further submission by Johns and discussions with Johns, Carr and Ryan, Moyle gave his approval.

Mr Ryan also did not recall whether he initially declined the facility. He did, however, remember that there were long discussions following approval of the extensions with Moyle and Johns, outside the boardroom, and these discussions were repeated at the board meeting.

Carr declined the extension without giving any reasons. After a further submission from Johns and discussions with him and Moyle (perhaps also Ryan) in which he received additional material, Carr approved the extension.

Facility increase: October 1988

Smith, Carr and Morton approved the $1m increase in the facility. Although the credit submission did not require cross-collateralisation of the GSH Investments facility with security on the Hersfield facility and the GSH Finance facility as a condition of approval, a requirement for cross-collateralisation was included in the letter of offer for this increase. In giving his approval, Carr indicated that a guarantee from MGICA was preferable to one from FAI, due to the existing group exposure to FAI.

(b) Monitoring

The board received reports from Johns in November 1987 after the stock market crash that, notwithstanding a security shortfall, management foresaw no problems with this account. In June 1988 the board was told, "Additional collateral security currently offered and being assessed". In July 1988, Johns informed the board that the facility was to be treated as partly secured.

In July 1989, the new board was told by management that, given an orderly disposal of assets, no loss was envisaged.
In January 1990 a specific provision of $35m in respect of all outstanding facilities to the Herscu group was made.

As at 30 June 1990, the specific provision of $35m was recorded, and a notional specific provision as at 31 December 1989 of $4m was made, in respect of all outstanding facilities to the Herscu group.

G. Role of Directors in GSH Finance Transaction
(a) Approval of facilities
Facility in name of Hersfield for $10m: July 1986

Approval was given by Ryan and Moyle.

Extension of facility: March 1987

Approval was given by Smith and Moyle.

Amendment and extension of facility: March 1988

Approval was given by Ryan, Carr and Smith. Mr Ryan recalls that the approval of the directors would have been subject to the recommendation made by Stott concerning repayment if Hooker was privatised.

Amendment and extension of facility: July 1988

Approval was given by Ryan, Carr and Moyle; see para 59 above.

Ryan did not recall whether he initially declined the facility; see para 60 above.

Carr declined the extension without giving any reasons; see para 61 above.

(b) Monitoring

The board received reports from Johns after the stock market crash that, despite a security shortfall, management foresaw no problems with this account; see para 63 above.
74 In July 1989, the new board was still told that no loss was envisaged; see para 64 above.

H. Role of Management in Both GSH Investments and GSH Finance Transactions

Mr Mountford

75 Mountford undertook enforcement action against the Herscu group.

76 On 28 June 1989, Mountford instructed Wigginton that default notices were to be served if contact was not made with Herscu by 30 June 1989, or if Herscu's "response/action plan" was less than satisfactory. Mr Wigginton attempted to contact Herscu to arrange an appointment.

77 In early July 1989, Wigginton attended a meeting of the Herscu group's major bankers, and on 4 July recommended to Mountford that given Tricontinental's "tenuous security position", default notices should be served as soon as possible.

78 On 4 July 1989, Mountford instructed Hunter to issue default notices to GSH Investments and GSH Finance and guarantors, as a priority. Notices of demand were served on 6 July.

79 In July 1989, Mountford attempted to arrange a meeting with Jeffrey Herscu. He was told by Mr D Crawford of Peat Marwick Hungerford, financial advisers appointed to the Herscu group, that there was little likelihood of anything being achieved by such a meeting until the investigating accountant's report was ready.

80 On or about 14 July 1989, Mountford arranged for notices of default to be served on the guarantors.
Role of Other Staff in respect of GSH Investments Transaction

(a) Mr David Venner

Essentially Mr Venner performed administrative functions for the facility, although on occasions he appears to have performed functions more in keeping with the role of an account manager - in that he signed letters of offer directed to the borrower, recommended declining an increase in the facility by $1m, because of the shortfall in the security, and permitted his name to appear on most of the later credit submissions as the designated account manager. Counsel for Mr Venner submit that Mr Venner always performed administrative functions and took instructions from Johns, who was shown as account manager on the initial submission.

Venner administered the facility by arranging for preparation of credit submissions, authorising release of share scrip to allow transfer of shares from NSW register to Victorian register and arranging documentation for the conversion of bill facilities to letters of credit.

Venner had conversations with Mr G H Nicholson in relation to a margin call by Tricontinental, and with Jeffrey Herscu about top-up security requests.

Venner also, on occasions, monitored the security cover of the shares.

Although Venner attended to these matters from time to time, the Commission accepts that Johns was the account manager, and Venner was essentially responsible for administrative matters only.

(b) Mr Alistair Clark

As a member of the Credit Committee, Mr Clark made recommendations following receipt of the 1986 financial accounts of the Herscu group and trusts to the effect that, "it would be useful to have June 1986 P&L accounts and 86/87 cash flow projections given high gearing and
accumulated losses". He also noted, when recommending the extension of the facility in June 1988, his recommendation was subject to (i) "cross-collateralisation with GSH Finance and Hersfield facilities" and (ii) "in the event [of privatisation of Hooker Corp] the company shall within 28 days either repay the facility or lodge additional acceptable security."

87 Clark received from directors their approvals or refusals of credit submissions, and sent credit submissions to directors.

J. Role of Other Staff in GSH Finance Transaction
Mr Venner

88 Mr Venner prepared or directed the preparation of credit submissions, monitored the security cover in respect of the facility, and signed letters of offer directed to GSH Finance.

K. Significant Issues in GSH Investments
(a) Quality of credit submissions - September 1986 and October 1986

Purpose of loan

89 The credit submission for GSH Investments, dated 6 October 1986, does not disclose on its face any purpose for which the funds were to be applied when borrowed.

90 The October credit submission was approved by Johns, Carr and Rawlins. Mr Carr gave evidence that, although he had no independent recollection, he felt sure he would have ascertained the purpose of the loan in discussions with at least Johns and Rawlins. Neither Johns nor Rawlins gave evidence on this particular matter.

91 Counsel assisting submit that the absence of any purpose for the loan on the face of the credit submission is a fundamental deficiency of the credit submission, which ought to have prompted the directors to complain and to
ensure that in future there was no repetition of the deficiency. Because neither Johns nor Rawlins gave evidence on this issue, counsel assisting submit that no findings should be made against the approving directors.

Counsel for the directors submit that most credit submissions do adequately describe the purpose of the loan, and it should not be assumed that the failure to specify a purpose on this particular submission was a regular occurrence. In any event, they submit, it was not of crucial importance in this particular case to know the purpose of the loan "other than determining its legality".

Adequacy of financial information

The September and October 1986 credit submissions contain financial information about Hersfield and Hooker, but not about GSH Investments.

Counsel assisting submit that these are further examples of credit submissions which omit information necessary to assess the creditworthiness of a borrower and, in particular, its ability to repay. They invite the Commission to make a finding that the senior staff, managing director and board of Tricontinental did not require or expect full financial details of borrowers in order to assess credit risk in margin lending transactions, as they took the simplistic view that facilities would soon be repaid by sale of securities. They further submit that the approving directors failed to exercise the degree of care and diligence required by s229(2) of the Companies Code in approving these credit submissions.

Counsel for the directors submit that it was not unreasonable for the directors to have expected repayment to be achieved by resale of the securities in the foreseeable future, particularly where the security provided was from a source independent of the borrower and, further, that the approving directors had conversations with Johns and amongst themselves, and so did not rely solely on documentation.
Departure from guidelines

The share cover guidelines of 1.5 times for mining shares and 1.3 for industrial shares (applicable to Hooker) were departed from on this occasion and reduced to 1.25.

The guidelines further provided, after March 1987, that the maximum security exposure of Tricontinental to any company should not exceed 5% of the company's issued capital. This guideline also was departed from, as Tricontinental eventually held 6.45% of the issued capital of Hooker.

The September and October 1986 credit submissions were approved by only three directors. The submissions were not endorsed so as to indicate that these were the only directors available on the day.

Counsel assisting submit that the departure from the guidelines, without explanation or comment, demonstrates an overall lack of concern for guidelines, based in turn on a lack of foresight in relation to margin lending.

Counsel for the directors submit that the directors did not regard themselves as being bound by the guidelines and accordingly, there could be no 'departure' from them. They further submit that the directors were not aware that guidelines were being breached by management.

Prudential considerations

Mr Weaving dealt with prudential considerations in relation to Tricontinental's capital base and gearing and stated in the context of the Atoll loans that they warranted "in depth" analysis, having regard to the possible impact of any default in relation to Tricontinental's capital base. A write-off of $10m, for example, would require either an injection of $10m capital from SBV or a reduction of $250m in Tricontinental's balance sheet, to retain gearing of 25 to 1.
Counsel assisting submit that GSH Investments is a specific example of a general criticism made of the failure of directors to consider the impact, on Tricontinental’s capital base, of corporate borrower failures, in this case of a total exposure of $30m (or $40m when the GSH Finance facility is taken into account).

Counsel for the directors submit that it is necessary to look at the total exposure against the capital base of the State Bank group but, in any event, the capital base is only one criterion to take into account in determining whether a transaction is appropriate. They submit that the transaction was clearly commercial, and prudential considerations are only one element of determining whether or not to lend money.

(b) Monitoring issues

Use of funds

The use to which the funds advanced to GSH Investments were put is unclear on the evidence.

Counsel assisting submit that there was no monitoring procedure in place to ensure that funds were applied or used for the purpose for which they were initially advanced. Mr Ryan gave evidence that the directors would have been aware from the credit submission that at least $12m of the advance was to be used to repay the investment banking facility of $12m, but they would have needed to have made enquiries as to the use of the other $18m.

Mr Jeffrey Herscu gave evidence that he believed that the funds were used to acquire parcels of shares in Hooker under the 3% creep provisions of the Companies Code. During the period from September 1986 to June 1987, interests associated with Herscu increased their shareholding in Hooker by some 11.3m shares or 5.1%.
Precondition to drawdown

The letter of offer, dated 30 October 1986, was accepted by GSH Investments on 31 October 1986. It was not in the form of the approval given by the directors to the credit submission dated 6 October 1986. The letter of offer included an option for the commercial bill facility to be converted to a letter of credit, and it omitted the precondition to the directors' approval that, before any drawdown, Tricontinental's Hooker investment banking facility of $12m was to be fully repaid. It also indicated a 'purchase of shares' purpose which was not shown in the credit submission.

In December 1987, $18m was drawn down on this facility although the investment banking facility to Hooker had not been repaid. It was not in fact repaid until July 1988.

Counsel assisting submit that the absence of any monitoring procedures enabled this to occur and, further, that the directors were negligent in failing to ensure that a monitoring procedure was in place which ensured that preconditions to drawdown were satisfied before drawdown.

Counsel for the directors submit that they were entitled to rely on management. The letter of offer, dated 30 October 1986, is materially different from the credit submission approved by the directors and should have been the subject of a fresh credit submission, or referred to the board to obtain approval for the amendments.

(c) Extension of facility in July 1988

In July 1988, Johns, Moyle, Carr and Ryan approved an extension of the facility to 31 December 1990. At the time they gave approval to this extension, the facility still had approximately 15 months to run and had a security shortfall in excess of $16m. The default of the security covenant
had been notified to the board in November 1987 and February 1988, but
with reassuring forecasts of no loss.

Mr Moyle gave evidence that he had discussed the credit submissions with
other directors and had queried the need to extend the facilities to 31
December 1990 when the existing expiry date was 31 October 1989. Mr
Moyle said that he had discussed the credit submission with Johns at a
board meeting, and furthermore had conveyed his intention to decline
the credit submission to Johns - subject to Mr Johns presenting further
information for his consideration.

Johns justified the extension by saying that the real value of the shares
Tricontinental held as security, which were readily marketable, was in
excess of market values, that property values were still improving and that
Tricontinental’s best interests lay not in exercising its rights under the
security, but in allowing property values to improve, thereby adding to the
value of its security. Mr Moyle said that he took comfort from the fact
that the share price of Hooker did not reflect the value of its underlying
assets and that Tricontinental stood only to gain by extending the facility.

Mr Ryan gave evidence that he could not recall the specific reason for
extending the facility, but all options available (including allowing another
financier to take out Tricontinental) were explored by the directors.

Mr Carr gave evidence that he had no independent recollection as to why
he may have initially refused to give his approval to the extension, and
that he did not consider deferring for a short time the decision to extend,
pending the outcome of Herscu’s privatisation bid.

Counsel assisting submit that, despite the evidence of the approving
directors that there existed sound commercial reasons for such an extension
of the facility, no reasonable director of a merchant bank would have
approved an extension, for a period of 2½ years, of a facility that was already substantially in default of its share cover and still had some 15 months to run before its expiry date.

Counsel for the directors submit that sound commercial reasons existed for the approval given by the directors to the extension. However none of the reasons advanced, such as an anticipated continuing rise in property values and fall in interest rates, explains satisfactorily why the extension had to be granted then, rather than as the facilities approached their expiry dates.

(d) Credit submission - October 1988

It was a condition of approval of the credit submission dated 5 October 1988 that a guarantee for $1m, plus costs and interest, be obtained from MGICA or FAI. Both Smith and Ryan, who approved the $1m increase in the facility, were strongly influenced in making their decision by the existence of this condition.

A guarantee of $900,000 was obtained from FAI. The board was not informed that a guarantee for a lesser sum was obtained.

Mr Venner gave evidence that the reason for the taking of a guarantee from FAI for less than $1m plus interest and costs, was that the amount required for the dividend cover was less than $1m and was sufficiently covered by $900,000.

Counsel for the directors submit that the transaction involved no additional risk to Tricontinental, as the directors had given their approval subject to obtaining a guarantee from either FAI or MGICA to the extent of $1m plus interest and costs. Tricontinental was also to receive further Hooker shares by way of security.
Significant Issues in GSH Finance

(a) Credit submission - July 1986

Change in identity of borrower

In July 1986, Johns, Moyle and Ryan approved a $10m facility to Hersfield. But a letter of offer dated 30 July 1986 was sent to GSH Finance and not Hersfield. The change in the identity of the borrower was not brought to the attention of the approving directors.

123 Counsel assisting submit that it is unlikely that the approving directors would have declined to approve the credit submission even had they known that GSH Finance was to be the borrowing entity. However counsel for the directors refer to the evidence of Mr Ryan and Mr Moyle, who said they would have expected to have been notified by Johns of the change in the identity of the borrower, as such a change could involve a change in the risk and might require different security.

Purpose of loan

124 The credit submission relating to Hersfield shows on its face that the purpose of the loan was to provide "additional working capital and to assist in refinancing existing borrowings".

125 However, the credit submission did not inform directors of the reasons why additional working capital was required or which existing borrowings were to be refinanced and for what reasons.

126 Counsel for the directors submit that information to the directors came not only through documentation, but also through oral communications, in all likelihood from Johns, further informing the board. Thus there may have been nothing wrong with providing, as a purpose, "additional working capital and to assist in refinancing existing borrowings", especially where there is a long history with that particular client.
Adequacy of financial information

127 The credit submission relating to Hersfield contains a balance sheet of Hersfield to 30 June 1985. Counsel assisting submit that this information was not sufficient to enable the approving directors to assess the creditworthiness of the borrower and, in particular, its ability to repay.

128 Counsel for the directors refer to the evidence of Mr Ryan in which he noted that the financial information did not include the most recent share prices of Hersfield, or even the last sale price of Hooker shares. He said that the submission was recommended for approval on the basis that the proposed facility was adequately secured, and the Herscu group was strong and had a long and close association with Tricontinental.

Departure from guidelines

129 The credit submission dated 14 July 1986 was approved by only three directors. It was not endorsed so as to indicate that these were the only directors available on the day.

130 Counsel assisting submit that the pattern of tolerating departure from guidelines, or of setting guidelines which were not expected to be followed, constitutes negligent conduct by all directors.

131 Counsel for the directors rely upon their submission relating to departure from guidelines in respect of GSH Investments (see para 100 above).

(b) Credit submission - March 1988

132 The credit submission dated 24 March 1988 relating to GSH Finance was approved by Johns, Ryan, Carr and Smith. Its purpose was to extend the $10m facility to GSH Finance for a further 19 months and to cross-collateralise security with a related Hersfield facility.
At the time the directors approved the facility on 7 April there was a security shortfall of $8.7m, and the bid by Herscu to privatise Hooker was due to close on 19 April. These matters were disclosed by the credit submission.

Counsel assisting submit that no reasonable director of a merchant bank would approve an extension of the facility for 19 months in circumstances where there was already a significant security deficiency and the outcome of the privatisation bid was imminent. It is further submitted by counsel assisting that the prudent course, if the directors determined that the outcome of the privatisation bid was significant, would be to extend the loan for a short period to enable that outcome to be ascertained before committing Tricontinental to a 19 month extension.

Counsel for the directors submit that the test is not what a reasonable director of a merchant bank would have done, but to determine whether in fact the director was negligent having regard to the law as it stands in relation to directors' duties. It is further submitted that this was in fact a commercial transaction, because it enabled Tricontinental to cross-collateralise its security with the Hersfield facility and so improve its security position.

(c) Extension of facility in July 1988

In July 1988, Johns, Moyle, Carr and Ryan approved an extension of the facility to 31 December 1990. At the time of giving their approval to this extension the facility still had approximately 14 months before expiry and had a substantial security shortfall.

Counsel assisting submit that, for the same reasons as they advanced in relation to the facility to GSH Investments, no reasonable director of a merchant bank would have approved an extension, for a period of 2½
years, of a facility that was already substantially in default of its share cover and still had some 14 months to run before its expiry date.

Counsel for the directors submit that the board was justified in extending the facility because the Hooker group of companies at that stage appeared to be trading profitably, and there was a cross-collateralisation of the security held for the Hersfield facility. This does not, however, explain the timing of the extension (see para 117).

M. Significant issues in respect of both GSH Finance and GSH Investments
(a) Failure to obtain financial information

Despite covenants in the loan documentation requiring the borrower to provide to Tricontinental financial accounts of itself and related companies, Tricontinental did not receive such information. Mr Jeffrey Herscu gave evidence that he provided to Mr Venner, from time to time, financial information about the companies in the Herscu Group when he was requested to do so. He further gave evidence that he did not, as a matter of routine practice, deliver the annual accounts and the half yearly unaudited accounts to Tricontinental in spite of terms in a letter of offer imposing that obligation on the borrower.

Mr Nicholson, the chief accountant for the Herscu Group, gave evidence that he believed the auditors' qualification on the valuation of $200m for the Jolimont railyards air rights, appearing in the 1988 accounts, would have caused concern in the mind of a lender to the Herscu Group of Companies. Mr Nicholson further gave evidence that he expected a lender would ask questions in relation to the directors' valuation of $280m as opposed to the market valuation of $140m in respect of shares in Hooker included in the balance sheet for the year ended 30 June 1987.

Counsel assisting submit that it is open to find that, had Tricontinental received the financial accounts of GSH Finance for the years ended 30 June
1987 and 1988 and subjected them to analysis, it would have identified matters relevant to the company's creditworthiness.

Counsel for the directors, however, submit that, from the point of view of persons reading the accounts, the matters identified would only be said to enhance the creditworthiness of GSH Finance. They submit that the question to be asked is whether or not any different view would have been appreciated at the time had questions been asked about the value of Hooker shares. They say it was reasonably assumed by directors that financial information would be sought from the borrower, obtained, and properly analysed.

(b) Failure to obtain further security

Messrs Ryan, Smith and Carr each gave evidence to the effect that they had been informed by Johns that there was no further security available to Tricontinental.

Mr Nicholson gave evidence to the effect that there was further security available, although the quantity and quality reduced as time passed. Mr Nicholson expressed the view that, if Tricontinental had adopted a more robust or aggressive stance in respect of its facilities, it may have obtained additional security.

Counsel assisting submit that it is open to the Commission to find that Mr Johns did not adopt a sufficiently aggressive stance when demanding additional security, but was prepared to accept assurances that no additional security could be provided. They further submit that the directors were apparently prepared to accept Mr Johns' assurances in this regard and to adopt a "passive" attitude to security breaches.

Counsel for the directors submit that it is not open to find that Johns had not been sufficiently aggressive and that there was no evidence to suggest
that Johns did not seek additional security from people other than Nicholson. They further submit that the directors were entitled to accept Johns’ assurances that, as far as possible, top-up security was being sought.

(c) Release of security

The board was not told of the release of security by Tricontinental to, and at the request of, the borrower. 2.5 million shares were released a month before the stock market crash.

Mr Ryan gave evidence that, in his view, it was not appropriate for Tricontinental to release security because the security held was in excess of the minimum requirement. He further said that the guidelines establishing security cover were minimum guidelines only, and that shares were a volatile security requiring a degree of buffer.

Counsel assisting submit that it is open to find that the absence of any guidelines dealing with the release of security enabled senior management of Tricontinental to release temporarily excess security, and that the directors were negligent in failing to ensure that appropriate guidelines for the release of security were in place and adhered to.

Counsel for the directors submit that guidelines were in place as to the cover that was required in relation to security, and that security could be released where the times cover stipulated in the credit submission was being adhered to.

N. Conclusions and Findings

A review of these transactions serves to illustrate a number of the weaknesses which the Commission has discovered in the credit risk management of Tricontinental. Dealing first with GSH Investments, this was a credit submission for $30m, a large loan by any standards, yet it
provided no information as to the purpose to the loan. Evidence before the Commission suggests that in fact the money went towards the gradual acquisition of more shares in Hooker Corporation, so as not to infringe the so-called 'creep' provisions of the Companies (Acquisition of Shares) Code. The mere fact that a credit submission could be prepared by an analyst, and pass the various members of the credit committee, without any reference to the purpose of the loan, says a great deal about the lack of discipline in Tricontinental's credit management. Directors gave evidence that they felt sure that they would have asked for information about the loan’s purpose before approving it. However none of them could actually recall having done so. In the absence of evidence from Mr Johns, the Commission cannot be sure whether any questions were asked or, if they were asked, what answers were given. However, the Commission notes that this transaction is by no means the only one it has seen in which either the purpose of the loan was unstated or, more often, it was expressed in some such vague terms as "working capital".

The explanation for this appears to lie in the fact that, when lending secured by shares was involved, little interest was taken in anything other than the security cover provided by the shares in question. This was further illustrated in the present case, in that no financial information was provided about the particular borrower, and there was nothing to indicate the borrower’s ability to repay the loan or to meet interest payments as they fell due. The only information that seemed to be required was the name of the group behind the borrower - that of a well known commercial developer - and the share security offered.

This emphasis on share security highlights the fact that, in this particular case, there were two departures from guidelines. In the first place the share cover required in the letter of offer was 1.25 times rather than 1.3 times. This, in itself, was not a major departure from guidelines, but it needs to be considered along with the other departure which later occurred.
This was that the share security eventually taken constituted 6.4% of the issued capital of Hooker Corporation, whereas from March 1987 the guideline provided that no more than 5% of the shares of any company should be accepted as security. There was good reason for this limitation because the larger the parcel of shares held, the more difficult it would be to realise the security without further depressing the market value of the shares. It must, of course, be realized that if the security has to be called upon, it is because the borrower is in such difficulties that it is unable to meet its commitments under the loan. Such problems in the group are likely to have already depressed the price of the shares held as security, and it then becomes very difficult to unload a further substantial number of shares on the market.

It is true, as counsel for the directors submitted, that they were not bound by their own guidelines and could depart from them at any time. But, for the reasons just given, the guidelines were very prudent and, since total reliance was placed on the value of the security, they should not have been departed from without explanation and thought. The credit submission did not draw attention to the departure from the 1.3 times cover guideline, nor did it offer any explanation as to why it was necessary or desirable.

The next significant matter to note about this transaction was the departure from the precondition, which had been part of the understanding upon which the directors based their approvals. This was that the $12m investment banking facility held by the GSH group must be repaid before drawdown of any of the $30m. Had this precondition been enforced, it would have provided some reassurance as to the financial stability of the borrower. In the event, it was ignored, and the $12m was only repaid from the second drawdown, months later, of exactly that sum. This was a major departure from the terms of the transaction which had been approved, but there is no suggestion that Mr Johns informed his fellow directors of the variation. Nor was there anything in the monitoring or
reporting systems in place which would draw this circumstance to the attention of other directors.

The Commission accepts that this is one area in which those other directors could properly claim that they were entitled to trust their managing director, who in this case had control of the transaction as account manager. The drawdown of $18m in breach of the precondition occurred in December 1986, at the end of Johns' first year as managing director. At that time the other directors had no reason to believe that the managing director would, without informing them, approve such a major departure from the agreement they had approved.

The next matter to be noted in this transaction is the rather strange circumstance that the facility was extended for 14 months at a time when it still had 15 months to run and there was already a security shortfall of some $16m. Moyle, Carr and Ryan were apparently persuaded by Johns to agree to this extension, although Moyle and Carr at least initially were unwilling to approve the submission. The reasons advanced by Johns are set out in para 113 above. They do not explain why it was thought necessary to extend the term of the facility so long before it was due to expire.

Finally, in connection with this facility, there was the question of the $1m addition to the facility, which was advanced in apparent breach of the condition relied on by directors that there would be a guarantee for the same amount in place before Tricontinental was committed to the additional sum. In fact, a guarantee of only $900,000 was obtained. However this was, in the view of the Commission, a reasonable departure from what had been agreed because, as it transpired, less than $1m was actually required by the borrower, and the guarantee proved sufficient to cover the amount involved. Nevertheless, the failure to report this variation to the board, in
writing, does provide some further evidence of the lack of system in dealings between the board and management at Tricontinental.

159 Turning then to the GSH Finance facility, the first matter to be noted is the change in identity of the borrower. Although, in the event, it made no difference, the directors were at least entitled to be informed of the change which management had accepted. Two different companies, within the same group, cannot necessarily provide similar assurances of their ability to service a loan if the group runs into difficult times. The occurrence provides another example of the lack of system referred to in the last paragraph. It also serves to underline the reference in para 152 above to the fact that financial records of the borrower were considered of no importance in a lending transaction secured by shares. As in the case of the GSH Investments facility, there was little information provided to directors about the purpose of the loan when it was acknowledged to be to GSH Finance and extension for 12 months was sought. The reference was to "additional working capital and to assist in refinancing existing borrowings". No further information was given as to the requirement of working capital, or as to what borrowings were being refinanced. This latter requirement should have excited some interest, because it may have represented a situation where other borrowers were withdrawing their support from the GSH group and Tricontinental was seen as a last resort.

160 It is true that the directors may have asked for and been given some additional information, but the Commission can find no reason for believing that this was likely. If directors had really cared about such matters, they would have insisted that the information be provided routinely in the credit submissions, and would not have relied upon individual directors having to make separate telephone calls to obtain the necessary information. Almost certainly, the truth of the matter was that this was another example of 'name lending', where the only other interest lay in the share security.
161 This conclusion is reinforced by the fact that, once again, there was inadequate financial information supplied.

162 This facility also provides a further example, repeated in many other cases, where approval was at times given by only three directors, without any explanation for the absence of a fourth director.

163 As in the case of GSH Investments, this facility was also extended for 14 months at a time when it still had 15 months to run and there was a security shortfall of $8.7m. The same comments made in para 157 above apply to this extension.

164 Finally, on the question of release of security, the Commission does not believe that security held, which temporarily exceeded the ‘times cover’ covenant in the particular case, should have been routinely returned to the borrower. In the Commission's view, guidelines should have been in place, requiring either a further margin above the minimum before shares would be released, or a careful review of the particular case in order to determine the underlying strength of the current share price.
TRANSACTION REPORT 14

JACK CHIA AUSTRALIA LTD AND CAMSAN PTY LTD -
LONG CORPORATION LTD SHARES

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H. Conclusions and Findings 55
A. Background and Summary

(a) Long Corporation Limited

Long Corporation Limited ("Long Corp") was a residential property developer which appointed Tricontinental Securities Limited ("Tricontinental Securities") to assist it in a Part B defence of a cash takeover offer announced by Barina Corporation Limited on 14 April 1986. These events were reported to the Tricontinental board in the managing director's reports from April to August 1986 inclusive.

During the Barina offer, on 16 April 1986, Tricontinental Securities was briefed to find an alternative bidder and, later, to prepare a Part B report in response to an offer by Jack Chia (Australia) Limited ("JCAL"), a company introduced to them by Mr Johns.

Long Corp paid a total of $200,840 to Tricontinental Securities for work done in relation to the takeover offers by Barina and JCAL.

(b) Jack Chia (Australia) Limited

JCAL was a publicly listed property developer, 80% owned by companies associated with Jack Chia. Mr Johns introduced Mr Tim Hewison (managing director of JCAL) to the idea of JCAL making a takeover offer for Long Corp.

JCAL purchased its initial shareholding in Long Corp (14.96%) in April 1986 from Mr Edmond Long. Tricontinental fully funded the initial purchase by granting a $2.5m facility to JCAL. The facility was approved by Mr Johns and Mr Ryan. After this purchase JCAL issued a successful share offer for Long Corp.

JCAL paid Tricontinental a fee of $50,000 for advice received concerning the Long Corp takeover.
(c) Camsan Pty Ltd

Camsan Pty Ltd was a private investment company owned by Mr Peter James Sanders, as trustee for the PJ Sanders family trust. On 15 July 1986, Camsan borrowed $865,000 from Tricontinental to fund its purchase of shares in Long Corp. This was at the same time that JCAL had issued a share swap takeover offer for that company. The facility was approved by Mr Johns under his discretion as group managing director.

JCAL paid $60,000 to Camsan Pty Ltd on 17 July 1986, the day after the Camsan facility was drawn down. This represented the profit of $60,000 to Camsan on the sale of Long Corp shares to JCAL.

This sale was not recorded at the time, and Tricontinental continued to record a facility to Camsan. In February the following year Mr Sanders, on behalf of Camsan, accepted an extension to the facility that had been granted by Tricontinental.

On 22 July 1986, Mr Johns required Mr Sanders to accept the JCAL offer and return the acceptance to him.

(d) Jacy Investments Australia Limited

After the share swap offer was accepted, JCAL shares held by Tricontinental in the names of Camsan, Tricontinental-Muron, Tricontinental Nominees Limited ('Tricontinental Nominees') and Tricontinental were sold to Jacy Investments Australia Limited ('Jacy'), another company within the Jack Chia group, in March 1987. Tricontinental agreed to transfer the shares to Jacy in two separate transactions six months apart.

Jacy had been identified by JCAL as an associated company within the meaning of s7 of the Companies (Acquisition of Shares) Code in a substantial shareholding notice dated 15 May 1986.
B. Chronology

13 The chronology of granting the facilities is as follows:

**JCAL**

14 May 1986 Credit submission for $2,500,000
23 May 1986 $2,491,980 drawn down
31 July 1987 Facility repaid

**Camsan**

11 July 1987 Approval of cash advance of $865,000
14 July 1986 Letter of offer, credit submission for $865,000
15 July 1986 $864,593.83 drawn down
17 July 1986 $60,000 received on Camsan ledger from JCAL
12 February 1987 Credit submission extending time for amortisation payment of $435,000
24 February 1987 Letter of offer re extending time for amortisation payment of $435,000
6 March 1987 Facility repaid from funds held in a money market account as trustee for JCAL.

C. JCAL's Takeover Bid for Long Corp

(a) JCAL

14 On 14 May 1986 JCAL purchased 2,460,000 shares in Long Corp (14.96%) from Edmond Long (chairman of Long Corp). This purchase was funded by Tricontinental, which lent $2.5m to JCAL the next day with the Long Corp shares as security.

15 The same day, JCAL informed both Long Corp and the Australian Stock Exchange of its intention to make a two-for-one share offer for Long Corp, through a wholly owned subsidiary called Sundell Pty Ltd (Sundell), conditional on 51% acceptance. At the time, JCAL shares were trading around 56c per share while Long Corp shares were trading at 90c per share.
On 23 May 1986 the JCAL facility was drawn down in Sydney with funds of $2,491,980 being paid to John Anschau, Fay and La Forest, Sydney brokers.

(b) Camsan

On 11 July 1986 Mr Johns, under his discretion, approved a $865,000 cash advance facility to Camsan to fund the purchase of 1,007,100 shares (6.12%) in Long Corp. The facility was due to expire on 31 July 1987, with a part repayment of $435,000 due by 31 December 1986. A credit submission was prepared on 14 July 1986. The security was expressed to be the lodgement of the shares purchased, with signed blank transfers, and personal guarantees from Mr Sanders and his wife.

The Camsan facility was drawn down on 15 July 1986 for $864,593.83, with funds being paid to Frank Renouf Brokers. The purchase price was 85c per share and brokerage.

An amount of $60,000 from JCAL is recorded as being received on 17 July 1986 in Camsan's ledger, described as "Fees-Other" for "Long Ind. Ltd." Mr Sanders said this was the profit he received from selling the Long Corp shares and that, after the receipt of the $60,000, he had no further interest in the shares. He was not able to point to anything which enabled him to assess that $60,000 was an appropriate profit for holding the shares for two days. The next day, 18 July 1986, Camsan drew a cheque for $4,000 payable to Tricontinental, being the establishment fee for the facility.

On 22 July 1986, Mr Johns wrote to Mr Sanders confidentially, requiring him to accept the JCAL offer and to return the acceptance to Tricontinental.

On 28 July 1986, the directors of Long Corp recommended shareholders accept the JCAL offer; and Sundell (the JCAL vehicle) declared the Long
Corp offer unconditional on 31 July 1986, after receiving acceptances for 51.26% of the issued capital.

22 The payment of $435,000, due on the Camsan facility on 31 January 1987, was not received. On 12 February 1987, the Camsan facility was amended to extend the date for part repayment of $435,000 to 30 April 1987. Although the JCAL shares, which were identified as substitute security in this credit submission, were only trading at 23¢ a share (representing a security value of $463,266), no top-up security was requested when amending this facility.

23 On 24 February 1987, a variation and amendment to the original letter of offer dated 14 July 1986 was sent to Camsan. This letter was accepted by Peter and Mary Sanders, but the acceptance was undated.

(c) Long Corp

24 On 18 July 1986, the directors of Long Corp recommended that shareholders reject the Barina offer. Tricontinental Securities supported this by a report that the offer was neither fair nor reasonable.

25 On 28 July 1986, the directors of Long Corp recommended that shareholders accept the JCAL offer.

26 On 13 August 1986, Tricontinental Nominees agreed to purchase 1,655,596 JCAL shares from E Long & Co at a cost to Tricontinental of $827,998 which represented 50¢ per share. At the time JCAL shares were trading at 42¢ a share. Mr Johns approved a $830,000 investment banking facility within his discretion to enable Tricontinental Nominees to hold these shares on behalf of E Long & Co.

27 Mr Green, who held a position in corporate services at the time and was a member of the investment banking credit committee, gave evidence that he
was not aware of any other examples like this, where Tricontinental paid a vendor for shares then continued to hold the shares on behalf of the vendor. He also gave evidence that he did not recollect obtaining a legal opinion on any investment banking transaction, despite a memorandum from Mr Johns and Mr Ziebell, dated 26 August 1986, referring to such a verbal opinion. On the same day, Mr Johns requested $50,000 as a general advisory fee from JCAL. He wrote "Tricontinental was instrumental in JCAL's successful bid" for Long Corp.

On 12 September 1986, Long Corp paid $50,000 to Tricontinental Securities as the first progress payment for advisory work carried out by Tricontinental Securities on the Part B response. On 26 November 1986 a cheque for $34,950 was received by Tricontinental Securities, representing a further part payment of the Long Corp advisory fee. On 17 December 1986, Tricontinental Securities received a further cheque for $115,980, representing final payment of the Long Corp advisory fee. The total fees paid by Long Corp to Tricontinental Securities were $200,840. On 18 December 1986, Tricontinental received $50,000 from JCAL being payment of its advisory fee charged 13 August 1986.

(d) Clarendon Finance Pty Ltd (‘Clarendon’)

Clarendon purchased Long Corp shares during the JCAL takeover bid. On 7 October 1986, Tricontinental agreed to purchase 119,000 JCAL shares from Clarendon, a "friend of Tricontinental". Clarendon had originally purchased Long Corp shares and then accepted the JCAL offer. The purchase price paid by Tricontinental was $56,302.99, representing 47c per share. At the time, JCAL shares were trading at 34c a share.

(e) Muron Nominees Pty Ltd (‘Muron’)

Muron was a private company associated with Mr Tim Hewison, managing director of JCAL. Tricontinental held 592,000 shares and 375,000 options
in JCAL under a put option agreement, and had done so since 1984. These were sold to Jacy in March 1987.

(f) **Acquisition by Jacy of various share parcels**

On 4 March 1987, $2,100,000 was deposited on the Tricontinental money market in the name of "TCL atf Jack Chia Industries Pty Ltd" TCL4517 (the JCI Trust account).

Between 25 February 1987 and shortly thereafter, Mr Atlas calculated and updated the payout figures required for the Chia group to acquire various share parcels, held as follows:

(a) Tricontinental-Muron Nominees parcel;
(b) Tricontinental Nominees-Long parcel;
(c) Tricontinental Investments-Clarendon parcel
(d) Camsan parcel.

He gave evidence that this was done by allowing 22c per share, the prevailing market price, with the balance (by which he meant the balance needed for the Chia group to recoup Tricontinental fully for the historical costs of all the parcels plus interest) being described as management fees.

On 11 March Tricontinental confirmed to Jacy the sale of all JCAL shares, indicating Jacy had acquired a total of 4,422,196 shares.

To avoid breaching the 3% 'creep' provisions (see s15 of the Companies (Acquisition of Shares) Code), Tricontinental Nominees agreed to hold 2,057,196 JCAL shares on behalf of Jacy, which were then released over time.

**D. Role of Mr Johns**

(a) **JCAL**

Category "A" investment banking, referred to at paras 13.93-95 of this report, was controlled by Ian Johns. The board was aware of this. In his
role as managing director, Johns spoke to Mr Tim Hewison, managing
director of JCAL, suggesting the possibility of the Jack Chia group making
a bid for Long Corp. This was after Long Corp had approached
Tricontinental Securities to assist in the preparation of a Part B report in
response to a cash offer by Barina.

36 Under his discretion as group managing director, Johns approved the
$2.5m facility granted to JCAL to fund its initial purchase of Long Corp
shares. No immediate lending security ratio was provided, although at the
time the facility was granted the shares proposed as security represented
just under 1 times cover. The then guidelines required a minimum cover
of 1.25 times. Additional Long Corp scrip was to be lodged after the
takeover to maintain 1.5 times cover.

37 Johns wrote to Hewison in August 1986 requesting payment of $50,000 as
an advisory fee in relation to advice given on the Long Corp takeover.

(b) Camsan

38 Under his discretion, Johns also approved the $865,000 cash advance
facility granted to Camsan for the purpose of purchasing shares in Long
Corp. Security for this facility, being merely the shares purchased, was in
breach of Tricontinental's guideline requirements. The lending was for
100% of the purchase price. The security cover required at the time under
the guidelines was 1.25 times cover.

39 Johns wrote to Mr Sanders of Camsan requiring that he accept the Jack
Chia share offer. This acceptance was to be returned to Mr Johns.

(c) Long Corp

40 Johns arranged for Tricontinental to hold, on behalf of E Long & Co Pty
Ltd, 1,655,596 ordinary shares in JCAL, stating in a memorandum to Mr
Ziebell dated 13 August 1986 that it was 'necessary to settle off-market'.
The cost was $827,998, representing a purchase price of 50¢ per share while trading at the time was at 42¢ per share. The transfer was apparently not registered as the shares were to be sold within 3-6 months. It appears this decision was made after discussion with Mr Green.

(d) Clarendon

On 7 October 1986 Mr Johns wrote to Mr Ziebell informing him that Tricontinental had agreed to purchase 119,000 shares in JCAL from Clarendon Finance Pty Ltd ('Clarendon') at a cost of $56,302.99. This represented a purchase price of 47¢ per share against a current market price of 36¢ per share. Mr Johns explained that "during the takeover battle between Jack Chia (Australia) Limited and Long Industries Limited, a number of shares in Long Industries were purchased by friends of Tricontinental". Mr Efrem Goldhammer, principal of Clarendon, was one such friend.

The investment banking facility was increased. In fact there were two facilities, $830,000 to Tricontinental Nominees and $70,000 to Tricontinental Corporation Limited, shown as one facility of $900,000 on a credit submission dated 22 October 1986.

E. Role of Management

(a) Staff

Mr Johns made the decisions in relation to the JCAL facility, the Camsan facility, the Long Corp investment banking facility and the Clarendon purchase by Tricontinental. Members of staff to whom he directed memoranda merely carried out his instructions. They did not initiate matters.

(b) Mr Green

Mr Green was a member of the investment banking credit committee, the other two members being Mr Johns and Mr Stott. However, the committee
never met and Mr Green described it as essentially acknowledging "... transactions which, in the majority of cases, were already consummated". He gave evidence that Mr Johns told him it was not his function to query or analyse investment banking transactions. He said he reported to Johns, and if Johns gave him an instruction he implemented it. He was also a member of the Tricontinental management committee and a manager of Tricontinental's Corporate Services division.

(c) Mr Atlas

Mr Atlas gave evidence of being involved in two ways. First, he arranged the payment out of all the various acquisitions as described under Section D above. Secondly, he was involved in arranging for the balance of shares to be transferred gradually to Jacy, to avoid infringing the 'creep' provisions of the Acquisition of Shares Code. However, as his counsel point out, he was only involved in administrative actions, as instructed by the managing director, after the friendly takeover plan had succeeded.

F. Role of Directors in the Long Corp Transaction

(a) JCAL

Mr Ryan is noted as approving the initial facility granted to JCAL. The credit submission indicates Ryan orally indicated his approval to Johns. It was not signed by him, as was his custom. As this facility was within the discretionary limit of the group managing director, Mr Ryan's approval was not required. He was unable to recall approving the submission.

(b) Camsan

In February 1987 the Camsan facility was extended. This extension was approved by Johns, Ryan and Moyle, although the facility was well within the discretion of the group managing director. It is notable that the value of security recorded in the submission is $463,266. There would appear to have been no other involvement of the directors in the Camsan facility.
(c) Long Corp

The directors do not appear to have had any involvement with the Long Corp facility.

(d) Clarendon

The directors do not appear to have had any involvement with the Clarendon facility.

G. Significant Issues Arising

(a) Credit Issues

Credit issues concerning the grant of the Camsan facility were examined in greater detail than credit issues for the other facilities. Counsel assisting contend that Mr Johns did not apply to the Camsan application the standards of a prudent and reasonable banker. In particular, the main credit submission contained no details of Camsan or its principal, Mr Sanders, and the security cover was in breach of guidelines.

(b) Extension - Monitoring

Counsel assisting further submitted that, in so far as a request to extend a facility presents an opportunity to monitor its detail and conduct, Camsan appears to be another example of the lack of prudent monitoring.

The said that extending the time for repayment in ignorance of the transaction's details, if that is what the directors did, would constitute another example of the endemic lack of monitoring of facilities by the directors. The fact that they agreed to extend the facility, as evidenced by the documents, despite the drop in share cover, indicates the probability that they did not ask for details and were not given any. However, counsel concede, there are gaps in the evidence; and other less probable possibilities are that the directors asked questions and were satisfied with truthful answers, or they asked questions and were satisfied by untruthful
answers. The fact that Mr Johns did not give evidence and Mr Moyle was unavailable, left the issue of monitoring unresolved.

(c) Absence of reasonable and prudent board policies

**Investment Banking**

Counsel assisting contend that the board failed to set or implement any reasonable and prudent policies concerning investment banking, and it generally failed to monitor category "A" investments.

**Lending against shares**

Further, counsel assisting say, the Camsan facility is another example of lending against shares affected by -

- the absence of a prudent and reasonable board policy; and
- tolerance of imprudent departures from guidelines concerning share cover.

(d) Breaches of Companies legislation

Counsel assisting submit that the evidence suggested JCAL, Camsan, Clarendon and Muron Nominees/Tricontinental were "associates" within the meaning of s7 of the Companies (Acquisition of Shares) Code (‘CASA’) and JCAL breached s11 of CASA.

H. Conclusions and Findings

Although there is evidence in this transaction of an inadequate first credit submission, and poor security cover, it is not a very convenient peg on which to hang such criticisms. This is because the respective facilities were merely part of a much wider scheme, apparently contrived by Mr Johns, which was never documented. Without knowing what arrangements Mr Johns made with Mr Tim Hewison to protect Tricontinental's position, there is little point in criticising the details. Mr Hewison was unavailable to give evidence because of illness and Mr Johns declined to give evidence.
Johns' failure to give evidence also deprived the Commission of any knowledge as to why he bothered to involve directors in two credit submissions which were well within his discretion to approve, or what he told them in order to obtain their approvals in those cases. Mr Ryan has no recollection of them and Mr Moyle was unable to be called because of illness.

The Commission can only repeat its view, expressed elsewhere, that investment banking transactions, such as these, having the hallmarks of warehousing arrangements, were entirely inappropriate for Tricontinental and should never have been entertained.

However, in view of the uncertainty as to the details of the arrangement, and the long period of time which has passed since this particular takeover occurred, the Commission does not recommend that any further inquiries be made into the aspects of it which have been dealt with in this transaction report. It should be noted, however, that another aspect of this series of transactions has been dealt with in confidential volume 4 of the Commission's report.
TRANSACTION REPORT 15

ROCADO INVESTMENT & FINANCE LTD AND CAMSAN PTY LTD - COMMAND PETROLEUM N.L. SHARES

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I. Conclusions and Findings 43
A. **Background and Summary**

1. Camsan Pty. Ltd. (‘Camsan’) was a private investment company owned by Mr Peter James Sanders, a resident of Victoria at the time.

2. Camsan was lent $1,386,247 by Tricontinental in February 1986 to purchase 9,064,000 shares (9.8%) in Command Petroleum N.L. (‘Command’) from Perth stockbrokers, Benny Partners. Mr Johns approved the loan within his discretion.

3. Rocado Investment and Finance Limited (‘RIFL’), an investment company of Mr Stephen Matthews and Mr Peter Francis Hunt, was making a partial takeover bid for Command at the time the Camsan loan was approved. At the time RIFL’s shareholding in Command was 19.89%. Mr Johns had been a director of RIFL since December 1985.

4. Mr Johns agreed that Tricontinental would fund RIFL in the partial takeover bid when the bid changed from a share scrip swap to a cash offer in February 1986.

5. At the time RIFL and Camsan had substantial shareholdings in Cord Holdings.

6. Between 11 February and 3 April 1986, Command issued notices under s261 of the Companies Code to Benny Partners, the individual partners, its nominee company, Alexisse Nominees Pty. Ltd. (‘Alexisse’), Camsan and Mr Sanders, calling on them to declare their interests in Command shares. In his response on 9 April 1986, Mr Sanders claimed neither he nor Camsan had any beneficial interest in the 9.8% parcel.

7. RIFL discontinued its takeover bid for Command in April 1986 after failing to remove the incumbent board.
The Camsan facility was extended three times by Mr Johns and was repaid on 1 July 1986 with funds which had been placed on deposit with Tricontinental by RIFL the previous day.

B. Chronology

The chronology of granting the facility is as follows:

7 February 1986: Letter of offer for $1.5m unsecured facility for working capital - accepted but not drawn down
24 February 1986: Letter of offer for $1,386,247 facility
24 February 1986: Credit submission for $1,386,247
25 February 1986: Amount of $1,386,247 drawn down
15 April 1986: Extension for one month
2 May 1986: Credit submission for extension to 15 June 1986
20 June 1986: Credit submission for extension to 15 July 1986
1 July 1986: Facility repaid

C. Partial Takeover Bid for Command by RIFL

RIFL purchased 17,507,205 shares (19.0%) in Command for cash on 11 December 1985.

On 23 December 1985 Johns was appointed a director of RIFL. On 27 December 1985 RIFL directors, including Johns, resolved to undertake a partial takeover offer for Command. RIFL’s interest in Command arose because Command, in turn, had a substantial shareholding in West Coast Holdings, a gold mining exploration company. Benny Partners who had been asked on 23 December 1985 by a Mr John Fox (spokesman for a syndicate) to sell a 9.8% parcel of Command shares were appointed to advise RIFL on the Command offer.
On 6 January 1986 RIFL lodged a substantial shareholders' notice and informed the Australian Stock Exchange of its intentions to announce a partial takeover offer for Command by way of share swap.

On the same day Benny Partners sent a telex to Mr Fox confirming the sale of 9,064,000 Command shares at 15.25 cents per share. Cash for the sale was to be paid on 28 February 1986.

On 3 February 1986 RIFL revised its share offer to a cash offer of 15 cents per share.

The share registry of Command recorded purchases of Command shares by Alexisse, of parcels of 8,739,000 and 321,000 on 6 February 1986 and 4,000 on 19 February 1986.

Command sent s261 notices to Alexisse on 11 February 1986, to Benny Partners on 16 February 1986 and to the individual partners of Benny Partners on 20 February 1986. Mr Kelly of Benny Partners replied on 20 February 1986 that the shares were held on Benny Partners' own behalf as 'trading stock'. On 21 February individual partners Kelly, Magnus and Benny replied in the same terms.

On 21 February 1986 Johns on behalf of Tricontinental confirmed an unconditional undertaking to provide a credit facility to RIFL to fund the proposed takeover offer for Command. He was a director of RIFL at that time. There was no contemporaneous record of this undertaking in Tricontinental's board minutes.

A credit submission dated 25 February 1986 showed that Johns approved, under his discretion, a $1,386,247 loan for Camsan to acquire 9,064,000 shares (9.8%) in Command at 15c per share. A letter of offer had been sent to Camsan on 24 February 1986 for this facility. A letter of offer for a $1.5m working capital facility had been sent on 7 February and accepted on
10 February but was never drawn down. Camsan drew down funds on the Command share acquisition facility on 25 February 1986 in the form of a cheque in favour of Alexisse for $1,386,247. On the same day as the Camsan settlement with Alexisse, 25 February 1986, RIFL drew a cheque for $40,000 in favour of Benny Partners recording this payment as "commission in advance for advisory services".

On 6 March 1986 proceedings were instituted by Command in the Supreme Court of New South Wales against Alexisse, Benny Partners and the individual partners of Benny Partners to seek orders for compliance with the s261 notices.

RIFL further revised its offer for Command on 13 March 1986 increasing the cash offer to 20 cents per share.

On 20 March 1986 the share scrip for 9,064,000 Command shares was delivered back by Tricontinental's Perth office to Mr Kelly at Benny Partners. On 24 March 1986, Mr Sanders wrote to Benny Partners stating in his letter that, on 25 February 1986, a sum of $1,386,248.16 was lent unsecured at call to Benny, Kelly and Magnus by Camsan and that Camsan did not regard itself as having any right in relation to any Command shares purchased with the funds lent.

On 3 April 1986, Command served s261 notices on Camsan and Sanders. In response on 9 April 1986, Sanders stated that neither he nor Camsan had any relevant interest in the parcel of 9,064,000 Command shares. Mr Sanders gave evidence that he was concerned that he may have been said to be an "associate" of RIFL and he indicated this concern to Peter Hunt and Mr Johns.

He was concerned to ensure the loan facility was repaid by somebody other than himself. He said the letter of 24 March 1986 was "done after consultation with the parties in trying to unwind the mess". Mr Sanders gave
evidence that he never regarded himself as a lender to Alexisse or partners of Benny Partners rather than a buyer of the shares, and his letter of 24 March 1986 was accordingly contrived, at the request of RIFL or Tricontinental, "with the intent of unwinding what had already occurred".

Mr Hunt was asked before the Commission, whether he was conscious of or suspected warehousing in relation to this transaction or the 9.8% parcel. He responded by saying, "... obviously the warehousing concept was uppermost in our minds". Mr Matthews gave evidence that he "... was aware that Johns was bumbling around, attempting to achieve some arrangement whereby we [RIFL directors] could be secure in the knowledge that the Alexisse parcel would come our way". According to Matthews, Johns told Matthews he would make some arrangements whereby Sanders, a friend of RIFL's would become a holder of the Alexisse parcel. Mr Matthews' evidence was that, based on his understanding as a businessman, of warehousing, he believed that what occurred as a result of Johns' conduct in relation to the Alexisse parcel, was warehousing. However, Matthews also said it was his belief that Johns failed to appreciate the legal implications of what he was doing.

The RIFL partial takeover offer for Command was due to close on 14 April 1986 but was extended to 21 April 1986.

At an extraordinary meeting of Command on 18 April 1986, shareholders did not pass motions put forward on behalf of RIFL, the effect of which would have been to dismiss the incumbent directors. On 21 April 1986 RIFL announced that it would not proceed with the offer to shareholders of Command.

On 24 April 1986, an order by consent was made in the New South Wales Supreme Court, dismissing Command's application (para 19 above) with costs awarded against the defendants, Alexisse and the partners of Benny Partners, up to a maximum of $20,000.
D. **Other Matters of Importance**

(a) **Extension of facility**

On 9 April 1986 the Camsan facility was extended for a one month period, approved by Mr Johns under his discretion. A credit submission for a further extension to 15 June 1986 was approved, also under discretion, by Johns on 2 May 1986. The value of security had fallen, but no action was taken about it. A third extension was granted on 20 June 1986 to 15 July 1986, approved under discretion by Johns. The value of security had fallen even further. Details of the drop in share cover can be summarised from the evidence as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Price Per Share</th>
<th>Total Value</th>
<th>Times Cover</th>
</tr>
</thead>
<tbody>
<tr>
<td>24.2.1986</td>
<td>15c</td>
<td>$1,359,600</td>
<td>.98</td>
</tr>
<tr>
<td>11.4.1986</td>
<td>9c</td>
<td>$ 815,760</td>
<td>.59</td>
</tr>
<tr>
<td>2.5.1986</td>
<td>6c</td>
<td>$ 543,840</td>
<td>.39</td>
</tr>
<tr>
<td>20.6.1986</td>
<td>6c</td>
<td>$ 543,840</td>
<td>.39</td>
</tr>
</tbody>
</table>

At each time the principal loan amount involved was $1,386,247 for 9,064,000 shares.

(b) **Repayment**

On 24 June 1986 Johns asked Mr Matthews, a director of RIFL, to acknowledge that RIFL's purchase from Camsan of Command shares was to take place the following day and mentioned the need for funds to repay Mr Sanders. Two days later, referring to a telephone conversation the previous day, Johns informed Matthews in writing of the amount of principal and interest owing to Sanders. On 27 June 1986 Johns wrote to Matthews, saying that Sanders was prepared to accept a loan from RIFL on 30 June for the amount owing, and to effect physical sale of the scrip to RIFL on 1 July 1986.

On 30 June 1986 $1,500,000 was paid into Tricontinental's Westpac Sydney account by RIFL and placed on money market as TCL a/c Camsan (TCL167).
The Camsan facility was repaid on 1 July 1986 from funds transferred from the deposit account (TCL167) to the cash advance account (CAS 003). The balance of the deposit account was transferred into a deposit account for RIFL.

On 1 July 1986 the RIFL board agreed to execute a call option agreement whereby RIFL would purchase 9,064,000 Command shares from Alexisse at a strike price of 8 cents and a premium of 7.25 cents, totalling 15.25 cents per share. It was noted that funds held on deposit at Tricontinental would be used to fund this transaction. Less than one month later the directors of RIFL decided to sell their shareholdings in Cord, West Coast Holdings and Command. These decisions were effectively made by Johns, Hunt and Matthews.

(c) Mr Matthews’ request to Mr Johns

On 7 October 1986 Matthews of RIFL wrote to Johns saying that Neil Hunter of Tricontinental had told the auditors of RIFL that the deposit of $1.5m lodged with Tricontinental on 30 June 1986 was for the account of Camsan not RIFL. Matthews asked that Johns “rectify this please as it has a very significant effect on our accounts”.

On the same day Mr Hunter wrote to the directors of RIFL confirming that $1.5m was lodged with Tricontinental on 30 June 1986.

E. Role of Mr Johns

RIFL

On 21 February 1986, when Johns was a director of RIFL, as managing director of Tricontinental he confirmed in writing to Hunt an unconditional undertaking that Tricontinental would fund the RIFL, 15 cents per share, cash bid takeover offer for Command. This would have resulted in Tricontinental funding RIFL up to $4,200,000. At the time Johns only had authority to approve facilities to $3m. No credit submission was prepared outlining the proposal and, as noted in para 17 above, there does not appear to have been
any contemporaneous note of this decision in the board minutes for the period January to May 1986. However, Mr Johns declared his interest in RIFL at the April 1986 board meeting in the context of a different loan.

Camsan
The Camsan facility for $1,386,247 was approved by Johns within his discretion as managing director. He approved the facility and a letter of offer was sent on 24 February 1986, before the preparation of a formal credit submission the following day. Security for the facility was in breach of Tricontinental's lending guidelines, which required 1.3 times cover, but no cover was prescribed. The three extensions granted to Camsan were also approved by Mr Johns under his discretion. Each approval was granted after security values were falling, reaching .39 times cover, with no additional security being requested. Mr Johns co-ordinated the repayment, by RIFL, of the Camsan facility.

F. Role of Other Managers
Mr Johns approved the granting and extensions of the Camsan facility within his discretion and made the major decisions about the running of the facility. No members of staff to whom he directed memoranda, such as Mr Catterson and Mr Hunter, would have been expected to check or question Johns' instructions. No member of the credit committee seems to have questioned Johns' decision on this occasion.

G. Role of Directors
RIFL
There was no evidence to suggest that the directors were made aware, at the time, of the unconditional undertaking given by Mr Johns on behalf of Tricontinental to fund RIFL in its 15 cents a share takeover offer for Command. His declaration of his interest in RIFL, which may have been noted by them in April 1986, occurred after the relevant commitment was given and in a different context.
H. **Significant Issues Arising**

(a) **Credit risk analysis**

**RIFL approval**

The commitment by Mr Johns on behalf of Tricontinental to fund the RIFL takeover exceeded Mr Johns' discretion.

**Camsan approval**

Mr Johns approved the Camsan submission within his discretion. Had it been a normal arm's-length transaction it would not have met the standards of a prudent and reasonable merchant banker. However it was not a normal transaction; it was a small part of a complex arrangement involving a number of players.

(b) **Extensions**

The facility was extended three times by Mr Johns though the price of shares held as security was falling, as set out in paragraph 28 above.

(c) **Quality of credit submissions**

The credit submissions in this case were merely a record of what Johns had agreed to. They contained no financials of the borrower, Camsan, or its principal Mr Sanders. They revealed no equity contribution by the borrower. No security share cover as required by the guidelines was required. The only security was the Command share scrip and a personal guarantee of Mr Sanders. No establishment fees were payable in respect of the facility or the extensions. Interest payments were deferred until maturity. It was, on its face, an unusual transaction.

(d) **Advantage for RIFL**

Evidence suggested that Mr Johns obtained an advantage for RIFL, of which he was a director, by using his position as managing director of
Tricontinental. It was an advantage to RIFL to have a commitment from Tricontinental to fund the RIFL takeover because it appeared to have been shown to the Corporate Affairs Commission which had the task of approving the Part A Statement.

(e) Association between RIFL and Camsan

Evidence suggested that RIFL and Camsan may well have been ‘associates’ within the meaning of s7 of the Companies (Acquisition of Shares) Code (‘CASA’) and s136 of the Companies (Vic) Code and that RIFL may have breached s11 of CASA by use of Camsan to purchase a significant parcel of shares in Command.

I. Conclusions and Findings

This transaction cannot be judged by normal commercial standards, considering merely the alleged purpose of the loan, the security offered for it, the quality of the credit submission and similar matters. It was, in fact, one comparatively minor aspect of a takeover scheme in which Mr Johns was involved. The significance of the transaction, for present purposes, lies in what it tells us about Mr Johns.

The evidence shows, and Mr Johns has chosen not to contradict it, that he was prepared:

(i) to give a commitment beyond his authority to a company of which he was a director; no doubt he was confident that if it became necessary to obtain formal approval of the contemplated transaction, directors would give such approval;

(ii) to involve Tricontinental in a warehousing type of arrangement which could well have led to prosecutions if it had not been dismantled;

(iii) to commit Tricontinental to a loan for the purchase of shares, secured only by the shares themselves and a personal guarantee, in circumstances where, in the events that in fact occurred, the repayment
of the loan would have to come from a third party which was not contractually bound to repay; and
(iv) to do all these things without reference to his board.

In spite of the very revealing aspects of this transaction, no further action is recommended. This is because the scheme underlying it did not proceed, and this led to the situation becoming confused and its true nature somewhat obscured. Also, the events occurred over six years ago, and this would add to evidentiary problems.
TRANSACTION REPORT 16

WINDSOR RESOURCES NL SHARES

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A. **Background and Summary**

Windsor Resources NL ('Windsor') was incorporated in New South Wales on 10 September 1968 as Longreach Metals NL. Its name was changed to Windsor on 27 March 1981 and its main activities were gold production and mineral exploration. It was listed on the Australian Stock Exchange. Dallhold Investments Pty Ltd ('Dallhold') was a major shareholder throughout the relevant period.

Tricontinental established an investment banking facility relating to Windsor in or about May 1985. Because of time constraints, the Commission was unable to investigate fully all aspects of this facility. In the course of the Commission's investigations and hearings, certain matters emerged concerning the facility which warrant further investigation.

In May 1985, Dallhold purported to agree to pay Tricontinental a total fee of $500,000 for advice provided during the preceding year and to be provided during the next twelve months. A sum of $500,000 was paid to Tricontinental by Dallhold.

At or about the same time as Dallhold made this payment to Tricontinental, purportedly pursuant to the retainer, Tricontinental purchased 1,000,000 shares in Windsor at a cost of $483,840. These shares were sold to Dallhold in January 1986 for $750,000. From July to October 1985, Dallhold Resources Management Pty Ltd ('Dallhold Resources') invoiced Tricontinental for "services rendered" totalling $343,800. Payment was effected by placing funds on deposit in the name of Dallhold Resources. When the Windsor shares were sold to Dallhold, $500,000 of the purchase price was paid from a deposit in Dallhold Resources' name.

An issue which emerged before the Commission was whether the payment of the $500,000 to Tricontinental by Dallhold in fact related to the provision of advice, as indicated by the correspondence, or whether the purported
appointment of Tricontinental as financial advisers to Dallhold was really part of a tax planning scheme devised by Mr Johns and Mr Ziebell and implemented with the knowledge and assistance of Mr Pearce (the managing director of Dallhold), one purpose of which was to assist Tricontinental's taxation position - by enabling it to claim the benefit of dividend rebates in respect of dividends declared on preference shares held by Tricontinental.

Between May and September 1986, Tricontinental purchased 828,500 Windsor shares pursuant to an investment banking facility approved by Johns under his discretion.

Between 10 and 16 December 1986, Tricontinental Australia Limited ('TAL') purchased 887,600 Windsor shares at prices ranging between $1.20 and $1.30 per share. These shares were also purchased pursuant to an investment banking facility approved by Johns under his discretion.

On 28 January 1987, North Kalgurli Mines Limited ('NKM') made a formal unconditional cash takeover offer for Windsor which was accepted by Tricontinental and TAL.

The Commission examined internal correspondence between Mr Johns and Mr Goad which suggested that there was a profit sharing agreement between Tricontinental and Dallhold concerning the Windsor shares held by Tricontinental, and that the raising by Dallhold Resources of invoices totalling $575,000 relating to the provision of advice was a contrived means of giving Tricontinental a taxation advantage in respect of the payment of Dallhold’s share of the profit on the sale of the Windsor shares.

The documentary evidence also suggested that there was a profit sharing arrangement between Tricontinental and Mr Peter Laurance of Q-West Pty Ltd ('Q-West') relating to the sale of the Windsor shares held by TAL.
B. **Chronology**

The chronology of relevant events is as follows:

**1985**

14 May  
Johns wrote to Pearce accepting on behalf of Tricontinental appointment as financial advisers to Dallhold

17 May  
Johns sent a Dallhold cheque for $500,000 to Ziebell.  
Tricontinental purchased 1,000,000 shares in Windsor for $483,840

20 May  
Johns confirmed purchase of Windsor shares to Ziebell.  
Settlement of purchase of Windsor shares. Ziebell made diary note headed "Tax planning"

21 June  
Board of Tricontinental Finance Corporation noted investment banking facility of $484,000 relating to Windsor

July - October  
Dallhold Resources issued invoices to Tricontinental totalling $343,800

16 December  
Credit submission prepared to extend investment banking facility to 30 June 1986

**1986**

1 January  
Johns appointed as managing director of Tricontinental

17 January  
Tricontinental sold 1,000,000 Windsor shares to Dallhold for $750,000

April  
Tricontinental commenced purchasing Windsor shares

22 May  
Credit submission prepared to increase investment banking facility to $834,000 and extend expiry date to 30 June 1987

5 September  
Johns approved an increase in the investment banking facility from $350,000 to $450,000

24 September  
Pearce attended as guest at meeting of Tricontinental board

10 December  
TAL commenced purchasing Windsor shares
15 December Johns approved increase in investment banking facility for Windsor to $2.5m
31 December Credit submission prepared to increase investment banking facility to $2.5m

1987
28 January NKM made formal unconditional takeover offer for Windsor
10 February Tricontinental Securities Limited issued independent report for NKM in relation to the Windsor shares
25 February NKM increased its offer for Windsor shares
11 March Dallhold Resources invoiced Tricontinental for $475,000
12 March Johns instructed Shepherd to accept on behalf of Tricontinental the cash offer by NKM
24 March Dallhold Resources invoiced Tricontinental for $100,000
24 April Johns advised Goad that Tricontinental and TAL had accepted the NKM offer for Windsor and referred to profit sharing arrangements
18 June Secretary of Q-West informed Johns that its fee for the provision of investment and property advice was $86,000
23 June Johns informed Ziebell that a portion of Tricontinental's shares were held on profit share arrangement on behalf of Laurance of Q-West and that the profit due was $86,000
6 July Johns informed Goad that Laurance had returned cheque for $72,000 and requested cheque payable to Portsaid Investments Ltd

C. Narrative
12 On 14 May 1985 Mr Johns wrote to Mr Pearce informing him that Tricontinental accepted appointment as financial advisers to Dallhold for the
next twelve months, from 1 July 1985 to 30 June 1986, on an annual retainer of $250,000 payable in advance. Mr Johns also informed Mr Pearce that it was Tricontinental’s opinion that it should be paid a fee of $250,000 for advice provided during the preceding twelve months.

13 On 17 May 1985 Johns sent a memorandum to Ziebell enclosing a cheque received from Dallhold for $500,000 and stating that the cheque was "covering advisory fees for period 1/7/84 to 30/6/86".

14 On the same day as the Dallhold cheque was sent to Ziebell, Tricontinental purchased 1,000,000 shares in Windsor at a cost of $483,840 (48c per share).

15 In a memorandum from Johns to Ziebell dated 20 May 1985, Johns confirmed the purchase of the Windsor shares and stated that it was envisaged that the investment would be held for approximately six months.

16 Settlement of the purchase of the Windsor shares by Tricontinental occurred on 20 May 1985.

17 On 20 May 1985 Ziebell made a diary note headed “Tax planning”. In the diary note he recorded two ideas, the first of which was:

"... receive $500,000 as a fee from Dallhold at the same time we will purchase $500,000 worth of shares in a company associated with Dallhold being Windsor Resources NL. Next financial year we will pay Dallhold professional fees for the provision of possible geology services. This fee will be held on deposit with money market. In December 1985 Dallhold will purchase shares from us and accumulated geology fees will be paid to Dallhold."

18 The board of Tricontinental Finance Corporation, on 21 June 1985, noted an investment banking facility of $484,000 relating to Windsor.

19 Between July and October 1985 Dallhold Resources invoiced Tricontinental for $343,800 for "services rendered". Dallhold Resources requested that payment be made by the placing of funds on deposit in its name.
A credit submission, dated 16 December 1985, was prepared for the purpose of extending the investment banking facility for six months to 30 June 1986. The submission stated that the current usage was $483,840 and that the 1,000,000 Windsor shares were "held in TCL's name". The credit submission was recommended by four members of the credit committee, including Johns, and approved by Ryan (the managing director) and Carr.

On 17 January 1986 Tricontinental sold its 1,000,000 Windsor shares to Dallhold for $750,000. A memorandum from Johns (now managing director) to Ziebell, dated 20 January 1986, confirmed the sale and stated that settlement was to be effected on 3 February 1986 as follows:

- *(a) proceeds of deposit held TCL name of Dallhold Resources Management Pty Ltd - approximately $500,000*;
- *(b) balance payable by Dallhold*.

In April 1986 Tricontinental started purchasing Windsor shares again. Johns informed Goad, by means of a memorandum dated 19 May 1986, that Tricontinental had purchased a further 100,000 Windsor shares, taking its total holding to 660,000. On that date, Johns sent Catterson a memorandum stating that he (Johns) had approved an increased investment banking limit from $300,000 to $350,000, and asking Catterson to arrange for a credit submission to be prepared.

The credit submission, which was dated 22 May 1986, set out a number of purposes, two of which were to increase the investment banking facility to $834,000 and extend its expiry date by twelve months to 30 June 1987. The submission was recommended by the credit committee and approved by Johns, Moyle and Ryan. The submission incorrectly recorded that 1,000,000 shares in Windsor were held in Tricontinental's name. As stated above, those shares had in fact been sold in January 1986 and a further 660,000 shares had then been purchased for a consideration of $338,113.30. The managing director's report presented at the May 1986 board meeting recorded Tricontinental as having a current investment banking exposure to Windsor of $305,000.
On 5 September 1986, Johns sent a memorandum to Goad, stating that Tricontinental had purchased another 168,500 shares in Windsor, bringing its total purchases to 828,500 shares for a consideration of $439,794. On the same day, Johns sent another memorandum to Catterson informing him that, under his discretion, he had approved an increase in the investment banking facility from $350,000 to $450,000 to cover purchases of additional shares. He requested that a credit submission be prepared to record the increased facility. This request did not accord with the earlier credit submission dated 22 May 1986, which had already increased the facility to $834,000, even though the submission incorrectly referred to the 1,000,000 shares sold in January.

Mr Pearce attended as a guest at the Tricontinental board meeting held on 24 September 1986.

Between 10 and 16 December 1986, TAL purchased 887,600 shares in Windsor at prices ranging between $1.20 and $1.30 per share. Mr Pearce, when questioned about the purchase of Windsor shares by TAL, said that he had no recollection of it purchasing these shares.

In October 1986 Dallhold held 29.08% of Windsor shares. The shares then held by Tricontinental represented approximately 2% of Windsor shares. By December 1986, the holding of Tricontinental and TAL had increased to approximately 4%.

On 15 December 1986, Johns sent a memorandum to Clark informing him that, under his discretion as managing director, he had approved an increase in the investment banking facility for Windsor of $2.5m. Clark was directed to purchase the shares in the name of TAL.

A credit submission dated 31 December 1986 was prepared for the purpose of increasing the investment banking facility to $2.5m for the purchase of
further shares in Windsor. This increase was noted by the Tricontinental board at its meeting on 28 January 1987.

On 28 January 1987 NKM made a formal unconditional cash takeover offer for Windsor of $1.50 per fully paid share and $1.26 per partly paid share.

The managing director's report presented at the February Tricontinental board meeting stated that the corporate services division had prepared a report to the directors of NKM on the takeover offer for Windsor. The report was required to express an opinion as to whether the purchase consideration offered represented a fair and reasonable price for the acquisition of Windsor as far as NKM shareholders were concerned.

Tricontinental Securities Limited ('TSL') prepared a report which found that the purchase consideration offered was fair and reasonable. The report was despatched as part of an information memorandum to the shareholders of NKM, with TSL making a disclosure of the Tricontinental group's interests in Windsor and NKM held "in the ordinary course of business".

On 25 February 1987 an increased offer of $1.60 cash for each fully paid Windsor share and $1.36 for each partly paid Windsor share was announced by NKM.

On 11 March 1987, Dallhold Resources invoiced Tricontinental for $475,000 "for advisory services and information provided on various Western Australian companies and their owners". A further invoice dated 24 March 1987 was received at Tricontinental from Dallhold Resources for an amount of $100,000, being "for advice on the formation of a gold trust".

Mr Pearce, when questioned about these invoices, said that the services which Dallhold provided to Tricontinental were probably not worth $475,000.
On 12 March 1987 Johns sent a memorandum to Shepherd informing him that, in relation to Tricontinental's holding of 1,716,100 shares in Windsor, it was in order to accept on behalf of Tricontinental the cash offer of $1.60 per share by NKM. In fact at that time Tricontinental held 828,500 Windsor shares and the balance were held by TAL.

On 24 April 1987 Johns sent a memorandum to Goad informing him that Tricontinental and TAL had accepted the NKM offer for Windsor. He attached to the memorandum cheques covering the proceeds of the sales. In respect of the sale by Tricontinental of 828,500 Windsor shares at $1.60 the total proceeds were $1,325,600. The memorandum stated:

"Invoices (2) from Dallwall Resources Management Pty. Limited totalling $575,000 are attached for payment and I would appreciate cheques being handed to myself. Net profit on transaction of $310,625.23 is to be credited to investment banking division".

In respect of the sale by TAL of 880,600 Windsor shares at $1.60 the gross proceeds were $1,408,960. The memorandum stated:

"An arrangement was made with a Tricontinental client on the basis that Tricontinental would receive holding costs of 22% per annum capitalised monthly with capital profit thereafter split 50/50".

On 23 June 1987, Johns sent a memorandum to Ziebell informing him that a portion of Tricontinental's shares in Windsor were held on a profit share arrangement on behalf of Mr Laurance of Q-West. The memorandum stated:

"Profit due to Peter Laurance is $86,000 for which I enclose letter seeking payment of a fee relating to investment and property advice".

The letter referred to in the memorandum is a letter dated 18 June 1987 from the company secretary of the Q-West group to Mr Johns. The letter stated:

"Pursuant to our agreement for the provision of investment and property advice, our fee as agreed is $86,000.
Your cheque by return mail made payable to Q-West Pty Ltd would be greatly appreciated".
The figure of $86,000 had been amended to $76,000 and endorsed with the handwritten words "Profit Windsor $76,000".

On 6 July 1987, Johns sent a memorandum to Goad informing him that Laurance had returned a cheque for $72,000 and requesting that a cheque be drawn and made payable to Portsaid Investments Limited and be forwarded with a "with compliments" tag to the attention of Mr James Fulton, Portsaid Investments Limited, 12th Floor, 11 Duddel Street, Central Hong Kong.

The February 1988 managing director's report noted that amounts claimed in respect of fees paid to Dallhold had been disallowed by the Australian Taxation Office as a result of its internal audit of Tricontinental.

D. **Role of Mr Johns**

Mr Johns approved this investment banking facility and increases to it under his discretion as either general manager or managing director.

All significant events occurred at the instigation of Mr Johns who had a close working relationship with Mr Pearce.

E. **Role of Directors**

The directors other than Mr Johns had no significant role in this investment banking transaction.

Credit submissions relating to the investment banking facility were approved by directors and noted by the board from time to time. Mr Johns controlled all aspects of the facility, both before and after his appointment as managing director.

F. **Significant Issues Arising**

(a) **Retainer - $500,000 fee**

An issue arose as to whether the payment of $500,000 by Dallhold to Tricontinental in May 1985, purportedly as a fee for Tricontinental accepting
an appointment as financial advisers to Dallhold, and the later rendering of invoices by Dallhold Resources to Tricontental for services rendered, were part of a scheme or arrangement which was improper or in any way contrary to law.

Mr Pearce, when questioned about this transaction, said that it was initiated at the request of Mr Johns to "fix a tax problem" of Tricontental and that, although Tricontental had done work for Dallhold for which it had not been paid, "the tax problem was the driving force". Mr Pearce conceded that Tricontental had probably not done work to the value of $500,000 to justify the retainer fee and said further that the fee was intended to be returned to Dallhold by the issue of invoices in the early months of the financial year 1985/86. When examined as to the two invoices issued by Dallhold Resources in 1987, Pearce acknowledged that they were a means of facilitating the arrangement with Johns rather than bearing any relationship to services actually rendered. After Mr Pearce had given his evidence to the Commission, further documents, including the invoices dated in 1985, were located and put in evidence. The solicitors for Mr Pearce submit that his evidence cannot be taken as referring to these invoices as they were not put to him when he gave his evidence.

Mr Ziebell, when questioned about this transaction, was unable to recall any discussions with Johns about it, although he acknowledged that the memorandum dated 20 May 1985 and headed "Tax planning" was his idea put in writing. He said that Tricontental at that time had a problem "sheltering dividends" and that he would have been playing with ideas of ways of earning assessable income. He explained that this was because Tricontental had a portfolio of preference shares on which it received dividends and that, without assessable income to match those dividends, the benefit of the dividend rebate was lost to Tricontential. (This seems to have been a perennial problem for Tricontental; see first report para 9.19(iii).)
Counsel assisting submit that, on the evidence, it is open to the Commission to find that the relevant events all occurred at the instigation of Mr Johns pursuant to an agreement between Mr Pearce and himself. They further submit that the purported appointment of Tricontinental as financial advisers to Dallhold was a sham, in that the real purpose for the events occurring was not the purpose stated on the face of the documents, but rather to assist the taxation position of Tricontinental, by enabling Tricontinental to claim the benefit of dividend rebates in respect of dividends declared on preference shares held by Tricontinental.

Counsel assisting submit further that the acceptance and the payment by Tricontinental of invoices rendered by Dallhold Resources in the second part of 1985, which counsel assisting assert were acknowledged by Mr Pearce as being a means of returning the $500,000 fee to Dallhold, did involve the commission of offences by Tricontinental, Mr Johns and Mr Ziebell under s267(11) of the Companies Code and that Mr Pearce aided and abetted those offences. They further submit that it is not clear on the evidence whether any other unlawful conduct has occurred. They submit that the matter requires further investigation which the Commission was unable to undertake due to time constraints and they recommend that further investigation be undertaken.

Counsel for Mr Ziebell submit that the payment of the $500,000 fee and the events surrounding it occurred at the instigation of Johns, pursuant to an agreement between Pearce and himself. They submit that it cannot be said that Mr Ziebell was involved in, or appreciated the purpose of, the agreement or the terms of the agreement, at least at the time it was entered into by Johns and Pearce. The only involvement Ziebell had, if any, was after the arrangement had been put in place by Johns. They further submit that Ziebell relied upon Johns for the information to be put in the accounting records and that, in this event, it cannot be said that Ziebell failed to take all reasonable steps to secure compliance by Tricontinental with s267(11). They further submit that Mr Ziebell had reasonable grounds to believe, and did believe, that a competent and reliable person was charged with the duty of seeing that
the particular accounting record was accurate and, in the circumstances, was in a position to discharge that duty.

They finally submit that the matter was not adequately examined by the Commission in the presence of Mr Ziebell, and that the nature of the offence would normally have required some investigation of the "reasonable steps" available to Mr Ziebell, which were not investigated.

Solicitors for Mr Pearce submit that he gave no evidence at all in relation to the 1985 invoices and therefore his evidence cannot be asserted to verify or relate to those invoices and that the evidence does not support any finding or suggestion of unlawful conduct involving Mr Pearce.

(b) Investment in Windsor shares by Tricontinental

An issue arose as to whether the two invoices from Dallhold Resources totalling $575,000 referred to in the memorandum from Johns to Goad dated 24 April 1987 were in fact genuine invoices raised for services actually rendered, or whether they were a further example of a sham transaction being entered into by Tricontinental to facilitate some extraneous purpose.

Mr Pearce, when questioned about the purchase of Windsor shares by Tricontinental and TAL, said that he was not aware that they had begun acquiring the shares.

Counsel assisting submit that, if the invoices were not genuine, as seems probable from the evidence of Mr Pearce and Mr Ziebell that they were not aware of services provided by Dallhold to Tricontinental which would justify the invoices, a question arises as to whether the payment of $575,000 pursuant to the invoices was made under some arrangement with Dallhold which involved the purchase of the Windsor shares. They submit that, in these circumstances, it would be necessary to investigate fully the arrangement under which the Windsor shares were purchased, and the terms of any such arrangement, to determine whether Tricontinental and Dallhold were
"associates" within the meaning of s136(3) of the Companies Code at the time the shares were purchased, and whether one purpose of the transaction was to provide Tricontinental with an artificial taxation benefit. They submit that, as time constraints did not permit the Commission to undertake this course, the matter should be further investigated.

Counsel for Mr Goad submit that there was no suggestion that Mr Goad did not regard the invoices sent to him by Mr Johns as other than genuine.

Solicitors for Mr Pearce submit there is no evidence which is properly open to the construction that Mr Pearce has or may have been involved in unlawful conduct of any kind.

(c) Investment in Windsor shares by TAL

An issue arose as to whether the memorandum from Johns to Goad dated 24 April 1987 evidences an "arrangement" to share the profit, on the sale of the Windsor shares, on a 50/50 basis.

Mr Pearce, when questioned about the existence of a profit sharing agreement, said that he had no recollection of any profit sharing agreement with Johns relating to Windsor shares.

Counsel assisting submit that, because the 887,600 shares in Windsor were purchased by TAL in December 1986, at between $1.20 and $1.30 per share, shortly before the announcement of the NKM takeover offer for Windsor (in respect of which TSL had been retained to prepare a report to the directors of NKM), a question arises as to whether TAL purchased the shares relying upon information that was not generally available in the market. They submit that, although the evidence raises such suspicions, it is not open on the evidence to make any positive findings in relation to this matter. They recommend that it be further investigated.
Further matters to be investigated are whether any information relating to Windsor not generally available in the market was provided to Mr Laurance of Q-West, and the terms of any arrangement between Tricontinental and Laurance to share profit on the sale of the Windsor shares.

Counsel for Mr Goad submit that the memorandum does not evidence an arrangement to share the profit on the sale of the shares on a 50/50 basis without more. The memorandum in itself does not indicate to the addressee (Mr Goad) any illegal arrangement.

Conclusions and Findings

The Commission finds that the various dealings outlined in this transaction report have an air of contrivance about them which warrants further investigation by the Australian Securities Commission. The amounts involved, and the possibly fraudulent nature of the activities, are sufficient to justify such a course, which the Commission recommends.

In the light of that recommendation, the Commission believes it would be inappropriate for it to express any tentative conclusions on the issues involved.
TRANSACTION REPORT 17
MID-EAST MINERALS LIMITED SHARES

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A. Background and Summary

1 Mid-East Minerals Limited (‘Mid-East’) was incorporated in Western Australia on 14 June 1968 and was a mining company listed on the Australian Stock Exchange.

2 In late 1985 Mid-East was owned as to approximately 58% by Winthrop Investments Limited, which was a wholly owned subsidiary of Dallhold Investments Pty. Ltd. (‘Dallhold’). Mid-East owned approximately 42.22% of Metals Exploration Limited (‘Metals Ex’).

3 In early May 1986 Mr Johns met Mr Robert Pearce, the managing director of Dallhold, and was informed that Dallhold intended to make a Part A bid for Mid-East at 50c per share, which would result in Bond controlling 100% of Mid-East. It was agreed between Johns and Pearce that Tricontinental would purchase shares in Mid-East.

4 On 9 May 1986 Johns, exercising his discretion, approved an investment banking facility of up to $1m to enable Tricontinental to purchase Mid-East shares. The investment banking facility was increased by Johns under his discretion from $1m to $3m in January 1987.

5 Mr Pearce gave evidence that, following the announcement of a rights issue by Mid-East in October 1986, an arrangement existed between Tricontinental and Dallhold that Tricontinental would, if requested by Dallhold, purchase shares in Mid-East or Metals Ex to avoid any apprehended downward effect the sale of the parcel of shares to another purchaser may have had on the market price.

6 In March 1987, following unsuccessful takeover bids by Dallhold for Metals Ex and Mid-East, Tricontinental purchased a total of 2,860,923 Mid-East shares.
On 30 September 1988 Tricontinental sold all its Mid-East shares for $1,037,023.10 in an off-market sale. This represented a loss to Tricontinental, taking into account its purchase and holding costs. Tricontinental was paid an additional $1.213m by Dallhold, as "amount due to [Tricontinental] regarding Mid-East" - to quote Mr Johns' memorandum.

B. Chronology

The chronology of relevant events is as follows:

1986
6 May Johns met Pearce and was informed that Dallhold intended to make a Part A bid for Mid-East
9 May Johns approved under his discretion a $1m investment banking facility to enable Tricontinental to purchase Mid-East shares
13 May Credit submission prepared for $1m investment banking facility relating to Mid-East
15 - 18 August Dallhold announced a cash bid for all shares in Mid-East and Metals Ex. Johns had "brief discussions" with Alan Bond and spoke to Barry Casson at Dallhold on 18 August to "ascertain precise role to be played by Trico"
19 August Dallhold sought $35m short-term bridging finance from Tricontinental to aid bids for Mid-East and Metals Ex

September Johns reported to the board that Tricontinental had been appointed financial adviser to Dallhold in respect of its bids for Mid-East and Metals Ex

10 October Mid-East announced a renounceable rights issue to its shareholders
22 October  Johns instructed Shepherd not to accept Dallhold's offer for Mid-East or Metals Ex

12 November  Dallhold informed Mid-East that because the minimum acceptance conditions of its offers had not been fulfilled it was not proceeding with the Mid-East takeover offer

20 November  Johns informed Clark that he had agreed to allow the $35m Dallhold facility to remain in place until 28 February 1987 and that up to $25m could be drawn for working capital requirements against BCHL scrip

27 November  Johns instructed Shepherd to accept the two-for-one rights issue

1987

7 January  Johns approved under his discretion an increase in the investment banking facility relating to Mid-East from $1m to $3m and an extension to 31 January 1988

8 January  Credit submission prepared which recorded the increase and extension approved by Johns under his discretion

4 March  Pearce asked Johns whether Tricontinental would be interested in purchasing 1.5m Mid-East shares at 70/75c

5 & 9 March  Tricontinental purchased a total of 2,860,923 Mid-East shares through broker in London

7 July  Green gave instructions to acquire up to 200,000 shares in Mid-East

December  Tricontinental accepted a takeover offer from Mid-East for its shares in Metals Ex
1988
29 January Credit submission prepared for purpose of extending facility a further six months to 31 July 1988
4 March Johns sent to Dallhold a schedule showing Tricontinental’s investment and holding costs for a total of 3,682,923 shares purchased in Mid-East
13 July Pearce told Johns that he might know of a party willing to purchase Tricontinental’s holding in Mid-East shares; Johns told Pearce Tricontinental would not sell for less than $1 per share
15 July Tricontinental sold 900,000 Mid-East shares for $1 per share
20 July Johns sent schedule of Tricontinental’s investment and holding costs for Mid-East shares to Goad and Pearce
1 August Credit submission prepared for purpose of extending facility a further six months to 31 January 1989
12 September Johns informed Michael Cross of Dallhold that Tricontinental held 2,962,923 Mid-East shares and that they would be sold before 30 September 1988
30 September Tricontinental sold all its Mid-East shares for $1,037,023.10 in an off-market sale. Tricontinental received cheque for $1.463m ($1.213m for this transaction) from Dallhold.

C. Narrative

A file note, dated 6 May 1986, prepared by Mr Johns stated that he met Mr Pearce and was informed that Dallhold intended to make a Part A bid
for Mid-East at 50c per share, "resulting in Bond controlling 100% of Mid-East". It also stated that it was agreed between Johns and Pearce that Tricontinental would purchase shares in Mid-East:

*on basis that Dallhold would acquire for:-
Principal cost
Holding cost (20%)
50% profit from sale*.

Mr Pearce gave evidence that he had no recollection of any profit sharing arrangement with Tricontinental in relation to Mid-East shares in May 1986.

On about 9 May 1986, Mr Johns approved under his discretion a facility to enable Tricontinental to acquire "up to $1m in value of ordinary shares in Mid-East". He instructed Mr Catterson that the shares purchased were not to be sold without his consent, the term of the facility was to be six months to 31 October 1986, and that the anticipated return to Tricontinental was "not less than 20% per annum".

On 9 May Johns informed Mr Goad that he had recently approved an investment banking facility to acquire shares in Mid-East and that he had purchased 10,000 shares for $2,526.25.

A credit submission was later prepared, dated 13 May. It stated that the $1m facility was approved by the managing director under his discretion and was for the purpose of enabling Tricontinental to purchase ordinary shares in Mid-East up to a value of $1m. The facility was noted by the board on 28 May 1986.

On 15 August 1986 Dallhold announced that it intended to make a cash bid for all shares in Mid-East and Metals Ex, conditional upon "receiving sufficient acceptances giving rise to compulsory acquisition under the takeovers code". The cash bid was to be 75c and 90c respectively. At
that time a subsidiary of Dallhold already held 58.53% of Mid-East, which in turn held 42.22% of Metals Ex.

Also on 15 August, Mr Johns had "brief discussions" with Mr Alan Bond followed by a discussion with Mr Barry Casson of Dallhold on 18 August to "ascertain precise role to be played by Trico". Tricontinental Securities Limited was to be appointed as adviser to Dallhold for both bids.

A file note prepared by Johns on 19 August stated that Dallhold "is also seeking short term bridging finance to assist with acquisition". In September 1986 Tricontinental provided Dallhold with a commercial bill facility of $35m as a "bridging facility" to finance the proposed bid for Mid-East and Metals Ex pending the provision of a credit line of $110m from the HongkongBank. Mr Pearce gave evidence that the facility was drawn down but he was unsure as to whether the credit line from HongkongBank was used to repay the loan.

Between 8 May and 15 August 1986 Tricontinental purchased 252,000 shares in Mid East at an average price of approximately 30¢ per share.

In September 1986 the managing director's report recorded, as a highlight of the corporate services division for the past month, Tricontinental's appointment as financial adviser to Dallhold for its bids for Mid-East and Metals Ex. This appointment was also referred to in the managing director's reports presented at the October and November 1986 board meetings.

On 10 October the directors of Mid-East announced that, subject to a two-for-one rights issue announced by Metals Ex proceeding and the grant of an exemption from certain stock exchange requirements, Mid-East intended to raise approximately $31.8m by way of a renounceable equity issue to shareholders.
20 On 22 October Mr Johns instructed Mr Neil Shepherd that, "under no circumstances is Dallhold Investments' offer for Mid-East Minerals and Metals Exploration to be accepted by Tricontinental". Tricontinental was then holding 252,000 shares in Mid-East.

21 On 12 November 1986 Dallhold informed Mid-East that, because the minimum acceptance conditions of the offers had not been fulfilled, it was not proceeding with the bid for Mid-East.

22 On 20 November, Johns informed Clark that the Dallhold bids for Mid-East and Metals Ex had been unsuccessful, that following a request he had agreed to allow the $35m Dallhold facility to remain in place until 28 February 1987 and that up to $25m could be drawn for working capital requirements "against BCHL scrip".

23 On 27 November Johns instructed Shepherd to accept the two-for-one renounceable rights issue announced by Mid-East. At that time, Tricontinental held 275,000 shares with an entitlement to 550,000 rights, which it took up at 75¢ each, taking its total holding of Mid-East shares to 825,000.

24 On about 7 January 1987, Johns, under his discretion, approved an increase in the investment banking facility relating to Mid-East from $1m to $3m and an extension to 31 January 1988.

25 A credit submission dated 8 January was prepared, which recorded that the increase and extension had been approved by the managing director under his discretion. The credit submission showed a current usage of "nil". However, on 17 December 1986, Tricontinental had paid $412,500 to take up its rights under the two-for-one renounceable rights issue.
Mr Pearce said in evidence that, following the announcement of the Mid-East rights issue in October 1986, an arrangement existed between Tricontinental and Dallhold that, if requested by Dallhold, Tricontinental would purchase shares in Mid East or Metals Ex to avoid any apprehended downward effect the sale of the parcel of shares to another purchaser may have had on the market price. The arrangement also involved Dallhold indemnifying Tricontinental for any losses made on the shares, as well as Tricontinental receiving a quarter of the profits after holding costs. Mr Pearce agreed that the purpose of the arrangement was "to prevent any downward effect that the existence of Mid-East or Metals Ex shares on the market may have had and to put a platform under the price of the shares".

On 4 March 1987, Pearce sent a facsimile transmission from London to Johns inquiring whether Tricontinental would be interested in taking a line of approximately 1.5m Mid-East shares at 70/75c.

On 5 and 9 March 1987, Tricontinental purchased a total of 2,860,923 Mid-East shares through Alexanders Laing & Cruickshank, London at 70c and 75c. The market price during this period was 78c.

On 7 July 1987, instructions were given by Mr Douglas Green to a broker to acquire up to 200,000 shares in Mid-East at a price of $1.10 per share. Purchases of approximately 200,000 shares were made between July and September 1987, pursuant to this instruction.

On 7 September 1987 Johns, in a memorandum to Green, asked why Tricontinental had purchased a further 3,500 shares and said "I would have thought we had enough". Mr Green was unable to offer any explanation for this comment by Johns.

As at 2 October 1987, Tricontinental held 5.9% (3,719,060) of the issued capital of Mid-East, and was the second largest shareholder behind
Winthrop Investments Limited, which held 59.05%.

In December 1987, Tricontinental accepted a takeover offer of $2 per share from Mid-East for its entire shareholding in Metals Ex.

A credit submission, dated 29 January 1988, was prepared for the purpose of extending the Mid-East investment banking facility a further six months to 31 July 1988. The current usage was disclosed as $2,870,584. The credit submission was noted by the board in February 1988.

On 4 March 1988, Johns wrote to Ms Delores Caboche, the secretary of Dallhold, enclosing a schedule representing Tricontinental's investment and holding costs for shares purchased in Mid-East. The letter stated that Tricontinental held 3,862,923 shares in Mid-East with an in-house cost as at 31 March 1988 of $3,481,656.62 - approximately 90¢ per share. It also stated that Tricontinental currently held a profit share of $547,502.01 from the Metals Ex transaction which, if taken into account, would provide an average cost per Mid-East share of 74¢.

On 13 July 1988, Pearce telephoned Johns to say that he may have an interested party who was willing to purchase Tricontinental's holding in Mid-East. Johns told Pearce that Tricontinental would not sell for less than $1 per share.

No further Mid-East shares were purchased by Tricontinental during 1988; however on 15 July 1988 Tricontinental sold 900,000 Mid-East shares to a Rothwell's subsidiary for a price of $1 per share. As at 18 July 1988 the market price of Mid-East was 34¢ per share.

On 20 July 1988, Johns sent to Goad an up-to-date schedule of Tricontinental's investment and holding costs for Mid-East with a memo which stated, "You will note from the schedule that I have allowed for
prior profit share arrangement regarding shares held in Metals Ex and to obtain average costs due to Tricontinental in its investment to date". The $547,502 profit due to Dallhold from the Metals Ex profit-sharing agreement had been offset against the Mid-East holding to reduce the average purchase price.

38 On 20 July 1988, Johns wrote to Pearce enclosing an up-to-date schedule showing details of Tricontinental's investment and holding costs for shares purchased and sold in Mid-East.

39 A credit submission dated 1 August 1988 was prepared for the purpose of extending the facility a further six months to 31 January 1989. The credit submission disclosed the current usage as $2,870,584. This was incorrect, as it did not take into account the sale of 900,000 Mid-East shares in July 1988. The actual usage was $1,970,584.

40 On 12 September 1988, Johns wrote to Mr Michael Cross of Dallhold confirming that Tricontinental held 2,962,923 Mid-East shares and that such shares "will be sold prior to 30 September 1988". Johns informed Cross that Tricontinental was seeking a total of $2.25m and was prepared to dispose of its shares at 35¢ per share.

41 On 26 September 1988, Johns again wrote to Cross referring to recent discussions and noting that Tricontinental would dispose of its current holding of Mid-East shares by 30 September 1988. Johns asked Cross to advise the name of the purchaser and settlement details.

42 On 29 September 1988, Johns wrote to Cross yet again, referring to a recent discussion and confirming that Tricontinental would be prepared to "hold this view". He also requested a cheque payable to Tricontinental for $2,250,000.
On 30 September 1988 Tricontinental sold all its Mid-East shares for $1,037,023.10 in an off-market sale. In addition, Tricontinental received a separate cheque for $1,463,000 from Dallhold which was said in a memorandum from Johns to Goad to be made up of $1,213,000 (an amount due to Tricontinental regarding Mid-East) and $250,000 (a fee due to the lending division for the extension of a facility provided to Dallhold). The total amount received by Tricontinental excluding the $250,000 fee was therefore $2,250,023.10.

D. Role of Mr Johns

Mr Johns approved this investment banking facility and the increase and extensions of it under his discretion as managing director. All significant events occurred at the instigation of Mr Johns, who had a close working relationship with Mr Pearce.

E. Role of Directors

The directors other than Mr Johns had no significant role in this investment banking transaction. Credit submissions relating to the investment banking facility were noted by the board from time to time, but Mr Johns controlled all aspects of the facility.

F. Significant Issues Arising

An issue arises as to whether Tricontinental, in purchasing the Mid-East shares, was an "associate" of Dallhold within the meaning of s136(3) of the Companies Code and, if so, whether Dallhold breached s138(1) of the Companies Code in failing to notify a change in its interest in Mid-East following the purchase by Tricontinental between May 1986 and September 1988 of 3,862,923 Mid-East shares.
On this issue counsel assisting submit that on the evidence it is not open to find that Tricontinental and Dallhold were "associates" within the meaning of s136(3) of the Companies Code. They submit that further investigation of the relationship between Tricontinental and Dallhold is required before any positive findings can be made and they recommend such further investigation.

The solicitors for Mr Pearce also submit that it is not open to the Commission to make any finding on the evidence that Tricontinental and Dallhold were "associates" within the meaning of the Companies Code.

A further issue for consideration is whether Tricontinental, in purchasing the Mid-East shares pursuant to an arrangement with Dallhold, which was intended to maintain the market price of Mid-East shares, did an act which was calculated to create a false or misleading appearance with respect to the market for, or the price of, Mid-East shares, in breach of s124(1) of the Securities Industry Code.

Counsel assisting submit that the arrangement between Tricontinental and Dallhold may have constituted a breach of s124(1) of the Securities Industry Code by Tricontinental. They further submit that Mr Johns and Mr Pearce may have aided and abetted such a breach by Tricontinental. They submit, however, that it is not open to make any positive finding in relation to this issue on the present evidence, and they recommend that the matter be further investigated.

The solicitors for Mr Pearce also submit that it is not open on the evidence for the Commission to make any finding against Mr Johns or Mr Pearce.

A further issue that arose was whether Mr Johns failed to exercise the degree of care and diligence required by s229(2) of the Companies Code in authorising, on or about 20 November 1986, the drawdown by Dallhold
of up to $25m for working capital on a facility which had been approved by directors as a bridging facility to finance a proposed bid by Dallhold for Mid-East and Metals Ex, which bids were no longer proceeding.

Counsel assisting submit that Mr Johns in authorising the drawdown was in breach of s229(2) of the Code. They submit that the facility was approved by directors as a bridging facility for a specific purpose and that no prudent director of a merchant bank would have approved a drawdown on this facility knowing that the specific purpose for which the facility was initially approved no longer existed.

G. Conclusions and Findings

The events referred to in paras 46 and 49 above are sufficient to arouse suspicions that breaches of the Companies Code or the Securities Industry Code may have occurred.

The Commission draws them to the attention of the Australian Securities Commission (‘ASC’), but stops short of formally recommending further inquiries because it suspects that the ASC has many more serious matters awaiting investigation. The dubious arrangements turned out to be generally unsuccessful and neither of the companies concerned is still operating.

With regard to paragraphs 52 and 53, the Commission believes that Mr Johns was wrong to authorise drawdown of a $25m facility for which the approved purpose no longer existed. He should have taken the matter back to the approving directors or to the board.

The approving directors were entitled to assume, as they did, that any major change in the purpose or terms of the facility would be brought back to them for further consideration.
However the Commission does not recommend any action against Mr Johns on this account, because there were no guidelines in existence to set the limits of his authority; and the Commission is unable to say, on the evidence, that his decision to permit drawdown was commercially negligent, or even constituted, in business terms, an error of judgment.
TRANSACTION REPORT 18
METALS EXPLORATION LIMITED SHARES

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| E. | Role of Directors      | 41 |
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A. **Background and Summary**

1. Metals Exploration Limited ('Metals Ex') was incorporated in Victoria on 26 August 1954 and was a mining company listed on the Australian Stock Exchange.

2. In July/August 1986 Mid-East Minerals Limited ('Mid-East') held 42.22% of Metals Ex. Dallhold Investments Pty Limited ('Dallhold') held 58.53% of Mid-East through a subsidiary.

3. In July 1986, Mr Johns, exercising his discretion, approved an investment banking facility of up to $200,000 to enable Tricontinental to purchase Metals Ex shares.

4. In December 1986, following unsuccessful takeover bids by Dallhold for Metals Ex and Mid-East, Tricontinental purchased 1,699,998 rights in Metals Ex, which Mr Johns stipulated were not to be sold without his approval. The investment banking facility was later increased by Johns under his discretion to $1.2m in December 1986 and to $3m in January 1987. The purpose in each case was to enable Tricontinental to purchase further shares in Metals Ex.

5. Mr Robert Pearce, the managing director of Dallhold, gave evidence that, following the announcement of a rights issue by Mid-East in October 1986, an arrangement existed between Tricontinental and Dallhold that Tricontinental would, if requested by Dallhold, purchase shares in Mid-East or Metals Ex to avoid any apprehended downward effect the sale of the parcel of shares to another purchaser may have had on the market price.

6. By mid June 1987 Tricontinental held over 2,000,000 shares in Metals Ex.

7. On 30 June 1987 Tricontinental sold all the shares it held in Metals Ex and, on 1 July 1987, repurchased the same number of shares. Johns later told
The same shares were again sold by Tricontinental in late 1987 when it accepted a takeover bid by Mid-East for Metals Ex of $2 per share. The profit due to Dallhold arising from acceptance of the offer was $98,053.39, resulting in a total profit from both sales of $547,502.01.

**B. Chronology**

The chronology of relevant events is as follows:

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<th>Date</th>
<th>Event</th>
</tr>
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<tbody>
<tr>
<td>18 July</td>
<td>Tricontinental purchased 350,000 Metals Ex shares for $177,275</td>
</tr>
<tr>
<td>22 July</td>
<td>Johns noted that he approved under his discretion an investment banking facility of up to $200,000 to purchase Metals Ex shares</td>
</tr>
<tr>
<td>15 - 18 August</td>
<td>Dallhold announced a cash bid for all shares in Metals Ex and Mid-East. Johns had &quot;brief discussions&quot; with Alan Bond and spoke to Barry Casson at Dallhold on 18 August to &quot;ascertain precise role to be played by Trico&quot;</td>
</tr>
<tr>
<td>27 August</td>
<td>Tricontinental board noted the $200,000 investment banking facility relating to Metals Ex</td>
</tr>
<tr>
<td>September</td>
<td>Managing director's report noted that Tricontinental had been appointed financial adviser to Dallhold Resources Management Pty Limited in its takeover bids for Mid-East and Metals Ex</td>
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<tr>
<td>10 October</td>
<td>Metals Ex announced a renounceable rights issue to its shareholders</td>
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<tr>
<td>22 October</td>
<td>Johns instructed Shepherd not to accept Dallhold's offer for Mid-East and Metals Ex</td>
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<tr>
<td>11 November</td>
<td>Johns gave instructions to accept Dallhold offer for Metals Ex</td>
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Dallhold informed Metals Ex shareholders that because the minimum acceptance conditions of its offers had not been fulfilled it was not proceeding with the Metals Ex takeover offer.

Johns sent contract notes to Goad relating to the purchase of 999,998 rights in Metals Ex. Johns approved under his discretion an increase in the Metals Ex investment banking facility to $1.2m to cover further purchases of Metals Ex shares.

Credit submission prepared for increase in investment banking facility to $1.2m.

Credit submission prepared to increase and extend Metals Ex investment banking facility to $3m to enable Tricentinal to purchase further shares in Metals Ex.

Johns reported to the board that Tricentinal had been appointed by North Kalgurli Mines Limited ("NKM") to advise its shareholders on the proposed acquisition of a subsidiary of Metals Ex.

Tricentinal sold its shareholding of 2,049,998 shares in Metals Ex.

Tricentinal repurchased 2,049,998 shares in Metals Ex.

Johns provided Goad with a schedule informing him of interest details and profit share on sale of Metals Ex shares.

Johns gave instructions to accept Mid-East takeover offer for Metals Ex shares.

Shepherd informed Johns that Tricentinal had received $4.1m on 28 December 1987 from acceptance of the Mid-East takeover offer for Metals Ex.
13 January  

Johns informed Goad that Tricontinental had accepted cash offer by Mid-East for Metals Ex shares of $2 per share, totalling $4,099,996. Johns informed Pearce that Dallhold’s total share of profit from the two Metals Ex transactions was $547,502.01.

C. Narrative

10 On about 22 July 1986 Mr Johns approved, under his discretion, an investment banking facility of up to $200,000 to enable Tricontinental to purchase 350,000 shares in Metals Ex at 50 cents per share - $175,000 plus costs.

11 On about 18 July 1986 Tricontinental purchased 350,000 shares in Metals Ex for $177,275.

12 On 15 August 1986 Dallhold announced that it intended to make a cash bid for all shares in Metals Ex and Mid-East, conditional upon receiving "sufficient acceptances giving rise to compulsory acquisition under the takeovers code". The cash bid was to be 90¢ and 75¢ respectively. At that time Dallhold was entitled, through Mid-East, to 42.22% of Metals Ex.

13 Also on 15 August, Mr Johns had "brief discussions" with Mr Alan Bond and spoke to Mr Barry Casson, the secretary of Dallhold, on 18 August to "ascertain precise role to be played by Trico". In a file note dated 19 August 1986, Johns recorded that Tricontinental Securities Limited was to be appointed as adviser to Dallhold for both bids, and that Dallhold was seeking short term bridging finance to assist with the acquisition.

14 On 27 August the Tricontinental board noted the $200,000 investment banking facility relating to Metals Ex.
The September 1986 managing director's report presented to the board noted that Tricontinental had been appointed financial adviser to Dallhold Resources Management Pty. Limited in its takeover offers for Mid-East and Metals Ex. This was also noted in later managing director's reports presented at the October and November board meetings.

On 10 October 1986 the directors of Metals Ex announced that, subject to an increase in the authorised capital of Metals Ex and the granting of an exemption from certain Stock Exchange requirements, Metals Ex intended to raise approximately $72.6m by way of a renounceable equity issue to shareholders.

Mr Pearce said in evidence, that following the announcement of a rights issue by Mid-East in October 1986, an arrangement existed between Tricontinental and Dallhold that, if requested by Dallhold, Tricontinental would purchase shares in Mid-East or Metals Ex to avoid any apprehended downward effect the sale of the parcel of shares to another purchaser may have had on the market price of the shares. Under the arrangement, Dallhold was to indemnify Tricontinental for any losses made on the shares and, for doing so, was to receive one quarter of the profits after holding costs. Mr Pearce agreed that the purpose of the arrangement was to prevent any downward effect that the existence of Mid-East or Metals Ex shares on the market may have had, and "to put a platform under the price of the shares".

On 22 October Johns sent a memorandum to Shepherd instructing him that under no circumstances was Dallhold's offer for Mid-East and Metals Ex to be accepted by Tricontinental.

On 10 November 1986 Johns sent a further memorandum to Shepherd enclosing the form of acceptance in relation to the current bid by Dallhold for Metals Ex "which is now accepted by Tricontinental".
On 11 November 1986 Shepherd sent an internal memorandum to Ms. Robyn Linehan advising her that Johns had said that he wished to accept the takeover offer by Dallhold for Metals Ex which expired that day. He instructed her to seal the attached acceptance form and send it by courier.

On 12 November Dallhold informed Metals Ex shareholders that, because the minimum acceptance conditions of its offers had not been fulfilled, it was not proceeding with the bid for Metals Ex.

On 2 December 1986 Shepherd, by memorandum, asked Goad to exercise the two-for-one renounceable rights issue for Metals Ex at a cost of 80c each. Tricontinental was holding 350,000 Metals Ex shares entitling it to 700,000 rights, which would cost $560,000 to exercise.

On 11 December 1986, Johns sent contract notes to Goad relating to the purchase of 999,998 rights in Metals Ex for a total consideration of $815,293.66. Johns stipulated that the rights were not to be sold without his prior approval. Tricontinental thus acquired a total of 1,699,998 rights in addition to its original 350,000 shares.

On 11 December 1986 Johns approved, under his discretion, an increase in the Metals Ex investment banking facility from $200,000 to $1.2m to cover further purchases of Metals Ex shares.

A credit submission dated 23 December 1986 was prepared in support of the investment banking facility increase to $1.2m.

A further credit submission, dated 8 January 1987, was prepared to increase the investment banking facility from $1.2m to $3m, to enable Tricontinental to purchase further shares in Metals Ex. It was noted by the board at its January 1987 meeting.
The April 1987 managing director's report presented to the board stated that Tricontinental had been appointed by North Kalgurli Mines Limited ('NKM') to advise shareholders on the proposed acquisition of Metals Exploration Pacific Pty Limited, a wholly owned subsidiary of Metals Ex.

On 30 June 1987 Tricontinental sold its entire shareholding of 2,049,998 shares in Metals Ex at $1.65 per share. The net proceeds of the sale were $3,350,362.98.

A Tricontinental investment banking report dated 30 June 1987, attached to the June 1987 board papers, revealed that Tricontinental had realised a profit of $1,797,794.32 on the sale of the Metals Ex shares.

On 1 July 1987 Tricontinental purchased the same number of shares it had sold on the previous day through brokers, MacIntosh Hamson Hoare Govett International Limited based in Hong Kong. The total consideration paid was $3,392,644.20, based on a purchase price of $1.65 per share.

On 3 July Johns provided to Goad a schedule informing him of interest details and profit share. The memorandum records that, "Tricontinental is entitled to 75% of profit i.e. $1,348,345.70 plus interest $181,730.40".

Also on 3 July, Johns wrote to Pearce confirming a recent discussion and stating that the client's portion of profit share was $449,448.62, being 25%.

A credit submission, dated 7 August 1987, was prepared in order to establish a $165m commercial bill facility to enable Metals Ex to take up euro convertible notes from Bond Corporation Holdings Limited. This submission referred to a separate credit submission being circulated at the same time to extend the $3m investment banking facility from 31 July 1987 to 31 August 1988.
On 14 August Johns, by memorandum, informed Goad that, in relation to the profit share of 75% Tricontinental/25% Dallhold, they inadvertently forgot to deduct holding costs of $181,730.40 from the proceeds of sale of the Metals Ex shares but that as Tricontinental’s share was approximately $1.3m, no amendments would be made. He also told Goad that the client’s profit share of $449,448.62 was to be held in a suspense account pending instructions from the client.

On 25 September 1987, Johns requested Ziebell to ensure that the format of the monthly board papers prepared for board meetings be amended to incorporate Metals Ex and others into category A investments.

On 16 October 1987, Johns issued instructions that the bid of $2 per share for Metals Ex by Mid-East was to be accepted on behalf of the investment banking division.

On 11 January 1988, Shepherd informed Johns that Tricontinental had received $4,099,996 on 28 December 1987 from the Mid-East takeover offer for 2,049,998 Metals Ex shares held by investment banking.

On 13 January Johns, by memorandum, informed Goad that Tricontinental had accepted the cash offer bid by Mid-East for Metals Ex of $2 per share, totalling $4,099,996. Johns enclosed a schedule covering details of purchases, holding costs and profit share arrangements. Holding costs of 19.5% per annum, totalling $325,275.74, together with Tricontinental profit share of $294,160.17 were to be credited to the investment banking division. The client’s profit share of $98,053.39, together with its profit share from the previous transaction of $449,448.62, was to be held in a suspense account pending further discussions with the client.

Also on 13 January, Johns wrote to Pearce informing him that Tricontinental had accepted the cash offer by Mid-East, and enclosing a schedule of
transactions, cost of funds and profit share. The total profit share due to Dallhold on the two Metals Ex transactions was $547,502,01.

D. Role of Mr Johns

Mr Johns approved this investment banking facility and increases to it under his discretion as managing director. All significant events occurred at the instigation of Mr Johns, who had a close working relationship with Mr Pearce.

E. Role of Directors

The directors other than Mr Johns had no significant role in this investment banking transaction. Credit submissions relating to the investment banking facility were noted by the board from time to time but Mr Johns controlled all aspects of the facility.

F. Significant Issues Arising

An issue arises as to whether Tricontinental, in purchasing the Metals Ex shares, was an "associate" of Dallhold within the meaning of s136(3) of the Companies Code and, if so, whether Dallhold breached s138(1) of the Companies Code in failing to notify a change in its interest in Metals Ex following the purchase by Tricontinental of the shares.

On this issue counsel assisting submit that on the evidence it is not open to find that Tricontinental and Dallhold were "associates" within the meaning of s136(3) of the Companies Code. They submit that further investigation of the relationship between Tricontinental and Dallhold is required before any positive findings can be made and they recommend such further investigation be undertaken.
The solicitors for Mr Pearce also submit that it is not open to the Commission to make any finding on the evidence that Tricontinental and Dallhold were "associates" within the meaning of the Companies Code.

A further issue to be considered is whether Tricontinental, in purchasing the Metals Ex shares pursuant to an arrangement with Dallhold which was intended to maintain the market price of Metals Ex shares, did an act which was calculated to create a false or misleading appearance with respect to the market for, or the price of, Metals Ex shares, in breach of s124(1) of the Securities Industry Code.

Counsel assisting submit that the arrangement between Tricontinental and Dallhold may have constituted a breach of s124(1) of the Securities Industry Code by Tricontinental. They further submit that Mr Johns and Mr Pearce may have aided and abetted such a breach by Tricontinental. They submit, however, that it is not open to make any positive finding in relation to this issue on the present evidence, and they recommend that the matter be further investigated.

The solicitors for Mr Pearce also submit that it is not open on the evidence for the Commission to make any finding against Mr Johns or Mr Pearce.

**Conclusions and Findings**

The matters referred to in paras 42 and 45 do give rise to suspicions that breaches of the Companies Code or the Securities Industry Code may have occurred.

The Commission draws these matters to the attention of the Australian Securities Commission (‘ASC’), but does not formally recommend further investigations because neither of the companies concerned is still operating and the Commission is aware of the heavy workload of the ASC.
# TRANSACTION REPORT 19

**SOUTHLAND MINING LTD AND AUSTRALIAN RACING & BREEDING STABLES LTD (ARABS)**

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E. Conclusions and Findings - ARABS 133
A. **Background and summary**

1 This transaction report deals with two investment banking transactions involving companies associated with John Maurice Messara and his associate Terence Joseph Caplice. Mr Messara and Mr Caplice have shared very close business ties for many years and worked out of the same office in Sydney. The Commission has concentrated on aspects of the relationship that Messara, Caplice and their entities had with Tricontinental, as no issue was taken concerning the process of credit risk assessment.

(a) **Mr Messara**

2 Mr Messara shared both a personal and professional relationship with Mr Ian Johns, particularly concerning their common interest in the horse racing industry.

3 Mr Messara had the following Sydney based interests:

(i) J.M. Messara Financial Services Pty Ltd ('JMM') - a private company involved in stockbroking and owned by Mr Messara and his wife, who were the directors. Mr Messara also acted as a consultant to the stockbroking firm of John Anschau, Fay & LaForest of Sydney ('Anschaus');

(ii) Australian Racing & Breeding Stables Ltd ('ARABS') - the first publicly listed company in Australia (formed in 1970) for the purpose of breeding and racing thoroughbred horses. Mr Messara was a major shareholder and director. In October 1987 the company changed its name to Arrowfield Group Limited ('Arrowfield') (Between June 1986 and December 1988 Tricontinental purchased on its own behalf more than $14m worth of ARABS shares);

(iii) Southland Mining Limited ('Southland') - a publicly listed company involved in mining exploration and development. Mr Messara was a director and had been chairman since 1983;
(iv) Devex Limited ('Devex') - another mining company of which Mr Messara was the chairman of directors. Devex took over Southland in 1986.

Unfortunately Mr Messara was unable to be called as a witness before the Commission as he was overseas on business at the time when public hearings into these transactions were held. Before this he had co-operated with Commission investigators and indicated his willingness to give evidence. A transcript of his ASC examination was tendered to the Commission.

(b) Mr Caplice

Mr Caplice, who gave evidence, had the following Sydney based interests:

(i) Kolback Corporation Limited ('Kolback Corporation') - a public company of which Mr Caplice was a director, to be distinguished from Kolback Pty Ltd, a private company. Kolback Corporation took over JMM in 1987 or 1988;

(ii) T J Caplice & Associates, solicitors - Mr Caplice did not practise as a solicitor, but he maintained a practising certificate. He wrote as a solicitor on behalf of other companies in which he had interests. The solicitor's letterhead shared the same address, telephone number and facsimile number as Messara's stockbroking business, JMM;

(iii) Rebecca Fashions Pty Ltd ('Rebecca') - a private company involved in fashion manufacturing and equity investment. Mr Caplice became involved with this company in the early 1980s and was a director;

(iv) HVRN Nominees Pty Ltd ('HVRN') - a trustee company for the McCarthy Charitable Trust, its shares were held by Mr Caplice and his wife.
B. **Southland Transaction**

(a) **Summary**

In February 1985 Tricontinental lent $2m to Messara’s company JMM for the purchase of 9 million Southland shares. At all relevant times Messara was chairman of directors of Southland. The shares were purchased and held in Tricontinental’s name. Security for the loan was a put option and repurchase agreement between Messara and/or JMM and Tricontinental, which covered all Tricontinental’s fees and costs and returned to Tricontinental a net 22.5% per year. In March 1985 Tricontinental held, on behalf of JMM, 11.15% of Southland’s issued share capital. By December 1985 this parcel had increased to 19.54%. In October 1985 Devex commenced to take over Southland. It is alleged by counsel assisting that the takeover documents were either false and misleading or lacking relevant detail in light of the Tricontinental/JMM shareholding arrangement. In January 1986, during the takeover period, Caplice told Tricontinental that his entity, HVRN, was the true owner of the Southland share parcel. Thereafter Tricontinental held the parcel on behalf of HVRN on the same terms and conditions as before. From time to time substantial shareholder notices were lodged by Tricontinental in respect of the changes to the share parcel; but these notices failed to disclose Tricontinental’s connection with Messara/Caplice or their entities.

(b) **Chronology**

The chronology of relevant events is as follows:

**1985**

20 February  
- Credit submission sought approval for a $2m facility to JMM to fund the purchase of Southland shares.
- Agreement signed between JMM, Messara and HVRN.

20-21 February  
Credit committee recommended facility.

22 February  
Redenbach approved submission.
26 February  Letter of offer.
15 March  Hunter filed substantial shareholder notice to Southland (Tricontinental holding 7,546,000 shares (11.15%)).

(July 1985 - January 1987)  Letter from Neil Gynther to Rod (Chandler?) indicated that, because of NCSC activity, deals like the Messara/Southland share purchase were only to be done by Johns.

July  Southland obtained ASX approval for a 1 for 5 share conversion (Tricontinental/Messara holding 1,700,400 Southland shares (13%)).
18 July  Letter of offer relating to further Tricontinental purchase of Southland shares ($2.4m).
2 August  Tricontinental/Messara held 2,020,400 shares (15.19%).
14 October  Devex issued notice of intention to take over Southland (one Devex share for every two Southland shares).
26 November  Devex issued Part A statement
10 December  Part A statement registered.
12 December  Substantial shareholder notice to Southland signed by Ziebell. Tricontinental holding 2,599,200 shares (19.54%).
27 December  Devex issued Part A statement detailing its offer for all the ordinary shares in Southland.

1986
20 January  Caplice informed Tricontinental that HVRN was the owner of the Southland share parcel.
28 January  Diary note by Ziebell that Southland shareholding was held on behalf of Messara.
31 January  Memorandum from Johns to Stott concerning transfer of beneficial ownership of shares held in Southland
from Messara to HVRN. Tricontinental to receive a return of not less than 22.5% p.a.

2 February 
Credit submission concerning the transfer of Southland shares to HVRN.

4 March 
Letter of offer sent to Caplice.

5 March 
Devex advised Sydney Stock Exchange that it had received 94.57% acceptances for the takeover offer.

19 March 
Southland delisted following successful takeover by Devex.

2 July 
Ziebell signed a change in substantial shareholder notice to Devex, showing only Tricontinental Corporation Limited and its related companies as having a relevant interest in the Southland share parcel (17.32%).

18 July 
Johns informed Hunter that HVRN had requested that the Devex shares be registered in HVRN’s name.

3 October 
HVRN lodged a substantial shareholder notice, indicating it held 1,295,000 Devex shares (10.79%).

20 October 
Ziebell lodged a cessation of substantial shareholding notice, confirming the sale by Tricontinental Nominees of 1,273,700 Devex shares for $6.23m on 3 October 1986.

(c) Narrative

Between 20 and 22 February 1985, the credit committee and Mr Redenbach (Tricontinental’s then managing director) approved an investment banking credit submission to provide $2m to JMM for the purchase of approximately 9,000,000 shares (13.67%) in Southland. The submission was in the name of the client, JMM, however, it showed that the shares were to be purchased in Tricontinental’s name. The submission also showed that Tricontinental was to receive $600,000 in fees, representing a pre-tax return of 22.5% per year. It was noted that Southland had a 34%
interest in Devex and that Messara was chairman of both Devex and Southland.

Security comprised:

(i) shares to be purchased in Tricontinental's name;

(ii) a put option and repurchase agreement, whereby JMM would repurchase the shares for the price paid plus any fees or costs incurred by Tricontinental. (A copy of this agreement has not been found by Commission officers or produced to the Commission. Apparently the option was to be exercised by Tricontinental on or before 30 June 1986); and

(iii) Mr Messara's personal guarantee (the submission showed his net worth as at 21 June 1983 as $2.4m).

The submission (compiled by Mr Johns and Mr Hauer) described Mr Messara as "well established in Sydney with an enviable reputation", and referred to his stockbroking, thoroughbred racehorse breeding and mining company activities. A related facility to Southland of $2.7m (as at February 1985), with a current usage of $1.75m, was noted. The proposal was recommended "Given the history and personal assets of J M Messara".

No reference was made to Mr Caplice, or any of his associated entities, in the submission or any other documentation passing between Tricontinental and Messara at that time. On the face of the credit submission, the risk was wholly carried by JMM/Messara. In evidence, Mr Ziebell said this facility would be a category A investment banking transaction, because of the existence of the put option and repurchase agreement.

No letter of offer for the purchase of this initial parcel has been sighted. There is a letter of offer of 18 July 1985, from Johns to Messara, for a further purchase of $2.4m worth of Southland shares by Tricontinental on
behalf of JMM. This letter referred to the original letter of offer dated 26 February 1985.

(d) Breach of guidelines

The facility was recommended by the investment banking credit committee (including Johns and Stott) and approved by Redenbach as managing director. Tricontinental’s investment banking guidelines at that time required that facilities between $1m and $5m be approved by the credit committee, managing director and one other director. There is no record of any other director approving this facility. In December 1985 the guidelines were amended to enable the managing director alone to exercise a discretion to approve an investment banking facility up to $3m.

It is worth noting that the guidelines stated:

"All transactions will be strictly maintained within AASE and NCSC regulations. Holdings in excess of 10% of issued capital will require to be disclosed, however, by restricting maximum holding to 20% of issued capital will prevent TSL being forced to make formal takeover offers.

Investment Banking activities will provide TSL with increased fee revenue and the potential of sizeable capital profits."

(e) Tricontinental’s further purchases of Southland shares and giving of substantial shareholder notices

On 15 March 1985, a substantial shareholder notice was lodged with Southland, which indicated that 7,546,000 shares (11.15%) had been purchased by Tricontinental. The notice showed that 7,413,000 shares were registered in the name of Tricontinental Corporation Ltd ('TCL') and 133,000 shares in the name of Portview Nominees Pty Ltd on behalf of Tricontinental Securities Ltd ('TSL'). The notice was signed by Mr Ziebell. While the notice referred to TSL as an associate of TCL, it failed to disclose Tricontinental's put option and repurchase agreement with JMM. It claimed that Tricontinental was the beneficial holder of the
shares. Having looked at the papers, Mr Ziebell said in evidence that Tricontinental was the beneficial owner of the shares and that, on the face of the documentation, Messara/JMM had no control over them.

Mr Ziebell said he had no recollection of this notice or discussing the transaction with Johns, that it would have been filled in by himself or Hunter (as the only two Tricontinental officers who had responsibility for compiling these notices), and that whoever filled in the notice would first need to ascertain what the terms of the deal were.

Paragraph 1(d) of the notice required Tricontinental to state:

"the name and address of person entitled to become registered as holder of the voting shares in which the relevant interest is held."

This paragraph was deleted and initialled by Mr Ziebell. Paragraph 6 of the notice required Tricontinental to state:

"Particulars of any qualification of the power of a person to exercise, control the exercise of, or influence the exercise of, the voting powers of those shares ..."

The answer provided was "No qualification". Mr Ziebell conceded that the notice should have been qualified to include some reference to the put option and repurchase agreement Tricontinental had with Messara/JMM.

In July 1985 Southland obtained ASX approval for a 1 for 5 share conversion which gave Tricontinental/JMM a holding of 1,700,400 Southland shares (13%).

On 18 July, Tricontinental sent to JMM a letter of offer indicating that Tricontinental would purchase up to $2.4m worth of shares in Southland. This letter of offer superseded the earlier one for $2m. The letter of offer referred to the put option and repurchase agreement between Tricontinental and JMM, under which JMM would repurchase the shares at the price paid
by Tricontinental plus any fees or costs. By 12 August 1985 Tricontinental held 2,020,400 shares (15.19%).

A change in substantial shareholding notice, signed by Ziebell, was lodged with Southland on 12 December 1985. This showed that Tricontinental had a relevant interest in 2,599,200 shares (19.54%). The notice detailed particulars relating to the change. Mr Ziebell deleted and initialled paragraph B(e) which read:

"Particulars of any additional benefit that a person has, or may, become entitled to receive, whether upon the happening of a contingency or not, as a consequence of a change in a relevant interest, particulars of which are set out in this form, are as follows:"

The notice failed to disclose details of Tricontinental’s agreement with JMM. In evidence, Mr Ziebell agreed that this notice should have disclosed the Messara/JMM connection with the transaction.

Between 15 March 1985 and 12 December 1985, Tricontinental purchased a number of Southland shares. These were exchanged for Devex shares following the takeover discussed below. With one exception (which was unsigned), all substantial shareholder notices were signed by Ziebell and none disclosed the Messara/JMM connection.

(f) Devex takeover of Southland

On 14 October 1985 Southland directors received from Devex a notice of intention to take over 90% of Southland. The takeover offer consisted of one Devex share for every two Southland shares.

On 26 November 1985 Devex issued a Part A statement which was registered on 10 December. This stated that Messara held only 1,006 Southland shares out of a total of 82,126 shares (0.6%) held by Devex or its associates. In fact, according to Tricontinental’s records, at this time Tricontinental held 2,020,400 shares (15.19%) on behalf of JMM.
The Part A statement noted that:

(i) Tricontinental had disclosed a substantial shareholding in Southland shares;

(ii) Tricontinental had an unsecured loan facility with Devex;

(iii) on 14 October 1985 TSL had been appointed financial adviser to Devex;

(iv) Messara was both the chairman of Devex and a director of Southland and that, "Given this relationship, J M Messara has deemed it inappropriate to comment on the offer"; and

(v) "There is no other information material to the making of a decision by the holders of [Southland] shares whether or not to accept an offer by Devex, being information that is within the knowledge of Devex which has not previously been disclosed to the holders of [Southland] shares".

On 27 December 1985, Devex issued to Southland shareholders its offer to acquire 100% of Southland’s ordinary shares. This offer document stated that, immediately before it was despatched, Devex was only entitled to 82,126 Southland shares.

On 5 March 1986 Devex informed the Sydney Stock Exchange that it had received 94.57% acceptances of the takeover offer. On 19 March 1986 Southland was de-listed, following the successful takeover by Devex.

(g) Messara/JMM/HVRN agreement

On 20 January 1986 Mr Caplice (as solicitor on behalf of HVRN) wrote to Tricontinental. He referred to an earlier discussion he had had with Johns concerning the Devex takeover of Southland, at which it was indicated that HVRN was in fact the beneficial owner of the Tricontinental Southland parcel. He said that the takeover offer was not contemplated when HVRN engaged JMM to acquire the shares and that, "In so far as the financing arrangements were not intended to precipitate the consequences for your
company that will arise from the offer, our client believes it proper that it become registered as the true owner of the shares ...". Mr Caplice then requested that Tricontinental manage these shares in the name of Tricontinental Nominees Pty Ltd (‘TNL’).

In evidence, Mr Caplice produced a copy of an agreement dated 20 February 1985, made between JMM (referred to as ‘MFS’), Messara and HVRN (‘the agreement’). In effect the agreement was that Messara would purchase the Southland shares on behalf of Caplice or his interests.

Mr Caplice explained in evidence that it was Messara who suggested that he purchase the Southland share parcel and that because of his (Messara’s) association with Tricontinental, he could arrange the finance. Mr Caplice claimed that Tricontinental "... wouldn’t deal with me because they didn’t know HVRN and he (Messara) would have to go up front". He said he never considered approaching Tricontinental himself as Messara told him Tricontinental would not be interested in lending to a small company like his which they didn’t know. In spite of this alleged reluctance, Mr Caplice conceded that, in February 1986, at his request, Tricontinental readily lent to HVRN as part of their relinquishing arrangement with Messara/JMM.

Mr Caplice said he believed that the shares were in Tricontinental’s name because Tricontinental had taken the shares as security.

The agreement provided Messara with an ex gratia payment, exclusive of brokerage fees, should the transaction be of an agreed minimum advantage to HVRN, and recited that Messara was to "... use his best endeavours as broker to subsequently trade the share parcels at profit subject to HVRN meeting all interest payments and associated costs and allowing him sufficient time to sell while maintaining an orderly market in the shares". Messara was permitted to enter into whatever loan arrangements were deemed necessary by Tricontinental to secure sufficient funds and it was "... agreed by all parties that these shares are acquired by MFS in the
capacity of trustee for HVRN”. HVRN indemnified Messara/JMM against any loss whatsoever.

Mr Caplice refused to acknowledge he was, in these circumstances, the true beneficial owner of the shares - this was, he said, a “great question for the lawyers”. He said, "I was the back-up client to John Messara and we would take financial responsibility for the transaction". In this way, he said, HVRN had the ultimate say in respect of the Devex takeover, and Messara had control over the parcel only as a broker who manages purchases and advises a client. However he later said he had no obligation to issue any substantial shareholder notices in February 1985, when the parcel was first purchased, because the shares were not in HVRN’s name, "so in effect we wouldn’t have a voting power".

A copy of the agreement between JMM, Messara and HVRN was to be annexed to documentation constituting the loan arrangement with Tricontinental and was to be initialled by all parties. According to Caplice, this did not happen as it was overlooked or ignored.

Significantly, the agreement stated:

"HVRN agrees to allow Messara full and free authority for a period of one year from the date of purchase of the first shares in Southland, to dispose of such shares in an orderly fashion and Messara agrees to use his best endeavours to so dispose of the shares held by MFS to the best advantage and profit of HVRN."

Subject to the sale of the shares resulting in a net profit exceeding 20% p.a. of the funds allocated, Messara would be entitled to a commission of 10% of the net profit. Messara undertook to keep HVRN fully informed as to all purchase and sale transactions and to forward appropriate documentation. Mr Caplice said this happened, although he appeared to have little understanding of Messara’s arrangement with Tricontinental or developments which took place between them. He claimed that he first
heard of the Devex takeover offer only when it was publicly announced in December 1985. Although he said he had not learnt of the takeover offer from Messara, later he said Messara would have told him of it. He said he received none of the Devex takeover documentation.

In his ASC examination, Mr Messara confirmed that he had initiated the purchase of the Southland shares, having approached Mr Johns, who was enthusiastic to enter into some sort of a profit-share arrangement. Mr Messara said he was unable to be a party himself and had suggested:

"... that HVRN, that other company of which Terry Caplice was a director, could enter into such an arrangement. The shares were purchased by Trico. As time went on, it was decided that - and I don't know the exact technical reason for it - but HVRN would actually have the shares transferred into their own name, and that's what happened. I think the reason for that was ... that when a takeover was mooted ... there would be some tax implications where ... Trico would get scrip, but they wouldn't be entitled to all the profits, so the scrip when issued would give them a tax problem in that they'd have to realise the tax profit from the issue of the scrip, and so that the shares ought to be in the name of the party that they're in business with, which was HVRN, so they then did that. The shares went into the name of HVRN".

Later, Mr Messara said that the reason he could not enter into the transaction to acquire the Southland shares was not because of the takeover but because he was a director of Southland. He regarded Tricontinental as the beneficial owner of the shares and regarded himself as "... the agent that arranged the transaction, put in there, because I was the person that everybody knew ... but Johns was insistent that I be there, obviously taking the view that my credit and my name would make everybody perform, that's exactly what happened". Mr Messara said that the only thing he got out of the Southland deal was the brokerage. He said that he agreed to provide a personal guarantee because Johns insisted upon it. "He (Johns) took the view that if he had me in the breach, he'd always be able to, you know, get to me". As a result, Tricontinental may have thought that Mr
Messara was the shareholder because "my neck was on the line in terms of the guarantee".

The existence of the agreement was confirmed in later documentation passing between Messara and Caplice. Mr Caplice also said that the shareholding was disclosed in a balance sheet in 1985. In fact the McCarthy Trust balance sheet, to 30 June 1985, disclosed the following entries:

<table>
<thead>
<tr>
<th>Current liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan - Tricontinental Group</td>
</tr>
</tbody>
</table>

**Investments listed companies**

| Shares in listed companies | $2,148,587 |

There was no mention of Southland by name. The Rebecca directors' report and balance sheet to 30 June 1986 disclosed that Rebecca had "entered into a joint venture to acquire a parcel of Southland shares ...".

(h) Transfer of shares to HVRN

Following receipt of the letter of 20 January 1986, Johns spoke to Ziebell about transferring the Southland shares from TCL to TNL. The conversation is recorded in Ziebell's diary note of 28 January 1986. The diary note says "Problem was to exercise the put option and transfer the shares into [Messara's] name at book value before surplus over market increased considerably due to takeover by Devex." The diary note makes no reference to the letter from Caplice or HVRN's beneficial interest but rather, indicates that the shares would be held on behalf of one of Messara's companies. Mr Ziebell's opinion at the time was that there would be no requirement for a substantial shareholder notice to be lodged, as the transfer from TCL to TNL was an internal transfer within the group. In evidence, however, he conceded that he was wrong about this and that a notice should have been lodged.
39 On 24 January 1986, Ziebell arranged for the transfer of 2,535,600 Southland shares from TCL to TNL. A further 11,800 shares were already in the name of TNL.

40 On 31 January 1986, Johns prepared a memorandum to Stott confirming the "transfer of beneficial ownership of shares held in Southland from Messara to HVRN Nominees Pty. Ltd." Johns requested that investment banking limits should be approved for HVRN, as the new beneficial owner. The facility was to be on the same terms and conditions as that extended to JMM. A credit submission, dated 2 February 1986, was accordingly compiled, noting HVRN as the borrower for $4.02m. The facility granted to HVRN was to be used to repay Tricontinental's facility to JMM. Tricontinental was to receive the same "excellent return" of at least 22.5%. Security was to be a "put option and [repurchase] agreement". This facility was agreed to by the credit committee, Mr Johns and Mr Ryan (in his own hand). At this time the guidelines required that a facility up to $5m was to be approved by any two directors, one of whom could be the managing director.

41 It was proposed to call Mr Ryan as a witness, however his counsel informed the Commission that Mr Ryan, having had the opportunity of reading the transaction report and all the documents accompanying it, had instructed them that he no recollection of the transaction; specifically, he had no knowledge of any allegation of warehousing by Tricontinental of the Southland share parcel. Nor did Mr Ryan have any knowledge of the allegation of insider trading or raising false documentation in the ARABS transaction (see below). In those circumstances, it was decided that he would not be called as a witness.

42 A letter of offer was sent by Johns to Caplice, on 4 March 1986, which embodied the put option repurchase agreement. The sum of $725,000 was
payable on 30 June 1986, and $456,000 was payable on 31 December 1986 (these payments constituted Tricontinental’s 22.5% return).

On 2 July 1986 Tricontinental filed a substantial shareholder notice to Devex, which still omitted to mention any interest of HVRN in the shares and, in particular, made no reference to Tricontinental’s agreement with HVRN. This was signed by Ziebell and notified that, as a result of an off-market purchase, Tricontinental’s holding of Devex shares had increased from 1,456,650 (14.56%) to 2,077,139 (17.32%).

On 18 July, Johns wrote a memorandum to Hunter informing him that HVRN had requested that the share parcel be registered in the name of HVRN and that Tricontinental take a mortgage over those shares. Johns said, “security for this facility is Devex shares registered in the name of Tricontinental Nominees Pty Ltd”. The put option and repurchase agreement were not mentioned. In any event, Johns requested that Hunter liaise with Messara (not Caplice) on the matter.

On 3 October 1986 HVRN lodged, with Sydney Stock Exchange, a substantial shareholder notice to Devex indicating that it held 1,295,000 shares (10.79%) in Devex. This was the first such notice lodged by Mr Caplice or any of his entities concerning the parcel of Devex shares that had been exchanged for Southland shares following the successful takeover of Southland by Devex.

The transfer of the shares into HVRN’s name was confirmed in a cessation of substantial shareholding notice lodged by Ziebell on 20 October 1986. This indicated that Tricontinental companies ceased to be a substantial shareholder of Devex on 3 October 1986, following the disposal of 1,273,000 shares to HVRN for $6.24m.
The respective share prices of Southland and Devex were:

<table>
<thead>
<tr>
<th>Date</th>
<th>Southland</th>
<th>Devex</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 February 1985</td>
<td>$1.10 (for 5 shares)</td>
<td>$5.90 ps</td>
</tr>
<tr>
<td>2 February 1986</td>
<td>$2.50 ps</td>
<td>$6.00 ps</td>
</tr>
</tbody>
</table>

(i) The Gynther note

Between July 1985 and January 1987, Mr Neil Gynther was Tricontinental’s regional manager of lending for Victoria and Tasmania. He said in evidence that, initially, he had a close relationship with Mr Johns. Later this changed, as Johns had less time to deal with him. The regional managers were required to attend conferences from time to time and, as a training exercise, they were issued with unmarked credit submissions upon which they were required to make their own assessments.

In a folder of such training submissions, the Commission’s investigators discovered a copy of the credit submission of 20 February 1985 proposing the $2m facility to JMM (paragraphs 8-11 above). Mr Gynther said it was not part of his function to be involved in investment banking facilities, nor would he ordinarily have looked at this transaction as part of any training exercise. In his early days at the Melbourne office he did see some investment banking documentation, but that ceased when Johns became aware of this.

Attached to that submission was a handwritten note from Mr Gynther to "Rod", who Gynther said he believed was Mr Rod Chandler of Tricontinental’s Brisbane office. Gynther’s note read:

"Rod,

JM Messara Financial Services Pty Ltd is an investment banking facility. $2m to buy Southland Mining Limited shares. JM Messara is chairman of SML (& others) Secured by a put option from Messara at our original purchase price. Return 22.5%. These deals not done like this any more NCSC after us for
wharfhousing (sic). Ian does not want anyone but himself doing these. Please read, memorise & then eat. Neil*.

Mr Gynther said, "I was obviously made aware that we weren't to look at these deals any more by someone. I cannot recall who it was". Gynther claimed to have no recollection of writing this note. He agreed that he must have written it while he was attached to the Melbourne office which was between July 1985 and January 1987.

When he wrote the note, he said, he would have been "very, very I would say naive and inexperienced in terms of share dealing". Mr Gynther rejected the suggestion of counsel assisting that the expression, "Please read, memorise & then eat", meant that Chandler should keep details of the transaction very secret because Tricontinental was breaking the law by warehousing. He said, "I meant for him to destroy the memo because I was not supposed to be involved in investment banking and neither was he".

(j) Role of Mr Johns

Mr Johns had an extensive involvement with this transaction. In particular:

(i) He was approached by Messara, who suggested that an investment in Southland "would be a good thing for Trico". These discussions led to the $2m facility to JMM. Messara's evidence tended to suggest that he told Johns of the involvement of Caplice/HVRN at this time.

(ii) As head of the lending division, Johns was co-author of the initial credit submission, dated 22 February 1985.

(iii) As a member of the investment banking credit committee, Johns recommended the proposal to provide $2m to JMM for the purchase of the Southland shares.

(v) Following receipt of Caplice's letter of 20 January 1986, Johns liaised with other Tricontinental staff to organise the transfer of the shares from TCL (which held on behalf of JMM) to TNL (which held on behalf of HVRN) and then from TNL to HVRN.

(vi) By February 1986, Johns was managing director. He was co-author of the credit submission of 2 February 1986 for a $2.4m facility to HVRN, and approved the submission as a director. He signed the letter of offer dated 4 March 1986.

(k) Role of other managers

Mr Ziebell

Mr Ziebell, who was the secretary of Tricontinental, signed almost every substantial shareholder notice to Southland and then, following the takeover, to Devex, and filed these with the ASX. With Hunter, he was responsible for compiling these notices.

Mr Hunter

Mr Hunter filed one substantial shareholder notice to Southland, dated 15 March 1985, with the Sydney Stock Exchange on 18 March. He was involved with security matters concerning the transfer of the shares from TNL (on behalf of HVRN) to HVRN.

(l) Role of directors - Mr Ryan

Mr Ryan approved the credit submission of 2 February 1986 ($2.4m to HVRN) in his own hand.

(m) Significant issues

The two significant issues which the Commission has considered are:

(i) the alleged warehousing of the Southland share parcel by Tricontinental on behalf of JMM/HVRN; and

(ii) the failure of the Devex takeover documents to disclose Tricontinental's arrangements with JMM/HVRN.
Warehousing

Counsel assisting submit that it is unclear whether the Tricontinental/JMM put option and repurchase agreement was ever documented. No record has been found, but it must be noted that the letter of offer dated 18 July 1985 referred to "... the existing put option repurchase agreement and guarantee in favour of Tricontinental". Knowledge of the precise terms and conditions of this agreement would assist a proper understanding of the relationship between Tricontinental and Messara/JMM. If the agreement mirrors that embodied in the later letter of offer, of 18 July 1985, the option was to be exercised by Tricontinental.

Neither Mr Johns nor Mr Messara was able to be examined before the Commission. Undoubtedly each played a significant role in the transaction, and each should have been able to shed light on it.

The agreement between Messara, JMM and Caplice (see paras 32-33 above), and the nature of their relationship, enabled Messara to deal fully and authoritatively with the Southland share parcel. At the relevant time Messara was the chairman of both Southland and Devex. Counsel assisting submit that, in this pivotal position, it suited Messara to have Caplice, a friendly and compliant party, holding a significant parcel of Southland shares. This was particularly so, it is argued, once the takeover of Southland by Devex was mooted. On any view, counsel submit, Messara was in a position where he could influence the voting in respect of this share parcel.

Counsel assisting submit that the way in which Mr Ziebell compiled the substantial shareholder notices ensured that there would be no official record of JMM's (or anyone else's) interest in, or ability to deal with, the shares. Mr Messara tended to suggest in his ASC examination that he had told Tricontinental of the Caplice/HVRN connection (see para 35 above),
but counsel assisting argue that this is an unclear reference, and that the Tricontinental documentation tends to suggest the contrary.

Counsel assisting submit that, on the evidence as it presently stands, it is open to the Commission to find that the substantial shareholder notices lodged by Mr Ziebell should have disclosed particulars of the put option and repurchase agreement between Tricontinental and JMM, and details of the Messara/Caplice agreement if they were known. Particularly, counsel argue, clauses 1(d) and 6 of the notice of 15 March 1985 (see para 17 above), and paragraph B(d) and (e) of the notice of 12 December 1985 (see para 20 above), should have disclosed the true situation. The same submission is made about the other notices, but it should be noted that they were only produced at a late stage and Mr Ziebell was not questioned about them.

Counsel assisting submit that Tricontinental had a relevant interest in the Southland parcel (see s136(2) Companies Code) and that Tricontinental, Messara/JMM and Caplice/HVRN were associates for the purposes of the Code (s136(3)). Counsel submit that Messara was not just acting as a broker and that he would not be able to claim the exemption (as a professional adviser) under s136(4) of the Code.

The Southland parcel was in excess of the prescribed percentage, namely 10% (s136(9)). Accordingly, counsel assisting submit Tricontinental, Messara/JMM and Caplice/HVRN were required to provide notices in the prescribed forms to Southland (and later to Devex) which specified their own relevant interests and those of their associates (s137(1)). Similarly, counsel argue, the numerous changes in interests of substantial shareholdings were required to be notified (s138(1)).

Counsel assisting submit that Mr Gynther's letter to Mr Chandler makes it clear that officers at Tricontinental recognised that the transaction with
Messara (and others like it) constituted "warehousing" and a breach of the Code. Counsel assisting submit that Mr Gynther was both defensive and evasive in his evidence on this matter. For example, he was unable to provide a satisfactory explanation as to the circumstances in which he came to consider the JMM submission and write to Mr Chandler.

Counsel assisting also submit that it is open to the Commission to find that Tricontinental, Ziebell, Messara/JMM and Caplice/HVRN have breached ss137 and 138 of the Code and that, accordingly, recommendations should be made that those persons be so charged. Counsel note, however, that the Commission may be reluctant to make such a recommendation concerning Messara, since he was not called as a witness.

Counsel for Mr Ziebell and other Tricontinental staff members submit that there is no evidence to suggest that, when signing the substantial shareholder notices on 15 March and 12 December 1985, Mr Ziebell knew of Messara's interest, or for that matter HVRN's interest, in the Southland shares. Counsel submit that there is no evidence on which the Commission could find that any officer of Tricontinental deliberately misled the NCSC in regard to this matter.

Counsel for Tricontinental staff also submit generally that, as Mr Johns and Mr Messara were (missing) pivotal witnesses in this matter, it is not open to the Commission to make findings in accordance with the submissions of counsel assisting.

In response to counsel assisting's submission that Mr Ziebell breached ss137 and 138 of the Code, counsel for Mr Ziebell submit that these sections are directed to "a person who is a substantial shareholder" and require this person to lodge the required notice when there is a change in the relevant shareholding of that person. Counsel submit there is no
evidence that Mr Ziebell at any stage held any shares in Southland and/or Devex on his own behalf - this is undoubtedly true.

The Commission understands that counsel assisting's submission concerning Mr Ziebell's culpability under ss137 and 138 of the Code was based on the effect of s572 of the Code which, assuming a breach of s138 has resulted in an offence pursuant to ss144, would make Mr Ziebell liable if he was knowingly concerned in or a party to that contravention. The Commission also notes the effect of s135 of the Code, which makes it clear that the obligation to comply with ss137 and 138 extend to both natural persons and corporations. However, with regard to Mr Ziebell's conduct, other sections of the Code appear more directly relevant, namely ss563(2) and (3) and ss564(1) and (2) (which deal with an officer making a false or misleading statement in a document required by the Code and/or furnished to a securities exchange, or failing to take all reasonable steps to ensure that such a document was not false or misleading).

Counsel for Mr Ziebell submit that he had no knowledge of any illegality and properly relied upon others for the information recorded, and they contend that he was not a party to any agreements or arrangements.

The Commission has received a submission on behalf of Mr Caplice. It argues that, on the facts, Mr Caplice himself did not have an entitlement to the share parcel (even if HVRN were entitled to any shares, which is not conceded). It is further submitted that Messara, JMM and HVRN were not 'associated' with respect to the Southland parcel, within the meaning of s136(3). Specifically, it is submitted that the agreement of 20 February 1985 does not:

(i) give to HVRN any control over the voting power attached to the shares;
(ii) have any provisions relating to control over the board of Southland or its affairs;
(iii) contemplate the acquisition of the shares by one party from the other; or

(iv) give HVRN any influence over the disposal of the shares.

Further, it is submitted that there is insufficient evidence to make a finding that Messara had a relevant interest in the shares, as the existence of a put option and repurchase agreement between Messara and Tricontinental is unproved and, even if it were in existence, such an agreement would not necessarily give Messara any relevant control over the shares.

Finally, it is argued on behalf of Mr Caplice that, notwithstanding Mr Ziebell's concessions in respect of the substantial shareholder notices, neither of the paragraphs on the form called for the disclosure of the assumed put option or repurchase agreement.

The Commission has also received a submission from solicitors on behalf of Mr Messara. The solicitors submit, in effect, that there would be a breach of the rules of procedural fairness for the Commission to make any adverse findings against Mr Messara. This submission is based, in part, on Messara's apparent willingness to give evidence before the Commission, his inability to do so due to being overseas on business and the absence of evidence from Johns, who, it is suggested, could corroborate Messara's evidence. The solicitors suggest Messara's evidence is to the effect that the shares were in TCL's name as part of a commercial deal structured by Johns whereby at all times TCL knew Messara was acting as an intermediary and broker for and on behalf of HVRN. It is argued that counsel assisting's submission that Messara's connection should have been disclosed, overlooks his role as broker and the effect of the exemption provisions of s8(8) and s136(4) of the Code. The solicitors note further that, at the relevant time, it was not the practice to treat shares, the subject of a put option, as having the requisite interest in the puttee. Specific reference is made to an NCSC practice note (release 335 effective from 28 January 1986). In any case, it is submitted that counsel assisting's
submission that Messara was not just acting as broker is untenable in light of the Messara/Caplice agreement (which, they argue, correctly identifies Messara's role as broker), and the accounts of Rebecca and HVRN which show that those companies claimed beneficial interest in the shares.

The Commissioners also received a submission from Tricontinental in respect of the suggestion from counsel assisting that Tricontinental may have breached the Companies Code. Counsel for Tricontinental submit it would be a barren and fruitless exercise to seek convictions against Tricontinental now in respect of alleged offences occurring as long ago as 1986. Counsel observe that the Tricontinental of today is vastly different from the Tricontinental of yesterday and that, even if Tricontinental was guilty of some offence, the only penalty which could be imposed is that of a fine which would be paid by the effective owner of Tricontinental, the State of Victoria.

(o) Devex takeover of Southland

Counsel assisting submit that the takeover documents contained a number of false or misleading statements or at least omitted material information, namely:

(i) that Messara held only 1,006 Southland shares when in fact Tricontinental held 2,020,400 shares (15.19%) on behalf of Messara/JMM;
(ii) the details of the Messara/JMM/HVRN agreement;
(iii) the ability of Messara to deal with and/or influence dealings in the Southland share parcel.

Counsel assisting submit that in these circumstances, as the chairman and a director of both Devex and Southland, Mr Messara was obliged to comment on the offer. Counsel argue he well knew there was "other information material to the making of a decision by the holders of shares whether or not to accept an offer by Devex", being information that was
within his own knowledge and which he was obliged to disclose to the holders of shares, namely details of his arrangement with Tricontinental and Mr Caplice. Counsel assisting submit that failure to so inform shareholders might have left them favourably influenced by Tricontinental’s apparently independent acceptance of the offer.

Section 44(1) of the Companies (Acquisition of Shares) Code (‘CASA’) made it an offence for a Part A statement and other relevant documentation to contain:

"(a) matter that is false in a material particular or materially misleading in the form or context in which it appears; or

(b) ... an omission of material matter from such a statement, offer or notice".

Accordingly, counsel assisting submit that, on the evidence as it presently stands, it is open to the Commission to find that Messara has breached s44 of CASA, and that such a charge should be recommended. Again, counsel note that the Commission may be reluctant to make such a recommendation given that Mr Messara was not called as a witness.

As already noted, the solicitors acting on behalf of Mr Messara submit that, in so far as JMM entered into arrangements with Tricontinental at the behest of Mr Johns, it did so in its capacity as a broker, and that there can be no question of any wrongdoing on the part of JMM or Messara. It is submitted that, as Messara was both chairman of Devex and a director of Southland, it was completely appropriate that he should have refused to comment on the offer, especially as many of the shareholders in both companies were his clients (as he acted as a broker for substantial placements of shares in both companies). The solicitors note that an independent expert’s report was obtained in respect of the takeover. They submit that Messara had no motive for not disclosing an interest in the shares (if in fact he had one) and that the true explanation is that he had no perception of having a relevant interest, because he was acting as a broker.
It is submitted that it is inaccurate to say that Tricontinental held 2,020,400 shares on behalf of Messara. It is submitted that the position was that Tricontinental held the shares legally on its own behalf, subject to a put option to JMM, who was acting as broker for HVRN. In these circumstances, it is submitted that Messara had no obligation to comment on the offer, except as he did. Finally, it is observed that the Commission has not had the benefit of hearing from the solicitors who were retained to prepare the Part A statement.

The evidence also discloses:
(i) that Tricontinental had been appointed financial adviser to Devex on 14 October 1985;
(ii) that Ziebell and Johns knew of the takeover offer; and
(iii) that Tricontinental would have received copies of the takeover documentation.

Counsel assisting observe that there is insufficient evidence, however, to conclude that a breach of s44 CASA has been committed by Tricontinental, Ziebell or Johns. Counsel assisting nevertheless submit that this is a matter which would be appropriate for further investigation by the ASC.

C. Conclusions and Findings - Southland
Having carefully considered the evidence and submissions, the Commission finds itself quite unable to reach any clear conclusion that offences were committed in dealings with Southland shares.

It is true that the circumstances give rise to suspicions of warehousing and of a lack of frankness in some of the substantial shareholder notices required by law. The Commission draws these matters to the attention of the Australian Securities Commission, in case it should take a more serious view of the matter but, in light of the reasonably plausible explanations offered by solicitors for the various parties, the generally ambiguous nature of the arrangements between Messara, Caplice and Johns, and the time that
has elapsed since the events in question, the Commission makes no recommendation for further investigation. In particular, it believes it would be quite unjust if Mr Ziebell, a minor player on any view, were singled out for further attention.

D. The ARABS Transaction
(a) Summary

On 3 March 1986, under discretion, Mr Johns approved a facility for $1.35m which was made available to Mr Messara, in the form of "a put option and repurchase agreement", under a letter of offer dated 11 March. The funds were actually used by Tricontinental to purchase 1,000,000 ARABS shares at a cost of $1.35 per share, which were then held in Tricontinental's name. The facility was to be secured by the share parcel. The letter of offer to Messara referred to the put option and repurchase agreement between Tricontinental and Messara and/or his nominee (the purchaser), and provided that all Tricontinental's fees and costs would be paid, and there would be a guaranteed net return of 25% p.a. By 17 April 1986 Tricontinental had a book profit of $550,000 (40.7%). On the basis of discussions with Messara, Johns told Ziebell that a much greater profit would be achieved.

On 10 May it was publicly announced that ARABS and Mr Robert Sangster's horse racing interests would enter a major joint venture project worth $17.5m. The ARABS share price increased significantly. It was agreed between Messara and Johns that there would be a 50/50 profit share on the sale of the shares. Communications both within Tricontinental and between Tricontinental and Messara were characterised by extreme confidentiality. The share parcel was sold on 27 June and repurchased on 30 June (by Tricontinental) for the same price. Tricontinental and Messara shared a profit of $865,000 each. Of Messara's profit, $725,000 was intended to be used to pay the interest costs on HVRN's facility of $4.02m which had been used to purchase the Southland share parcel. The balance
of $140,000 was paid to Messara. The two profit share payments were disguised by the parties raising invoices for these amounts which allegedly covered advisory services or consulting fees provided by Rebecca (one of Caplice's entities) and JMM to Tricontinental. In September 1986 and October 1987, aspects of this transaction were investigated by the National Companies and Securities Commission ('NCSC') and the Australian Tax Office ('ATO') respectively. By December 1988 Tricontinental had invested more than $14m in ARABS shares, accumulating approximately 3,600,000 shares and 2,000,000 options. As at January 1992, there was an anticipated loss for Tricontinental of $19.75m on the investment (including holding costs).

(b) Chronology

The chronology of relevant events is as follows:

1986

3 March Under discretion Johns arranged that Tricontinental would subscribe for 1m ordinary ARABS shares at $1.35 each.
6 March Credit submission seeking approval for an investment banking facility of $1.35m.
11 March Letter of offer to Messara incorporating a put option and repurchase agreement, whereby Tricontinental was to receive a net return of 25% per year.
16 April Johns met Messara. Discussed book profit to date of $550,000 (40.7%) and Messara indicated a much greater profit would be achieved. Johns agreed to pay Messara a small consultancy fee.
17 April Johns' confidential memo to Ziebell outlining discussion with Messara on 16 April.
2 May Johns' letter to Messara confirming that Tricontinental would pay a professional services fee to him based on the performance of ARABS shares.
ARABS/Sangster joint venture announced.

12 May  Johns’ memo to Catterson (Johns had agreed to provide standby facility of $10m to ARABS pending approval at an extraordinary general meeting to increase authorised capital and for a share placement to raise $10m).

23 May  Johns’ confidential letter to Messara (offsetting Messara’s profit on sale of ARABS shares against interest owed by HVRN on Southland facility).

19 June  Caplice/Rebecca seek payment by Tricontinental of $725,000 for "referral and advisory" services.

20 June  Johns’ confidential memo to Ziebell (Tricontinental to sell ARAB shares on 27 June at $3.20 per share).

23 June  Caplice/HVRN letter to Johns, enclosing HVRN’s payment of $725,000 for interest on Southland facility. Cheque no. 360869 for $725,000 drawn by Tricontinental in favour of Rebecca.

27 June  Tricontinental sold shareholding in ARABS for $3.20 per share through Messara. Profit share owing to Messara was $865,000 of which $725,000 was intended to be accounted for internally to cover holding costs associated with the loan to HVRN for Southland shares. The balance ($140,000) was to be paid to Messara.

30 June  Tricontinental repurchased the shares (at $3.20 ps).

1 July  JMM invoiced Tricontinental for $140,000 for "consultancy fees".

3 July  Tricontinental paid JMM $140,000 "consulting fees".

15 July  Messara requested Johns to pay stamp duty and brokerage fees ($25,600) for the sale and repurchase of the ARABS shares.

1 September  Tricontinental (Johns) responded to NCSC inquiry.
15 December Tricontinental agreed to subscribe for a further placement of 1,917,911 ARABS shares at $3 ps which would increase Tricontinental’s holding from 6.1% to 16%.

16 December Credit submission seeking to increase the facility from $1.35m to $7.2m (total consideration for further ARABS shares was $5,753,733).

1987

26 March Credit submission seeking to increase the facility from $7.2m to $9m.

23 July Credit submission seeking to increase the facility to $11.85m (to enable Tricontinental to take up 1,458,955 June 1992 options under a 1 for 2 rights issue for consideration of $2.04m).

14 August Tricontinental acquired a further 182,000 shares in ARABS at a cost of $3.10 ps. Tricontinental’s holding 14.59% of ordinary shares in ARABS.

18 August Credit submission seeking approval to increase facility from $11.85m to $12.45m.

31 August Tricontinental acquired a further 300,000 shares in ARABS at a cost of $3.23 ps.

28 September Credit submission seeking to increase facility from $12.45m to $13.42m.

October ARABS changed its name to Arrowfield Group Limited.

13 October Johns’ letter to Messara seeking comprehensive details of invoices relating to the professional fees paid to him in June 1986 as the ATO was investigating the transaction.

13 November Caplice/Rebecca letter to Johns re details of the $725,000 payment.
1988

February  
Johns' report to Tricontinental board re ATO inquiry (reference to "fees" paid to Messara being disallowed, no mention of Rebecca "fee").

21 March  
Messara letter to Johns telling him not to be concerned with the price of Arrowfield shares as he was lining up a strong party to take out the stock in the market and the price was expected to recover swiftly.

August  
Tricontinental purchased a further 204,963 Arrowfield shares.

19 December  
Johns wrote to Solomon Lew to confirm that Messara was seeking a friendly purchaser for 4,415,396 ordinary Arrowfield shares at $2.70 per share. Messara was to provide a put arrangement for shares to be put at cost in 2.5 years. To support the put arrangement Tricontinental was to provide its guarantee to support Messara.

23 December  
Credit submission seeking to increase facility from $13.42m to $14.07m.

(c) Narrative

85 On 3 March 1986 Mr Johns informed Mr Tony Goad that, under discretion, he had agreed that Tricontinental would subscribe for 1,000,000 ARABS shares (at $1.35 per share). Johns told Goad that "under investment banking guidelines, it is anticipated that Tricontinental will achieve a return of not less than 25% on its investment".

86 The credit submission noted that Messara's interests were about to become the major shareholder of ARABS. The submission stated that the purpose of the facility was to enable Tricontinental to purchase the 1,000,000 shares. Security was stated to be over the shares which were trading at
$1.48 (as at 4 March 1986). There was no mention of any put option or repurchase agreement between Tricontinental and Messara.

A letter of offer dated 11 March 1986 was sent by Johns to Messara. In it Johns said that Tricontinental would purchase ARABS shares to a maximum value of $1.35m, subject to a put option and repurchase agreement between Tricontinental and JMM whereby, "the purchaser shall repurchase the shares ... for the price paid by Tricontinental plus any fees or costs incurred by Tricontinental". Tricontinental was to exercise the put option on or before 31 March 1987 and to receive a net return of 25% per annum. Security was not mentioned. A handwritten notation appears on the letter. It suggests that Tricontinental's 25% return was to come from a fee of 0.03c per share per month, ie, $30,000 per month. They were also to receive "50/50 on profit". It is not known when, or by whom, this notation was written.

On 17 April 1986 Johns wrote a "highly confidential" memorandum to Ziebell. He said that, following a meeting with Messara on 26 April (presumably meaning 16 April, based on Johns' diary), it was confirmed that Tricontinental's ARABS share parcel was "held for its own account". This suggested a category B investment. He said the book profit to date was $550,000 (purchase price $1.35 p.s., market price $1.90 p.s.). Although this represented a return of 40.7% (well over the expected 25% return) Mr Johns said "... from discussion with John Messara a much greater profit will be achieved. It is proposed to sell parcel prior to 30/6/86 - however please do not budget for extra profit yet. ... P.S. I have agreed to pay Messara a small consultancy fee".

On 2 May 1986, Johns wrote to Messara saying, "Tricontinental is prepared to effect a professional services fee payment to yourself based on the performance of ARABS shares and profit received by Tricontinental from its sale of the shares". Mr Johns then proposed that the professional
services fee would equal 50% of the differential between the end sale price less the cost of the shares and holding costs at $30,000 per month. In effect Tricontinental entered into a 50/50 profit share arrangement with Messara.

(d) ARABS bid for Sangster interests

On 10 May 1986 (through a facsimile generated by Kolback Corporation, the Caplice company) Mr Messara and Mr Robert Sangster issued a joint press release. In part, this stated:

"The establishment of an alliance which could have a profound impact on the Australasian thoroughbred scene was announced today. The report of a joint venture between Australian Racing & Breeding Stables Limited (ARABS) and interests associated with Mr Robert Sangster represents the largest bloodstock deal ever consummated in this part of the world. ARABS, Australia's first listed thoroughbred company will hold a 70% interest in the southern hemisphere breeding interests formerly owned by Mr Sangster's Swettenham stud* ('the Messara/Sangster joint venture').

Mr Messara announced that the deal was worth $17.5m. ARABS intended to seek a listing on the New Zealand stock exchange and would investigate the possibility of a Hong Kong stock exchange listing. Notice of the arrangement was provided to the various Australian associated stock exchanges on the same day. The ARABS share price increased from $1.35 (6 March 1986) to $2.90 (10 May 1986 - date of joint press statement) then to a high of $3.50 in July 1986. (A submission on behalf of Mr Messara suggests that the price increased to a high of $4.60 in or about October 1987.)

The materials before the Commission do not disclose the date when the Messara/Sangster joint venture was first discussed. Particularly, it is unclear whether Mr Johns' statement to Mr Ziebell of 17 April 1986 - that from discussion with Messara "a much greater profit will be achieved" - was related to the joint venture and, at that time, the product of confidential information. As well it is unclear when the 50/50 profit share
arrangement was first struck between Johns and Messara. There was
certainly no mention of it in the letter of offer (only in the undated
handwritten notation). Mr Messara said in his ASC examination that, at
the time he was negotiating the purchase of the ARABS share parcel, there
were no discussions regarding the joint venture with Mr Sangster as "that
came later, quite a bit later". Mr Caplice claimed he had no knowledge of
this proposal until the public announcement on 10 May 1986. He said he
had no interest in what Messara was doing with Mr Sangster.

Of the $17.5m it would cost ARABS to acquire a 70% interest in Mr
Sangster's thoroughbred interests in Australia, $10m was to be paid by 30
June 1986. On 12 May 1986 Johns told Catterson that he had indicated to
ARABS directors that Tricontinental would provide a standby facility of
$10m to ARABS, pending approval at ARABS' extraordinary general
meeting to increase authorised capital and make a share placement to raise
$10m. Johns said that, although it was highly unlikely that the facility
would be used, it had to be approved. He noted that the ARABS share
price was expected to increase from $2.40 to not less than $3 per share.

(e) Tricontinental/Messara profit share

On 23 May 1986 in an "extremely private and confidential" letter to
Messara, Johns referred to the 50/50 profit share arrangement which had
been struck and continued:

"Secondly, during subsequent discussion it was agreed that
Tricontinental would upon sale, and effective at 30 June 1986, effect
a contra transaction between your 50% share of sale profit (as
described above) and fees due and payable by HVRN Nominees Pty
Ltd, of $725,000 on 30 June 1986. For this transaction to be
effected Tricontinental will need to sell its ARAB holding prior to 30
June 1986, however, would always consider undertaking a similar
investment in July 1986."

For this transaction to take place smoothly, Mr Johns said it was desirable
for Tricontinental to sell its ARABS investment for $2.92m (that is, for
$2.92 per share), giving a profit of $725,000 to each of HVRN and
Tricontinental (Tricontinental’s purchase and holding costs aside). He said that, in these circumstances, Tricontinental would be pleased to extend its arrangement, that is, extend its loan to HVRN for a further 12 months.

As noted (at para 40 above) Tricontinental had extended a facility of $4.02m to HVRN following Mr Caplice’s request that HVRN become the registered owner of the Southland shares (para 27 above). Under these arrangements the sum of $725,000 was payable, on 30 June 1986, by HVRN to Tricontinental.

On 20 June 1986, Mr Johns wrote to Mr Ziebell in a "strictly private and confidential" note confirming their recent discussion that Tricontinental would sell its ARAB share parcel through John Messara on 27 June 1986 for the increased figure of $3.20 per share. This gave a profit to Tricontinental and Messara of $865,000 each, in addition to repayment of principal and holding costs to Tricontinental. As to Messara’s profit share Johns said, "$725,000 is to be accounted internally to cover holding/interest costs of the loan to HVRN Nominees Pty Ltd. Balance will be payable to John Messara who will invoice separately after 1/7/86, (ie account how you wish)".

On 23 June 1986 Mr Caplice, as solicitor on behalf of HVRN, wrote to Mr Johns enclosing a cheque from Rebecca for $725,000. The covering letter indicated the cheque was from HVRN covering the fees payable on the HVRN (Southland) facility as at 30 June 1986. However Tricontinental’s cash book shows the cheque received was drawn on Rebecca’s account. On the same day, Tricontinental drew a cheque for $725,000 in favour of Rebecca from Tricontinental’s Westpac, Sydney, account. The cash book records the receipt from and payment to Rebecca as "chq swap - authorised by Ziebell". It would appear that, rather than Tricontinental simply effecting a book entry to record the profit share off-set, physical exchange of cheques occurred between Tricontinental and Rebecca.
Mr Caplice claimed that, notwithstanding his very close relationship with Mr Messara, he had no knowledge that Messara had arranged for HVRN's obligation to pay fees of $725,000 to be off-set against any profit to be paid to Messara.

(f) Sale and repurchase of the ARABS shares

On 27 June 1986, Tricontinental sold the 1,000,000 ARABS shares for $3.2m through the Sydney stockbrokers, Anschaus (with whom Messara worked as a consultant). On 30 June 1986 Tricontinental repurchased the same parcel of shares for precisely the same amount, $3.2m. Mr Messara sent a private and confidential note to Mr Johns, dated 15 July 1986, requesting payment of $19,200 stamp duty and $6,400 brokerage in respect of the sale and repurchase of the shares. The Tricontinental administration account records two payments to Anschaus, one for $19,200 and one for $6,400.

The question arises as to whether the parcel of ARABS shares was actually sold onto the market before it was repurchased by Tricontinental. Anschaus' file was unable to be found when the Commission sought its production. The ARABS share register does not record any sale and repurchase of such a large parcel (6%) and, as already noted, Mr Johns had settled on a sale price before the shares were traded. In later correspondence he informed the ATO that Tricontinental instructed Anschaus to sell at $3.20 "being the current market price and we advised that we intended to buy this line of stock back on the 30th June 1986".

Clearly Tricontinental and Mr Messara were anxious to crystallise the profit before the end of the financial year. Tricontinental repurchased the shares in its own name (presumably because it considered them to be a good investment). Between June 1986 and December 1988, Tricontinental purchased more than $14m worth of ARABS shares. As at January 1992
the anticipated loss (including holding costs) for this investment was $19.75m.

(g) Attempts to disguise profit share

It will be recalled that, of Mr Messara's $865,000 profit share, $725,000 was to be off-set against the same amount which HVRN was obliged to pay Tricontinental by 30 June 1986. On 1 July 1986, JMM sought payment of the balance of Messara's profit share by sending an account to Tricontinental for $140,000 (as altered), for "consulting fees as agreed for the period ending 4/7/86". This account was paid by Tricontinental on 3 July 1986.

On 19 June 1986 (letter incorrectly dated 19 July 1986) Mr Caplice wrote on behalf of Rebecca to Mr Johns, seeking the payment of $725,000 (as amended), representing the balance of the profit share. Mr Caplice stated that Rebecca had been "associated with your group in a referral and advisory capacity on numerous matters over the last 12 months". He detailed some particular companies said to be relevant, and continued:

"Our client company feels the goodwill and business opportunities generated by it and the general backup advisory services provided over the year (particularly in regard to the group's retail clothing customers) would warrant an overall fee of $725,000. This figure has been arrived at on the basis of a monthly retainer of $60,000 which earlier trial arrangements you have been apparently prepared to allow to accumulate considering the active association we have enjoyed over the last 12 months"

In evidence Mr Caplice explained how the Rebecca invoice for $725,000 came about. He said that, in June 1986, Messara came to him indicating that his profit share was $725,000 and that Tricontinental wanted a letter along the lines of "consultancy fees" for the $725,000. Accordingly, he drafted the letter of 19 June 1986 which was approved by Messara. Although reluctant to do so, Mr Caplice ultimately conceded that only some $33,000 out of the total of $725,000 could be genuinely claimed for advisory services provided to Tricontinental. Nevertheless, he refused to
agree with counsel assisting’s suggestion that the balance of the claim ($692,000) was simply a concoction to serve Tricontinental’s needs. Tricontinental’s cash book shows a payment of $725,000 to Rebecca on 23 June 1986 (refer para 97 above). This payment was made four days before the sale of the ARABS shares.

(h) Alleged Messara/Caplice arrangement

In evidence, Mr Caplice said that Rebecca was the true beneficial owner of the ARABS share parcel. He said that, as with the Southland share parcel, Messara had approached him with the proposal that Rebecca enter into a profit sharing arrangement with Tricontinental. This was, he said, first proposed around March 1986. As Mr Caplice explained it, Messara "said he would manage everything and negotiate it and on that basis I said to him [yes], with the same financial responsibility to my client if there was any loss or responsibility".

However, unlike the Southland transaction, there was no written agreement. Mr Caplice claimed that he had no control over the ARABS share parcel because Messara was to negotiate and manage the transaction and he (Caplice) did not have any contact at all with Tricontinental.

Mr Caplice had a very limited knowledge of the transaction. For instance, he said there was no mention of the 50/50 profit share, he just left it to Mr Messara to negotiate some sort of profit sharing arrangement. Mr Caplice had no knowledge of what the book profit on the share deal was at any particular time including the fact that at 17 April 1986 the profit available was $550,000. Although Mr Messara was to receive fees for managing the transaction, Mr. Caplice said, "I didn't know he would be getting any profit share if he did". In spite of that view, he claimed it came as no surprise that Tricontinental should pay $140,000 to Mr Messara as a profit share. He said, "I would have expected he would receive something out of a successful transaction like that". He said he did not know that there was
a put option and a repurchase agreement between Messara and Tricontinental. In fact he wasn’t aware of any of the arrangements which Messara may have been negotiating; in particular he had no knowledge of Tricontinental’s guaranteed 25% profit. He said that although Rebecca carried the risk, he, Caplice, had no control over the parcel because Messara was managing it. He was prepared to bear “whatever Messara said was the share of the loss”.

Mr Caplice claimed that, although he was obliged to pay Messara for his services, fees were not discussed. He merely presumed that Messara would charge brokerage fees and any other fees related to the success of the transaction.

Mr Caplice did not inform Tricontinental of his interest, notwithstanding the fact that, by this time, Tricontinental knew him through the facility it provided to HVRN in February 1986. Mr Caplice had no involvement in Messara’s negotiations with Tricontinental because, as he put it, he completely trusted Messara, who was acting as his broker. Mr Caplice claimed that he would not be wasting the, say, 10% he paid Messara for his services when he could have himself purchased the shares directly with Tricontinental because, as he said, “I wasn’t in the business of managing, negotiating and selling shares. Messara was doing all that on behalf of my client company. Why would I want to preclude Messara with our association?”.

In his ASC examination, Mr Messara said that he had approached Mr Johns to take an investment in ARABS as the company was being expanded through a float. He said that he could not be party to an arrangement involving a profit share split, and proposed that Mr Caplice would be part of the deal. The only benefit he claimed he gained out of the arrangement would be the brokerage, that was the underwriting fee, “and ultimately I was paid a professional fee for the thing being so successful. I was given a
bonus ...". He confirmed that the arrangement between himself and Caplice was never recorded in writing, although Caplice was behind him in meeting any obligations that he had. Mr Messara accepted that he understood the consultancy fees were really in respect of the profit share. He said that Mr Caplice had been a very good client of his for 15 or 20 years and that, at the date of the examination, he still dealt with him and saw him "all the time". He also confirmed his close racing associations with Mr Johns. At a later time Mr Messara was instrumental in seeking to sell the ARABS parcel to other prospective purchasers, including Mr Solomon Lew.

(i) NCSC/ATO inquiries

The NCSC and ATO conducted enquiries concerning some aspects of this transaction. By letter of 1 September 1986, Mr Johns informed the NCSC that the purpose behind the sale of the ARABS shares related to end-of-year tax planning. He said "Tricontinental Corporation Limited was the beneficial owner of the shares sold and is the beneficial owner of the shares reacquired".

On 13 October 1987, Johns wrote to Messara referring to the two payments of $140,000 and $725,000 for consulting services and confirmed his discussion that Tricontinental was being investigated by the ATO, which required further information and details of the two invoices. Johns asked that Messara provide such details.

As a result, on 13 November 1987, Mr Caplice wrote on behalf of Rebecca indicating that the bulk of the fee of $725,000 related to "our profit incentive" on the ARABS share deal. He said:

"You will remember our proposal that you take up a holding in the placement which was procured through us on the basis that you held the shares and we manage the investment and enjoy a profit incentive after you deducted your cost of funds".
This was the first suggestion that the profit share arrangement had been proposed by Mr Caplice or Rebecca to Tricontinental. The letter then set out the profit details, indicating that a payment of $692,000 represented a 40% profit incentive to Rebecca. This figure was then amalgamated with other fees for consulting and introduction services to Tricontinental, which was said to be a "convenient way of invoicing your company without conflicting with your accountancy practices which, considering your very competitive industry, we thought might require the highlighting of market performance". Mr Caplice concluded by saying that the full amount of the income derived from Tricontinental, namely $725,000, was disclosed under the general heading of consultancy income in Rebecca's 1986 return so "the full income on my company's side has been fully disclosed".

In February 1988, Johns reported to the Tricontinental board that, as a result of the ATO audit of Tricontinental, the amount claimed for fees paid to Messara was to be disallowed. No mention was made of the fees paid to Rebecca. Counsel assisting rely on this omission to suggest that the Rebecca fees did not form part of the ATO inquiry.

(j) Tricontinental's accounting procedures

Mr Ziebell said that he had no recollection at all of the ARABS transaction or of the Messara/Sangster joint venture. He said that the raising of the two invoices from Messara and Rebecca was a "mechanism" to disburse their share of the profit. He said the payments for these consultancy fees would have been deducted by Tricontinental for tax purposes. Mr Ziebell was responsible for signing those returns. He said the lack of documentation made it very difficult for Tricontinental in accounting for these sorts of transactions. He would not agree with counsel assisting's suggestion that the invoices were false documents in all the circumstances, although he did ultimately concede that this appeared to be the case. Mr Ziebell explained his problem (and Tricontinental's) in the following way:
"The problem that I had with some of these category A shares was that there would be various arrangements, whether it be profit sharing or whatever it happened to be and the way that we accounted for them, when we sold the shares they were in our name we took the profit, but in some cases the profit wasn't our profit and we then had to return that profit to another party, and that caused a lot of problems. It was something which was - because of lack of documentation, we had difficulty substantiating it for tax purposes, for audit purposes and I was conscious that I didn't want to be put in that situation and so I was trying to encourage the managing director to act on this before I was put in that problem.

... we needed to ensure that we could claim a deduction otherwise, if we couldn't, we'd end up being assessed for 100%, no deduction for 50% and in tax terms we would be at a disadvantage".

He agreed that ideally Tricontinental should have declared 50% of the profit for tax purposes and made it clear to the ATO that the remaining 50% went to somebody else, "But with a lack of documentation I'd have to be able to explain why I didn't take the other 50% profit".

The ARABS parcel was sold on 27 June 1986 so as to crystallise profit. Mr Ziebell explained that Tricontinental had the need to build up assessable income, whether that be from profit on sale or from fee income or interest income. Thus the shares were sold and repurchased in the same period because, as he said, "In our accounting policy we couldn't take revalued profit to income so we needed to sell to get assessable income". He assumed that the reason the parcel was repurchased was because Johns and Messara had a continuing relationship (in fact the shares were repurchased only by Tricontinental). The assessable income was off-set against dividend income.

Mr Ziebell said he never had any concerns that investment banking transactions might be breaking the law. He said this idea never crossed his mind. Tricontinental was simply providing a "service to clients".
(k) Role of Mr Johns

Mr Johns was extensively involved with this transaction. Particularly:

(i) he approved (under discretion) the initial facility to purchase the ARABS shares;

(ii) at this time, according to Messara, Johns knew that a client of Messara was part of the transaction;

(iii) he negotiated terms and conditions with Messara and (later) Caplice, settled the profit figure for sale of the shares and arranged the distribution of profit shares (disguised as advisory fee payments);

(iv) he closely directed Tricontinental staff in the transaction;

(v) he encouraged Ziebell to adopt (at the very least) questionable accounting practices for the transaction;

(vi) he supplied, on behalf of Tricontinental, answers to the NCSC/ATO inquiries; and

(vii) he reported developments to the board.

(I) Role of directors

Mr Ziebell

Mr Ziebell was kept informed of developments, particularly in confidential memoranda from Johns. He was told by Johns to "account how you wish" in respect of the offsetting of Messara's profit share against HVRN's holding/interest costs. Mr Ziebell was responsible for signing Tricontinental's taxation returns, which incorporated claims for fees paid based on allegedly false invoices, created to deal with profit received by Tricontinental on behalf of other persons.

Other directors

With the exception of Johns and Ziebell, directors were not involved in this transaction other than to approve, from time to time, investment banking credit submissions which increased the facility enabling Tricontinental to purchase more ARABS shares. As noted in para 1 above, the Commission
has not examined the question of credit risk assessment in respect of these investment banking transactions.

(m) Significant issues

The significant issues which the Commission has considered are:

(i) the true nature of the arrangements between Johns, Messara and Caplice; and

(ii) possible offences against the Code and the revenue laws.

(n) The arrangements between Johns, Messara and Caplice

Counsel assisting submit that a number of factors suggest no agreement existed between Mr Messara and Mr Caplice as contended in evidence by Mr Caplice. Counsel refer to the following matters:

(i) the lack of confirmatory documentation of any agreement;

(ii) the obvious lack of knowledge which Mr Caplice had of the arrangements;

(iii) the fact that Messara was prepared to guarantee a return to Tricontinental of at least 25% of its investment, in the absence of any written assumption of this liability by Mr Caplice; and

(iv) the fact that Messara himself received part of the profit share.

On the other hand, counsel assisting concede that Mr Messara was instrumental in arranging payment of the substantial portion of the profit share to Caplice/Rebecca. Counsel say he would be unlikely to do this unless there was some sort of agreement, as suggested, between himself and Mr Caplice.

In the absence of hearing from Mr Messara and taking some further evidence, counsel assisting submit it is not open to reach concluded views as to this particular aspect of the transaction.

The submission on behalf of Mr Messara contends that counsel assisting
have misconceived the true factual position as it concerned Mr Messara. It is submitted that, in respect of the ARABS shares, Tricontinental was always the beneficial owner, as the put option and repurchase agreement between Tricontinental and JMM (although suggested) never went ahead. The shares were not purchased on behalf of Messara, but rather by Tricontinental on a profit share basis with Rebecca. Further, it is argued that the transaction proceeded as a purchase by Tricontinental of the 1,000,000 shares as part of ARABS' placement to investors and institutions of 7,500,000 shares. Again it is submitted that, in return for acting as intermediary in the arrangement, JMM was to receive and did receive only a brokerage fee. It is submitted that the letter of 2 May 1986 is a retrospective reference to the original discussion and arrangement in respect of a fee to be paid to JMM. It is further submitted that Tricontinental was confused as to which of the Caplice-related entities (ie. HVRN or Rebecca) it was dealing with concerning the ARABS shares.

The solicitors for Mr Messara submit further that, around 30 June 1986, the shares were in fact crossed on the floor of the Exchange for tax or accounting purposes as disclosed by Johns to the NCSC (with no change of beneficial ownership). It is submitted that there is no evidence of any "trading", in any requisite sense, and that the shares have in fact been held by Tricontinental from March 1985 until the present.

The submission on behalf of Mr Messara does not explain why the Tricontinental documentation referred to Messara and/or his nominee entering into a put option and repurchase agreement and why this did not proceed as suggested, or why Johns wrote to Messara offering him a professional services fee to equal 50% of profit (if he was only taking a broker's fee) or why, if the shares were purchased as an investment by Tricontinental, it would offer Rebecca or anybody else 50% of its profits.
Possible dishonest statements and tax fraud

Counsel assisting submit that, on the evidence, it is open to the Commission to find that the invoices raised by JMM and Rebecca for $140,000 and $725,000 respectively, were false documents concocted at the request of Mr Johns to disguise the profit share payments on the sale of the ARABS parcel. Counsel submit that the reference to "professional service fee payment" made by Johns in his letter to Messara of 2 May 1986 was apparently false, and that made to the NCSC on 1 September 1986 (that Tricontinental was the beneficial owner of the shares sold) was arguably false.

Mr Ziebell explained that the raising of false invoices was a "mechanism" to distribute profit. Counsel assisting submit that Tricontinental was obliged to maintain appropriate documentation and to provide the ATO with a statement of the facts of a transaction which would enable the ATO to make its own decision as to what was or was not a proper deduction. Counsel assisting submit the same applies to the way in which the interests of Messara and Caplice dealt with these claims. The relevant taxation documents are not in evidence before the Commission. Counsel assisting submit that it would be appropriate for the Commission to refer this matter to the ASC (as to Tricontinental's accounting procedures) and/or to the ATO for further appropriate inquiries to be taken as to the possibility of any offences having been committed.

It is submitted on behalf of Mr Caplice that Tricontinental's "foolish practice" in respect of its accounting procedures ought not to suggest any culpability on the part of Mr Caplice. It is noted that Rebecca, for its part, declared the full amount received as assessable income in its taxation return for the year ended 30 June 1986. It is further submitted that counsel assisting's contention that the fees paid to Rebecca did not form part of the ATO inquiry is contradicted by Mr Johns' letter to Mr Messara of 13 October 1987, where he indicated that the ATO required further detail of
both invoices. In fact, in that letter, Mr Johns said the ATO was "seeking further information and details in relation to these discussions" (which he had had with Messara) and he asked Messara to provide more comprehensive details in relation to the two invoices. Counsel assisting's submission was based on the evidence that Mr Johns reported to the Tricontinental board that the amount claimed in respect of the fees paid to Messara was to be disallowed but made no mention one way or the other of the position concerning the Rebecca invoice for $725,000. The solicitors for Mr Caplice submit that the proper conclusion to be drawn is that the ATO investigated the Rebecca payments and was satisfied and, in that case, there is no need to refer it to them again.

Counsel for Tricontinental submit on this matter that the Commission should not refer the matter to the ATO. Counsel rely on the matters outlined at paragraph 74 above and contend, in addition, that the ATO has already investigated the two invoices, the deduction claimed from the Messara payment has been disallowed and, perhaps most importantly, once it is accepted that Tricontinental was only entitled to a share of the profit, it necessarily follows that Tricontinental could derive no tax benefits by making arrangements which had the effect of transferring to Messara and Rebecca their respective shares of the profit.

Counsel for the directors and Tricontinental staff submit generally that it is abundantly clear that Mr Johns played a dominating role in this investment banking transaction. It is submitted that any role played by Mr Ziebell was only at the direction of Johns and limited to implementing his instructions. Counsel submit there is no evidence of any improper conduct on the part of Ziebell in accounting for the transaction, contending that there is no evidence that Ziebell ever spoke to Messara or that he was aware that HVRN was a company associated with Caplice. He had no business relationship with Rebecca, nor was he aware of the details of the invoices. Finally, counsel submit that the Tricontinental accounts for the year ended
30 June 1986 correctly recorded Tricontinental's profit of $865,000. In summary, counsel submit that there is no evidence to establish that officers of Tricontinental, other than Johns, knew of any possible illegality surrounding the transaction.

Counsel for the directors and Tricontinental staff submit that it would be inappropriate to refer this matter to the ASC or the ATO for further inquiries as to the activities of Mr Ziebell as he has already been subjected to searching inquiry and he ought to be exonerated.

E. Conclusions and Findings - ARABS

In the absence of evidence from two of the three main actors in this transaction, the Commission is unable to identify its true nature. It seems probable that Mr Messara was undertaking the initial risk pursuant to some arrangement between himself and Mr Caplice. It was this risk which entitled them to a half-share of the profits. After this distribution occurred, Tricontinental continued to invest progressively at its own risk, and lost heavily.

So far as any further investigations are concerned, the Commission would have considered recommending them were it not for the fact that the transaction was looked at by both the NCSC and the ATO in 1986 and 1987 respectively.

As it is, having considered the various submissions made, the Commission believes no good purpose would be served by revisiting these matters. In particular, it would not be appropriate to consider any action against Mr Ziebell, particularly in view of his minor and subordinate role in the events which occurred.
The Commission reviewed 43 transactions in private, some of them inter-related. Nine involved investment banking, another nine the financing of share purchases or underwriting, the same number again were for refinancing or the provision of working capital, eight concerned commercial or farming properties, and five provided construction finance for commercial developments. There were three miscellaneous loans and, because some transactions had more than one object, there were also several other purposes involved.

Of those 43 transactions, there were six lending transactions in which no losses were sustained and, accordingly, these have not been named in appendix 4 which list these privately-reviewed transactions. One of these appears to be a quite exemplary loan which was put together by a Tricontinental officer whose name has not otherwise come to the Commission’s notice. This officer was familiar with the industry concerned with the loan, which no doubt assisted him in framing appropriate preconditions and terms for the finance agreement.

In three of the other cases where no loss resulted, some risk was taken with apparently inadequate security. However, because the loan was properly serviced, and the borrower had the resources to pay it out, questions of security never arose.

Of the investment banking cases reviewed, a number raised questions of propriety, particularly warehousing, which the Commission has not had the opportunity to investigate. It is possible that the questions may be investigated elsewhere. In three instances it appears that lack of documentation has led to losses being incurred. In some of the remaining cases useful profits were earned.
The remaining 29 lending transactions provided, on the face of the documentary evidence, instances of the following defects in practices or procedures which were also noted in the case of transactions examined publicly.

(a) There were no less than eight instances of loans being approved by directors before any credit submission had been prepared. In some cases only two or three directors gave approval.

(b) In six cases there was no sufficient evidence in the credit submission of capacity to service the loan. In four of these cases it became necessary to capitalise interest.

(c) In eleven instances there appeared to be quite inadequate financial analysis of the borrower to enable decisions to be reached about its capacity to service the loan or ultimately repay it. The source of repayment was often stated in vague terms, such as "sale of shares, refinance and/or cashflow".

(d) There were five instances where preconditions were either changed or disregarded without reference back to the directors who had approved the credit submission. Most of these cases involved valuations which were either not obtained or which proved to be significantly lower than the figure set as a precondition for the loan. There were also two other instances where directors were not consulted in circumstances in which it seemed that they should have been. In one case a significant commitment to a third party was undertaken and in the other case a request from a director for further information was apparently ignored.

(e) In two cases the identity of the borrower was changed from one company to another related company without reference back to directors who had approved the loan.

(f) There were four cases in which the security taken involved a substantial holding of shares. If it had been necessary to call upon the security it would obviously have been very difficult to obtain the
price for the shares at which they had been valued for security purposes.

(g) In six instances there was a failure to disclose, in the credit submission, substantial related exposures.

(h) In five instances it appeared that substantial security was released and poorer security accepted in order to suit the convenience of the borrower.

(i) There were three cases in which valuations were not checked by Tricontinental and five cases in which the amount of the loan either equalled or exceeded 100% of the valuation of property secured, or of the development and construction costs of a project for which money was being lent.

(j) In one instance a loan was allowed to be drawn down before appropriate approvals or permits for construction had been obtained.

(k) There were six cases in which it appeared that there may have been deceptive conduct by the borrower, either in the course of obtaining the loan or during later negotiations for additional moneys or extensions of time.

(l) Finally, there were no less than 13 instances in which it appeared that it might have been appropriate to direct some attention to the way in which SBV handled the transaction after integration. In no case was there any suggestion that SBV had acted with undue haste or lack of sympathy for the borrower’s problems. In all cases the question was whether SBV had been unduly sympathetic to, or slow in pursuing remedies against, borrowers in default.

The managing director was closely involved in a large number of the transactions reviewed. He was often the initial point of contact and, in a number of cases, was account manager. He approved 17 submissions under his discretion.