Pacific West Health Medical Center Inc. Employees Retirement Trust et al ...ld Greenwich Group et al Doc. 106 Att. 12

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PASHA S. ANWAR, *et al.*, Plaintiffs, v. FAIRFIELD GREENWICH LIMITED, *et al.*, Defendant. This Document Relates To: All Actions	Master File No. 09-cv-118 (VM)

Affidavit of Mark A C Diel

Tab 9

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329 In my view, their position of conflict of interest led Messrs Mullins and Rees to take an excessively over-optimistic view of the financial position of the Rendell group during the period from November 1985 to April 1986, while they were negotiating the acquisition of the Rendell Industries shares on behalf of Aequitas No 1 and assisting in the preparation of a private placement memorandum for investments by external investors into Aequitas. The recurrent financial difficulties experienced by the Rendell group in the period from November 1985 (when the share sale deed was entered into) and March/April 1986 (when substantial investments were made into Aequitas) were well known to Mr Mullins and Mr Rees. Both of them were directors of Rendell Industries, and Mr Rees was a director of RIH, the intermediate holding company which dealt in detail with the group's business operations.

330 I have given a detailed account of the development of the Rendell group's financial difficulties during the period from October 1985 to April 1986. It must have been evident to Mr Rees, by the time of the meeting of the board of RIH on 27 November 1985, that the financial difficulties of the group gave grounds for serious concern about future solvency. Messrs Mullins and Rees were aware of the financial crisis that led the ANZ Bank to refuse to meet a substantial payment to the Australian Taxation Office late in November 1985, and Mr Rees was very much involved in subsequent events concerning Rendell, busily preparing notes about AEFC's exposure to the Rendell group and about the group's financial problems generally. Mr Rees was a principal conduit between the Rendell group and AEFC, defending AEFC's position at the Rendell Industries board meeting on 5 December 1985 and writing frequent memoranda for Mr Gledhill and Mr Kelly on the developing financial position of the group. It eventually emerged that the Rendell group was in a worse position than Messrs Rees and Mullins believed, because Mr Griffin had failed to disclose various matters and, it was said, had engaged in fraudulent activities. But even on the basis of what was known, it was plain that during the period from November 1985 to April 1986 the Rendell group suffered recurrent and serious liquidity difficulties.

331 Messrs Mullins and Rees, together with Mr Gallois (AEFC's appointee to the board of RIH), were the sources of information for Bache when the underwriting and draft information memorandum were negotiated in March 1986. There is very little information in evidence about the nature and extent of the disclosure made by them to Bache, apart from the private placement memorandum itself. The statement in the private placement memorandum about the Rendell group is, as I have noted, very different from the information constantly accumulating, to the knowledge of Messrs Mullins and Rees, about the worsening financial affairs of the group. There is no hint in the private placement memorandum about Rendell's liquidity problems, reduction in staff numbers, difficulties with customers or uncertain financial arrangements. Instead, the private placement memorandum refers to a budgeted turnover for Rendell in excess of $20 million for the 1985/86 financial year and an estimated pre-tax profit of $750,000, to be sheltered by tax losses.

332 I infer, from the evidence, that the overriding interest of Messrs Mullins and Rees was to complete the transaction with Aequitas so that they, and Mr Gledhill, could point to the Rendell transaction as a model for the future. That, indeed, is what they did, in memoranda and papers to the Australian Committee of AEFC, until disaster befell Rendell. Driven by their overriding interest, Messrs Mullins and Rees failed to provide Aequitas with the 'unbiased and independent judgment' which, according to the *Byrnes* case, it was entitled to have from them: 183 CLR at 516-7. Instead, the private placement memorandum gave an unrealistically rosy view of the Rendell group. In allowing this to occur, Messrs Mullins and Rees either behaved in a knowingly deceptive fashion, or grossly failed to exercise sound judgment in circumstances of clear conflict of interest.

333 It was not open to Messrs Mullens and Rees to relieve one another from performance of their fiduciary obligations, in their capacity as directors of Aequitas. As Wilcox and Lindgren JJ said in *Australian Breeders Co-operative Society Ltd v Jones* (1997) 150 ALR 488, 512:

> 'If one fiduciary could absolve another from performance of the latter's obligation, serious consequences might ensue. The absolving fiduciary might be corrupt, profiting from the very circumstance that the other fiduciary was absolved from investigating or disclosing.'

Nor was it open to the board of Aequitas or Aequitas No 1 to relieve Messrs Mullins and Rees from the consequences of the positions of conflict into which they had placed themselves, after the appointment of some independent directors in March 1986, and certainly not earlier. The position was explained (in rather different circumstances) by Rich, Dixon and Evatt JJ in *Furs Ltd v Tomkies* (1936) 54 CLR 583, at 599:

> 'But the board could not relieve him of the equitable obligations which arose out of this conflict of duty and of private interest. His one resource, if he was resolved to adopt the unwise course of acting in the transaction on behalf of his company and yet seeking a profit for himself, was complete disclosure to and confirmation by the shareholders. But complete disclosure he was not prepared to make.
>
> 'We are unable to agree with the view that the respondent's principal placed him in a position in which his duty and interest conflicted and thus waived the right to the performance of an undivided duty. The board of directors could not do this in the case of a fellow director and, even if it could, no one contemplated anything but an ordinary agreement of employment is a salary.'

334 No adequate disclosure was made by Mr Mullens or Mr Rees to the shareholders disclosure to themselves and their wives cannot have been adequate when it was envisaged that external investors would be brought in: *Gluckstein v Barnes* (1900) AC 240, 247; *Australian Breeders Co-operative Society Ltd v Jones* (1997) 150 ALR 488, 510-12. For reasons already given, there was no adequate disclosure to the investors through the private placement memorandum.

Breach of duty by Mr Mullins' failure to disclose $69,400 commission

335 Mr Mullins was affected by another, more specific conflict of interest. He was a director and shareholder of CASO, which stood to gain a commission of $69,400 through the sale of the Rendell Industries shares to Aequitas No 1, although that commission was not arranged until settlement of the transaction in April 1986. If there was no adequate disclosure of this benefit, then Mr Mullins would be in breach of his duty.

336 As the statement of principle in the *Byrnes* case makes clear, the fiduciary duty of a director which arises out of having a personal interest or conflicting duty in respect of a contract with the company is capable of being, and frequently is, attenuated by the corporate constitution.

337 Article 36 of the constitution of Aequitas No 1 stated:

> 'No Director shall be disqualified by his office from contracting with or holding any other office under the Company, nor shall any such contract or any contract entered into by or on behalf of the Company in which any Director shall be in any way interested be avoided, nor shall any Director so contracting or being so interested be liable to account to the Company for any profit realised by any such contract by reason only of such Director holding that office or of the fiduciary relationship thereby established, provided that the nature of his interest must be disclosed by him at the meeting of Directors at which the contract is determined on if his interest then exists and has not been disclosed in accordance with the Code [the Companies Code], or in any other case at the first meeting of the Directors after the acquisition of his interest. A Director (or his alternate Director) may not vote in respect of any contract or arrangement in which he is interested, but shall be counted for the purpose of any resolution regarding the same in the quorum present at the meeting and may notwithstanding his interest participate in the execution of any instrument by or on behalf of the Company and whether through signing or sealing the same or otherwise.'

338 The requirement of article 36, that the director must disclose 'the nature of his interest', is a substantial one, and the director bears the onus of proving that proper disclosure has occurred. The matter was explained by the Privy Council in *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1, 14:

> 'There is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest. Rightly understood, the two things mean the same. The amount of detail required must depend in each case upon the nature of the contract or arrangement proposed and the context in which it arises. It can rarely be enough for a director to say 'I must remind you that I am interested' and to leave it at that, unless there is some special provision in a company's articles that makes such a general warning sufficient. His declaration must make his colleagues 'fully informed of the real state of things' (see *Imperial Mercantile Credit Association v Coleman* (1873) LR 6 HL 189 at 201, per Lord Chelmsford). If it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed (see Lord Cairns in the same case at p.205).'

339 The minutes of meetings of directors of Aequitas and Aequitas No 1 are in evidence. The meeting of the directors of Aequitas No 1 at which the contract for the purchase of Rendell Industries shares from AEFC Leasing was determined was the meeting of 25 November 1985. There is no record of any disclosure of interest at that meeting, or any previous meeting of the directors of Aequitas No 1 or of Aequitas. Nor is there any record of disclosure of the CASO commission in the minutes of any later board meeting of either company. There is no other evidence to suggest that disclosure was made. I find, therefore, that Mr Mullins failed to comply with his fiduciary duty to Aequitas No 1 and the requirements of the constitution of that company.

340 I note that according to article 49, the quorum for a meeting of the directors of Aequitas No 1 was three, unless otherwise fixed by the directors. There is nothing in the minutes to indicate that some other quorum was adopted. The minutes indicate that only Mr Mullins and Mr Rees were present at the meeting of directors held on 25 November 1985, at which the sale of shares agreement was executed (and, presumably, approved). Under article 36 Mr Mullins could be counted for quorum purposes, but there were still only two directors at the meeting. The plaintiffs note this discrepancy in their submissions, but they have not sought any relief in respect of it, treating it instead as merely an aspect of the directors' alleged failure to discharge their fiduciary duty. It would the surprising if, after all this time, it were possible for them to avoid the purchase of the Rendell Industries shares on this ground. Apart from questions of estoppel and the like, any deficiency of quorum may well have been cured by s 539 of the Companies Code (now s 1322 of the Corporations Law). But since no case was developed upon the specific basis of a lack of quorum, I need not explore such matters further.

Conclusions as to breach of directors' duties

341 My conclusions are that:

- during the period from November 1985 to April 1986 Messrs Mullins and Rees breached their fiduciary duty as directors of Aequitas and Aequitas No 1 by placing their personal interest in making and completing the sale of the Rendell Industries shares above their duty to act in good faith for the benefit of those companies; and
- Mr Mullins breached his fiduciary duty as a director of Aequitas No 1, and contravened the constitution of that company, by failing to disclose the nature of his interest in the commission of $69,400.

Breach of the fiduciary duty of promoters

342 The plaintiffs allege that those who controlled Aequitas and Aequitas No 1, and certain others, owed fiduciary duties to those companies as promoters. The promoters are alleged to have included AEFC, AEFC Leasing and Mr Gledhill. I permitted the plaintiffs to amend their statement of claim to include the pleading of breach of promoters' duty, at the hearing. I took the view that the pleading of breach of promoters' duty did not raise any new factual matters, and that prejudice to the defendants was unlikely (although I offered them a short adjournment). The defendants, wishing to preserve their rights with respect to any relevant limitation period, have not applied to have the leave rescinded on the basis, they say, that the plaintiffs are to be kept to their pleaded case. In that spirit, the defendants wish to confine the plaintiffs' case under this heading to the 'birth, formation and floating' of Aequitas, and they

say that the plaintiffs have not pleaded that any of the defendants were promoters of Aequitas, but only Aequitas No.1, and that the specific duties pleaded are all positive duties falling foul of the principle in *Breen v Williams*. I agree with the third point but not the other two. In my opinion, a fair reading of the pleading discloses that the words 'birth, formation and floating' are wide enough to extend to matters such as the preparation of the private placement memorandum. And the gist of the allegations implies that the plaintiffs claim that the defendants were promoters of Aequitas. In any event, the pleading does not, in my view, raise new factual matters.

The fiduciary duty of promoters

343 The promoters of a company or other business enterprise are treated as a category of 'accepted' fiduciary relationships: *Elders Trustee and Executor Co Ltd* v *EG Reeves Pty Ltd* (1987) 78 ALR 193, 228. As fiduciaries, they are required to act in good faith for the benefit of their fledgling company, and to avoid placing themselves in a position where there is a real sensible possibility of conflict between their duty and their personal interest.

344 Promoters who sell property to the fledgling company are placed under a particularly onerous duty in respect of that transaction. As Lord Blackburn said in *Erlanger* v *New Sombrero Phosphate Company* (1878) 3 App Cas 1218, at 1269-70:

> 'Where, as in the present case, the company is formed for the purpose of becoming purchasers from the promoters as vendors, the interests of the promoters and of the company clash. It is the vendor's interest to get as high a price as possible, and they have a strong bias to overvalue the property which they are selling; it is the purchasers' interest to give as low price as possible, and to secure that the price actually given is not more than the property is really worth to them.
> 'Lord Eldon, in *Gibson* v *Jeyes* (1801) 6 Ves Jn 278 [31 ER 1044, 1050], says that 'it is a great rule of the Court that he who bargains in matters of advantage with a person placing confidence in him, is bound to show that a reasonable use has been made of that confidence - a rule applying to trustees, attorneys, or any one else.' I think persons having property to sell may form a company for the purpose of buying it in such a manner as to shew this, and when they do so, the sale will be unimpeachable.'

345 A transaction by which promoters sell property to their company, without the approval of the company after full disclosure, is voidable at the option of the purchaser: *Tracy* v *Mandalay Pty Ltd* (1953) 88 CLR 215, 241. The promoters' duty may be discharged by the fully informed consent of a fully independent board, or the shareholders, as we have seen.

Identifying the promoters

346 Who is a promoter, for the purposes of the law of fiduciary duties? Although the word has no very definite meaning (*Tracy* v *Mandalay*, at 241), it includes those who actively participate in the getting up and starting (or floating) of the company: *Emma Silver Mining Co Ltd* v *Lewis & Son* (1879) 4 CPD 396. As Lord Cairns pointed out in *Erlanger's* case (at 1236), they may owe duties before the company comes into existence. It also includes those who actively participate in the work of raising equity capital for the new company after it has been incorporated but before an independent board has been appointed: *Emma Silver Mining*, at 408. Additionally, the concept of a promoter extends to some whose involvement is passive:

> 'But it is not only the persons who take an active part in the formation of a company and the raising of the necessary share capital to enable it to carry on business who are promoters. It is apparent from the passage cited [from the *Emma Silver Mining* case, at 407-8] that persons who leave it to others to get up the company upon the understanding that they also will profit from the operation may become promoters': *Tracy* v *Mandalay*, at 242.

347 These principles require the Court to undertake a close examination of the facts, to determine the precise roles played by various individuals and entities with respect to the fledgling company. As

Gummow J remarked in the *Elders Trustee* case (at 234), 'the end result is that although undoubtedly once identified as a promoter the defendant is *ipso facto* stamped as a fiduciary, the process required in order to identify him as such in most cases probably will differ very little from that involved in deciding whether, independently of any acknowledged category of fiduciary, the defendant was in the circumstances of the case a fiduciary and, if so, what were the incidents of his fiduciary duty.'

348 Relying on the *Elders Trustee* case, the defendants submit that it is necessary, in the case of each alleged promoter, to identify precisely what was done or undertaken to be done, because ultimately a fiduciary relationship arises only when one person undertakes or agrees to act in the interests of another. I do not regard Gummow J's reasoning in that case as requiring such an approach. His Honour acknowledged (78 ALR at 228) that the promoters of a company are treated as a category of 'accepted' fiduciary relationships. That being so, once a person is identified as a promoter according to the legal definition of that term, fiduciary duties automatically attach to that person, and it is not necessary to find a specific undertaking of a kind that would constitute a fiduciary relationship 'on the facts'. I should add that the facts of the *Elders Trustee* case are so far removed from the present case, that I do not regard it as a helpful analogy at that level.

349 In the present case it is clear that Messrs Mullins and Rees were promoters of Aequitas and Aequitas No 1. They described themselves as promoters. They were actively involved in every aspect of formation of the company, and of the capital-raising by the private placement memorandum. But that conclusion is of no consequence. As the defendants point out, Messrs Mullins and Rees were not selling anything to Aequitas or Aequitas No 1, and were not acting on behalf of AEFC Leasing as vendor in their personal capacities. The more difficult question is whether AEFCAS, AEFC, AEFC Leasing or Mr Gledhill was a promoter. The defendants have invited me to make a number of specific findings relevant to this issue. I find that:

- the expenses incurred in the formation of Aequitas and Aequitas No 1 were not borne by AEFC or AEFCAS but were borne by Mr Mullins, Mr Rees, and possibly Mr Elvy, through their private companies;
- when Aequitas and Aequitas No 1 were purchased from the shelf company provider, the shares were acquired legally and beneficially by Messrs Mullins and Rees, their respective wives and Mr Elvy; and
- the initial directors of Aequitas and Aequitas No 1 were not nominees or agents of, or appointed by, AEFC or AEFCAS.

These findings are relevant, but far from decisive.

350 I agree with the defendants that Arthur Young were independent of AEFC and AEFCAS when they were retained as the auditors for the Aequitas group, though they were subsequently retained by the Rendell group as well. However, Law & Milne did not act solely for the Aequitas group at any stage. I have found that their work on the sale of the Rendell Industries shares by AEFC Leasing to Aequitas No 1 was undertaken on behalf of AEFC, the joint venture and AEFC Leasing, as well as Aequitas and Aequitas No 1. Subsequently they acted for Rendell Industries. The fact that Law & Milne acted for both sides of the share sale transaction points significantly, though not conclusively, towards the conclusion that the vendor (and its holding company) were engaged in the exercise of getting up and launching the purchaser (and its holding company). That fact establishes that the purchaser could not have received independent legal advice at the time of the transaction.

351 The defendants submit that participation in the formation and promotion of Aequitas and Aequitas No 1, other than as a supplier of corporate advisory services, was not within the business of the joint venture or the business which AEFCAS was authorised to carry on. In my view, however, the provision of corporate financial advice in a commercial context encompasses a degree of assistance, ancillary to the advisory task.

352 It is clear that, in communicating with third party advisers such as Arthur Young, Messrs Mullins and Rees described themselves as promoters of Aequitas and Aequitas No 1 and made no reference to any comparable role by AEFCAS or the joint venture. The internal memoranda of Arthur Young, as well as memoranda by Messrs Mullins and Rees, indicate that Messrs Mullins and Rees were the persons making decisions concerning the creation and formation of the two new companies. In some of

their private and public statements, Messrs Mullins and Rees described their role as promoters, undertaken on their own behalf rather than on behalf of the joint venture (for example, in the briefing of Arthur Young which led to that firm's tender for the Aequitas audit work).

353 However those claims, generated by Messrs Mullins and Rees, are outweighed by the objective facts. I have found that Aequitas engaged AEFCAS, which undertook the assignment in its capacity as manager of the joint venture, to provide corporate advisory services which included advice on the raising of equity capital by private placement and through stock exchange listing. In taking up that role on behalf of AEFCAS, Messrs Mullins and Rees became actively involved in the formation and capital raising process. The opportunity for that involvement came through their positions with AEFCAS, which gave them connections with AEFC and the Rendell group. If they had acted purely as advisers, they may not have been promoters. But they went beyond a purely advisory role, taking up the opportunity to do so provided by their positions with AEFCAS. In my view, it is not possible to draw any sharp distinction between their advisory work for AEFCAS and their promotional work. Their work for AEFCAS (especially the work of Mr Rees) included activities of a kind carried out by promoters. Specifically, while it may be that the acquisition of the shelf companies was not an AEFCAS activity, the development of the private placement memorandum was an activity in which Mr Rees participated in his role of providing corporate advice on behalf of AEFCAS, as well as in his role as a director of Aequitas.

354 Consequently AEFCAS, as well as Messrs Mullins and Rees became a promoter. Since AEFCAS acted only in the capacity of manager of the joint venture, the consequence was that the joint venturers also became promoters. That conclusion is reinforced by the fact that Mr Gledhill was well aware of the activities of Messrs Mullins and Rees with respect to the promotion of the Aequitas companies, and by the presence of a close connection between that work and other work of the joint venture, undertaken in the interests of the venturers.

355 The defendants submit that AEFC was merely a financial institution which, in the context of the private placement, was regarded as a prospective investor rather than a promoter. They say that the relationship between AEFC Leasing and Aequitas No 1 was that of vendor and purchaser of the Rendell Industries shares, and in the negotiations for that transaction Mr Gledhill spoke on behalf of AEFC Leasing and Messrs Mullins and Rees spoke only on behalf of Aequitas No 1.

356 The defendants' analysis of the facts overlooks two matters of cardinal significance. The first relates to the position of AEFC as a joint venturer. AEFCAS, as I have said, became a promoter by virtue of the activities of Messrs Mullins and Rees. But AEFCAS was only ever an agent, acting as manager of the joint venture. AEFC was a principal, as joint venturer. The acts of Messrs Mullins and Rees by way of promoting the Aequitas companies were undertaken, therefore, for AEFCAS as agent for the venturers, and those acts are to be attributed to the venturers as principals. As a venturer, AEFC became a promoter in this way.

357 Secondly, the defendants' analysis overlooks the active role played by Mr Gledhill in developing the Aequitas concept. I have given an extensive description of the contents of Mr Gledhill's board paper dated 2 September 1985. In that paper he advocated the establishment of a publicly listed company that would take options over AEFC's short-term investments, and would augment the activities of the Advisory Service by providing an alternative repository of equity funds, to assist advisory clients. As I have shown, he returned to the same themes on subsequent occasions. Most importantly, he wrote an open letter on behalf of AEFC dated 10 March 1986 declaring that AEFC supported the formation of Aequitas and endorsing the company's objectives.

358 Mr Gledhill was actively involved in the formation and flotation of the Aequitas companies from the outset, at this conceptual level. His activity was that of a promoter, undertaken in his capacity as general manager of AEFC. That would be enough to make AEFC a promoter, even apart from the fact that it was a principal in the promotional activities undertaken by AEFCAS as agent.

359 The personal position of Mr Gledhill is in some ways the most difficult question to address. Clearly he was very active, as I have said, in developing the Aequitas concept, and in ensuring that the interests of AEFC were advanced by the implementation of the concept. But his activities were

undertaken as general manager of AEFC, rather than in any personal capacity. Unlike Mr Griffith and Miss Withy in *Tracy v Mandalay*, he did not stand to gain personally from the promotion of the Aequitas companies, except in the sense that success would enhance his reputation within AEFC and advance his career in that company.

360 In my opinion he did not personally place himself in a fiduciary relationship with the fledgling companies, although his activity caused his employer to become a fiduciary. His activities were all undertaken within the scope of his employment and with the express or implied actual authority of AEFC. But he was far from autonomous in his decision making on behalf of the company. In particular, he was answerable to the AEFC Board and the Australian Committee, to whom he reported regularly. Through the board and the Australian Committee, the bank shareholders of AEFC exercised considerable influence on the company's policy and decisions. When Mr Gledhill recommended that AEFC take an equity position in Aequitas, the chairman of the Australian Committee, Mr Christie, effectively overruled the proposal. The board's attitude to Mr Gledhill's strategy of involving AEFC in equity investments was supportive but cautious. In all the circumstances, it could not be said that he was the directing mind and will of AEFC, either generally or in any particular field of operations.

361 Mr Gledhill's activity, along with the activities of Messrs Mullins and Rees on behalf of AEFCAS, led to AEFC occupying a fiduciary position with respect to the Aequitas companies, for the reasons I have given. AEFC became a fiduciary 'vicariously' rather than directly (cf *Hamilton* v *Whitehead* (1988) 166 CLR 121), as Mr Gledhill was not its directing mind and will.

362 I turn finally to the position of AEFC Leasing. In my view that company was a promoter of Aequitas and Aequitas No 1, because (like Mr Griffith and Miss Withy in *Tracy* v *Mandalay*) AEFC Leasing left it to others to get up those companies upon the understanding that it would profit from the operation. It profited in the most direct way, by selling its Rendell Industries shares for $710,000 more than it had recently paid them. It was under the control of AEFC, and therefore was affected by Mr Gledhill's knowledge of the arrangements for formation and capital raising for those companies, and of the relevant circumstances of the purchase transaction.

Conclusions as to breach of promoters' fiduciary duties

363 My conclusions are that Messrs Mullins, Rees, AEFCAS, AEFC, CASO and AEFC Leasing were all promoters of Aequitas No 1, but Mr Gledhill was not. The promoters failed to discharge their fiduciary duty to the fledgling companies because they did not accurately and completely disclose, to the independent directors and in the private placement memorandum, all material facts with respect to the sale of the Rendell Industries shares to Aequitas No 1 and the financial position of the Rendell group; and they did not give the independent directors the opportunity to review the participation by Aequitas No 1 in that transaction. The provision of information to Mr Pond was inadequate to constitute discharge of the promoters' duty, for the reasons I have already given.

Secret commissions (bribes)

364 There were two payments that, according to the plaintiffs, were bribes or secret commissions. The first was the payment of $50,000. To recapitulate, the relevant facts were that:

- Mr Gledhill and Mr Rees regarded $910,000 as the figure to be recouped to AEFC Leasing from its disposal of the Rendell Industries shares;
- in his memorandum dated 12 November 1985, Mr Gledhill recorded his decision on behalf of AEFC and AEFC Leasing that the sale to Aequitas No 1 would go ahead at an increased price of $960,000, and the extra $50,000 would 'be passed through the joint venture accounts of AEFC Advisory Services in recognition of the part played in structuring the transaction';
- under the terms of the joint venture agreement, the $50,000 was part of the first tier of profits, therefore AEFC was entitled to it;
- Messrs Gledhill, Mullins and Rees were aware of these arrangements;
- in his letter to Arthur Anderson & Co dated 26 February 1986, approved by Mr Gledhill, Mr Kelly referred to the $50,000 as a 'fee'.

365 The facts relevant to the payment of $69,400 were that:

- when the joint venture agreement was amended by agreement dated 13 March 1986, a provision was included (clause 7A .04) to the effect that within 30 days after 30 June each year, AEFC would pay to CASO 10% of the pre-tax net profit earned and collected by AEFC during the preceding financial year, which resulted directly or indirectly from business introduced by AEFCAS, but the first year for the purposes of these arrangements was the period of 1 April 1986 to 30 June 1987;
- notwithstanding the terms of the amended agreement, AEFC agreed to make a special payment under this clause, after 1 July 1986, by reference to the profit made by AEFC Leasing on the sale of the Rendell Industries shares;
- the amount paid to CASO was 10% of the profit on the transaction, which was calculated by deducting from the sale price of $960,000 the subscription price of $250,000 and a 'cost of funds' factor on the latter amount;
- the amount of $69,400 was paid on 14 July 1986;
- Messrs Gledhill, Mullins and Rees were aware of these arrangements.

366 Neither payment was disclosed in the Aequitas private placement memorandum, nor to the independent members of the Aequitas board. In these circumstances the plaintiffs argue that both payments were bribes or secret commissions in respect of which they claim civil remedies.

The nature of a bribe

367 In *Hovenden & Sons v Millhoff* (1900) 83 LT 41, 43, Romer LJ gave the following statement of what constitutes a bribe:

> 'If a gift be made to a confidential agent with the view of inducing the agent to act in favour of the donor in relation to transactions between the donor and the agent's principal and that gift is secret as between the donor and the agent - that is to say, without the knowledge and consent of the principal - then the gift is a bribe in the view of the law.'

368 The Privy Council explained the concept of a bribe somewhat more widely in *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324, 330:

> 'A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust. A secret benefit, which may or may not constitute a bribe, is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary. A fiduciary is not always accountable for a secret benefit but is undoubtedly accountable for a secret benefit which consists of a bribe.'

369 Once the giving of a bribe, in this sense, is shown, it is unnecessary to establish a subjective intent to defraud: *T Mahesan S/O Thambia* v *Malaysia Government Officers' Co-operative Housing Society Ltd* [1979] AC 374, 383 . According to Romer LJ in the *Hovenden* case, if it is shown that a bribe has been given, the Court will not inquire into the donor's motive, and will presume irrebuttably in favour of the principal and against the donor and the agent bribed, that the agent was influenced by the bribe. There is also a presumption, apparently irrebuttable, that the true price was no greater than the price charged less the value of the bribe: *Mahesan's* case, at 383 (dealing with the elements of fraud). It does not matter that the recipient may have behaved honestly: *Ex parte James* (1803) 8 Ves Jn 337, [32 ER 385, 388], per Lord Eldon LC. In *Attorney-General* v *Reid* their Lordships explained that although the legal title to a bribe passes to the recipient, equity insists that it is unconscionable for the fiduciary to obtain and retain a benefit in breach of duty, and will therefore grant proprietary remedies to aid recovery of the bribe.

370 At least for the purposes of the present case, the following elements emerge as the ingredients of a bribe:

(a) a donor makes a gift to a fiduciary;

(b) the gift relates to the fiduciary's position, in the sense that it is an inducement to the fiduciary to use his or her position in a particular way; and

(c) the gift is secret between the donor and the fiduciary, in the sense that the principal is not aware of it.

Put together, these three elements give rise to an undisclosed conflict of interest: *Panama and Southcap Pacific Telegraph Co* v *India Rubber, Gutta Percha, and Telegraph Works Co* (1875) LR 10 Ch App 515, 530-1 (James LJ), 533 (Mellish LJ).

Were bribes given in the present case?

371 Ingredient (a) is satisfied in the present case. I have found that AEFC and CASO, as joint venturers, and AEFCAS as their agent, owed fiduciary duties to Aequitas in respect of the provision of corporate advice. The first payment in the present case was made by AEFC Leasing as 'donor', out of the proceeds of sale of the Rendell Industries shares to Aequitas No 1. The payment of $50,000 was made to AEFCAS, and AEFC became entitled to it under the terms of the joint venture agreement. The second payment of $69,400 was made by AEFC as donor to CASO. Thus, both payments were received by fiduciaries. Both payments in the present case were 'gifts' for the purposes of determining whether they were bribes. The payment of $50,000 arose out of Mr Gledhill's decision to increase the purchase price payable by Aequitas by that amount, and to pass the proceeds through the AEFCAS joint venture accounts - there was no obligation to do so. The payment of $69,400 was purportedly made under the amended joint venture agreement, but the amendment which provided for it was made after AEFC Leasing had sold the Rendell Industries shares to Aequitas No 1, and further, the payment was made earlier than the amended clause required. Again, therefore, it was a payment which AEFC was not obliged to make.

372 In my view, ingredient (b) was satisfied in respect of the payment of $50,000 but not the payment of $69,400. The payment of $50,000 was made at a time when it was capable of being an inducement to AEFCAS, Mr Rees and Mr Mullins to effectuate the sale of the Rendell Industries shares to Aequitas No 1. As I have explained, that transaction was in breach of AEFCAS' fiduciary duty, as agent for the joint venturers and as a promoter, to avoid conflicts between interest and duty. According to Mr Gledhill, whose purpose (expressed in his memorandum of 12 November 1985) should be attributed to AEFC, the payment was to be made to recognise the part played, presumably by AEFCAS, in structuring the transaction. It was, therefore, a reward for a transaction structure which involved a breach of fiduciary duty. The promise of payment of such a reward, to be made out of the proceeds of a sale that had not been completed, from money to be raised from external investors who had not yet invested, was an inducement to AEFCAS, Mr Rees and Mr Mullins to complete the transaction in order to secure the payment. The fact that AEFCAS itself would not be the ultimate beneficiary of the payment was not decisive. It was in the interests of AEFCAS, and Mr Rees and Mr Mullins, to see the transaction through to its completion and secure the fee for AEFCAS, so that AEFCAS could be regarded as successful and profitable and worthy of further support from AEFC.

373 The arrangements which led to the payment of $69,400 were made after AEFC Leasing had contracted to sell the Rendell Industries shares to Aequitas No 1 for $960,000. The amendments to the joint venture agreement, dated 13 March 1986, were effectively contemporaneous with the issue of the private placement memorandum, under which investment funds were raised and used to complete the share transaction. It might be argued that AEFC agreed to the amendments in order to induce Mr Mullins, through his company CASO, to ensure that sufficient funds were raised so that the share transaction (which, as I have said, involved a breach of fiduciary duty) could be completed. However, the evidence falls short of establishing that AEFC or Mr Gledhill had such a purpose in agreeing to the joint venture agreement amendments. The amendments covered a wide range of matters, including the way in which CASO would be remunerated in respect of profits. I accept, as the plaintiffs submit, that Messrs Gledhill, Rees and Mullins must have realised on 13 March 1986 that clause 7A.04 would give CASO an eventual entitlement to approximately $70,000 in respect of the purchase of the Rendell shares by Aequitas No 1. That conclusion was drawn in a paper for the May 1986 meeting of AEFC's board. But the evidence does not indicate that any of the amendments to the joint venture agreement were made for the specific purpose of providing an inducement to CASO in respect of the share transaction.

374 Nor, it seems to me, could they have done so. Bache had already agreed to underwrite the private placement of shares in Aequitas to an amount of $1 million, an amount sufficient to cover the payment due to AEFC Leasing. The payment was made a year earlier than the amended joint venture agreement required, by arrangements made in May 1986, well after completion of the share transaction.

375 In these circumstances I find that neither the payment of $69,400, nor the promise to pay it, operated as an inducement to CASO to give effect to the share transaction in breach of its fiduciary duty. I should add that, notwithstanding an ambiguous answer by Mr Gledhill in cross-examination, I do not regard the payment of $69,400 as capable of being an incentive to ensure that Aequitas No.1 did not walk away from the deal. I have rejected Mr Gledhill's evidence that they would have been allowed to do so; further, the transaction was settled well before the payment was calculated and made.

376 Ingredient (c) raises the question whether Aequitas or Aequitas No 1 was aware of the payments. The arrangements for the payments were well known to Messrs Rees and Mullins. Mr Rees was managing director and chief executive officer of Aequitas at the relevant time. In the defendants' submission, his knowledge was the knowledge of Aequitas, either because he was to be regarded as the directing mind and will of the company, or on the basis that, as an executive director of the company, his knowledge was the knowledge of Aequitas because he had authority to receive information for the company on matters concerning its affairs. For the reasons given earlier, I find that Mr Rees was not the directing mind and will of Aequitas and his knowledge is not to be attributed to Aequitas because he was acting in fraud of the company.

377 The plaintiffs submit that once a prima facie case of an agreement to pay a bribe has been established, the onus is on the defendants to prove that full and frank disclosure was made: *Federal Supply & Cold Storage Co of South Africa v Anghern & Piel* (1910) 80 LJPC 1, 4; *Hayward v Roadknight* [1927] VLR 512, 517 (Dixon AJ), 521 (Full Court). But in the present case there is no evidence to suggest that anything like adequate disclosure was made to the independent directors of Aequitas or in the private placement memorandum, so it is unnecessary to rely on any proposition about onus of proof.

Conclusions as to bribes

378 My conclusion is that, while ingredients (a) and (c) are satisfied with respect to both payments, ingredient (b) is satisfied only in respect of the payment of $50,000. Therefore the payment of $50,000 was a bribe, but the payment of $69,400 was not.

379 The plaintiffs submit that the fact that the arrangements for the second payment varied from those for the first payment did not palliate the wrong, or the consequences of it. They refer to *Re Morvah Consuls Tin Mining Company (McKay's Case)* (1875) 2 ChD 1. I agree with this submission in principle, but it does not apply to the present case, in view of my finding that the second payment lacked one of the characteristics of a bribe.

Remedies in respect of bribes

380 I turn to the question of the most appropriate remedy in respect of the bribe. At common law, the principal has alternative remedies, both against the donor and against the fiduciary agent, as the Privy Council explained in *T Maheson S/O Thambiah v Malaysia Government Officers' Cooperative Housing Society Ltd* [1979] AC 374, 383. The principal may recover the amount of the bribe in an action for money had and received or, alternatively, sue for damages for fraud to recover the amount of the actual loss sustained in consequence of entering into the transaction in respect of which the bribe was given.

381 In equity, however, the giving of a bribe is treated as a species of equitable fraud, for which the remedies include rescission of the transaction induced by the bribe. As James LJ said in *Panama & South Pacific Telegraph Company v India Rubber Gutta Percha & Telegraph Works Co* (1875) LR 10 Ch App 515, 526:

'According to my view of the law of this Court, I take it to be clear that any surreptitious dealing between one principal and the agent of the other principal is a fraud on such other principal, cognisable in this Court. That I take to be a clear proposition, and I take it, according to my view, to be equally clear that the defrauded principal, if he comes in time, is entitled, at his option, to have the contract rescinded, or, if he elects not to have it rescinded, to have such other adequate relief as the Court may think right to give him.'

382 The 'other adequate relief' to which James LJ referred includes equitable compensation in a measure designed to restore the plaintiffs to the position they would have occupied had the bribe not been given. It might seem harsh that the payment of a bribe of only $50,000 should lead to the rescission of a contract producing an obligation to pay $960,000 plus interest and other adjustments, or equitable compensation requiring a money payment of the same order. That, however, simply reflects the fact that, as Romer LJ said in the *Hovenden* case, at 43, the courts have always 'strongly condemned' the giving of bribes. The Privy Council put the point even more strongly in *Attorney-General for Hong Kong v Reid*, at 330: 'Bribery is an evil practice which threatens the foundations of any civilised society'. I shall return to the measure of recovery later.

Liability **for knowing** involvement in breaches **of equitable duties**

383 A third party (a 'stranger') who becomes involved with fiduciaries who breach their duty to their principal may also be liable to the principal, as a constructive trustee. In *Barnes v Addy* (1874) LR 9 Ch App 244, 251-2, Lord Selborne LC said:

'[The responsibility of a trustee] may no doubt be extended in equity to others who are not properly trustees, if they are found ... actually participating in any fraudulent conduct of the trustee to the injury of the cestui que trust. But ... strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps, of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees. ... If those principles were disregarded, I know not how anyone could, in transactions admitting of doubt as to which view a Court of Equity might take of them, safely discharge the office of solicitor, of banker, or of agent of any sort to a trustee. But, on the other hand, if persons dealing honestly as agents are at liberty to rely on the legal power of the trustees, and are not to have the character of trustees constructively imposed upon them, then the transactions of mankind can safely be carried through; and I apprehend those who create trusts do not expressly intend, in the absence of fraud and dishonesty, to exonerate such agents of all classes from the responsibilities which are expressly incumbent, by reason of the fiduciary relation, upon the trustees.'

384 The principles of that case apply where a stranger becomes involved in a breach of duty by a fiduciary who is not an express trustee: *Consul Developments Pty Ltd* v *DPC Estates Pty Ltd* (1975) 132 CLR 373. I have referred to the 'second limb' of *Barnes v Addy*. That expression is commonly used to refer to the category of liability of someone who has not received trust property but has become involved with knowledge in a dishonest and fraudulent design. The first limb of Lord Selborne's formulation is concerned with 'the liability of a person as a *recipient* of trust property or its traceable proceeds'; while the second limb 'is concerned with what, for want of a better compendious description, can be called the liability of an *accessory* to a trustee's breach of trust': *Royal Brunei Airlines* v *Tan* [1995] 2 AC 379, 382. Although Lord Selborne's formulation has been described as a 'straitjacket' that has been interpreted as if it were a statute, inimically to analysis of the underlying concept (*Royal Brunei Airlines*, at 386), the *Barnes v Addy* apothegm still usefully describes the general territory of third party liability for breach of fiduciary duty.

385 Lord Selborne referred to an agent who 'assists' in a dishonest and fraudulent design. But if a stranger can be said to have procured or knowingly induced the fiduciary's wrongdoing, the case against the stranger is even stronger: see *Royal Brunei Airlines*, at 384; and note generally C Harpum, 'The Stranger as Constructive Trustee', (1986) 102 LQR 114, 141. The assistance or procurement or

inducement must relate to 'a dishonest and fraudulent design on the part of the trustees [or other fiduciaries]'. The meaning of these words was considered by the Privy Council in the *Royal Brunei Airlines* case.

386 In that case the airline appointed a company called Borneo Leisure Travel ('BLT') to act as its general travel agent in Borneo for the sale of passenger and cargo transportation, by a written contract signed on behalf of BLT by Mr Tan. BLT was required by the contract to hold money received for the sale of passenger and cargo transportation in trust for the airline, and pay that money to the airline within 30 days. In practice, the money received by BLT was paid into its general account rather than any separate bank account. Mr Tan and his wife were the directors of BLT and its sole shareholders, and the company was effectively controlled by Mr Tan. BLT failed to pay the airline as required by the contract, and the airline terminated the contract and took proceedings against Mr Tan to recover the unpaid money. The trial judge found Mr Tan liable under the accessory limb of *Barnes v Addy*, since he authorised the wrongful use, for ordinary business purposes, of money that he knew to be subject to an express trust in favour of the airline. It was not necessary, according to the judge, to show that Mr Tan had personally gained from the breach of trust. The Court of Appeal of Brunei Darussalam allowed Mr Tan's appeal on the ground that, although there had been a sorry tale of mismanagement and broken promises, it had not been established that BLT was guilty of fraud or dishonesty in relation to the amounts it held in trust for the airline. Consequently there was no 'dishonest and fraudulent design'.

387 The Privy Council reversed the Court of Appeal's decision, holding that it was not necessary for the breach of trust to be a dishonest and fraudulent breach by the trustee, but it was necessary to show dishonesty on the part of the accessory. The principle adopted by their Lordships was that 'a liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation' (at 392). Mr Tan was liable to the airline because he caused or permitted his company to apply money collected in trust for the airline in a way he knew was not authorised by the trust of which the company was trustee (at 393). He used the airline's money to relieve cash flow problems, treating it as a rolling 30-day credit. That was sufficient to render his conduct dishonest, even though he hoped to be able to repay the money. It was not necessary to establish that he intended to defraud the airline.

388 Their Lordships made some pertinent observations on the meaning of 'dishonesty', as follows (p 389-90):

> 'Whatever may be the position in some criminal or other contexts (see, for instance, *R v Ghosh* [1982] QB 1053), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonestly are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be acquainted with conscious impropriety. However, the subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. And honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.
>
> 'In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others' property. Unless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless.'

389 Their Lordships applied these observations to the area of commercial risk-taking. They observed (at 389) that all investment involves risk, and that 'imprudence is not dishonesty, although imprudence may be carried recklessly to lengths which call into question the honesty of the person making the decision', this being especially so if the transaction serves another purpose in which that person has an interest of his own. They referred to 'commercially unacceptable conduct' and added (at 390) that 'acting in reckless disregard of others' rights or possible rights can be a tell-tale sign of dishonesty', concluding (at 391) that 'ultimately, in most cases, an honest person should have little difficulty in knowing whether a proposed transaction, or his participation in it, would offend the normally accepted standards of honest conduct'.

390 As to the relevance of the personal characteristics of the third party, their Lordships said (at 391):

> '... when called upon to decide whether a person was acting honestly, a court will look at all the circumstances known to the third party at the time. The court will also have regard to the personal attributes of the third party, such as his experience and intelligence, and the reason why he acted as he did'.

391 Finally, I should note their Lordships' discussion as to whether mere negligence is sufficient to generate accessory liability. As I read their advice, the question for their Lordships was whether the accessory owes a common law duty of care to the beneficiaries, the assumption apparently being that equitable liability is confined to cases where the accessory's conduct is dishonest. In most cases, in their Lordships' opinion, no such duty of care will be owed.

392 Although various Australian courts have applied the *Royal Brunei Airlines* case (for example, *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1; *Humphris v Jenshol* (1997) 160 ALR 107; *Duke Group Ltd v Pilmer* (1999) 73 SASR 64), the High Court of Australia has not yet had the opportunity to consider it. However, in my opinion those principles are generally consistent with the High Court's judgment in the *Consul Development* case. Indeed, the Privy Council in *Royal Brunei Airlines* treated the *Consul Development* case as broadly in line with the dishonesty test which their Lordships enunciated (at 388). The singular contribution of the *Royal Brunei Airlines* case to the development of law is that their Lordships treat the accessory's liability as dependent on dishonesty rather than knowledge, and therefore consign to legal history the numerous cases that had identified increasingly refined sub-categories of actual and constructive knowledge. The High Court did not take that step in *Consul Development*, but by adopting a narrow view of 'knowledge', the practical effect of which is similar to a test of dishonesty, they paved the way for that step to be taken. It is therefore clear, in my opinion, that the *Royal Brunei Airlines* case is a statement of the modern Australian law.

393 I have dealt with the *Royal Brunei Airlines* case extensively because, in my opinion, it is a case of particular importance with respect to the position of Mr Gledhill. In the further amended statement of claim, the plaintiffs seek to invoke the principles of accessory liability under *Barnes v Addy* with respect to the breaches by Messrs Mullins and Rees of their fiduciary duties as directors of Aequitas and Aequitas No 1. They contend that Mr Gledhill dishonestly procured or assisted in those breaches. It is clear, first, that Mr Gledhill did not procure or induce or assist the breach of fiduciary duty which arose when Mr Mullins failed to disclose his interest in the $69,400 commission to the board of directors of Aequitas No 1. He had no actual knowledge that disclosure had taken place, and it could not be said that his connection or relationship with Aequitas No.1 was such that he ought to have known that there had been no disclosure: Companies (NSW) Code, s 68A(4). He was therefore entitled to assume that the constitution of the company had been complied with, and that Mr Mullens as a director had properly performed his duty to the company: ss 68A(3)(a) and (f). As to that breach of duty, the question of dishonesty does not even arise.

394 I have also found that Messrs Mullins and Rees breached their fiduciary duty as directors of Aequitas and Aequitas No 1 by virtue of their overall conduct during the period from November 1985 to March/April 1986. My findings on this point disclose a substantial level of involvement by Mr Gledhill. The seed of the problem leading to the breach of duty by Messrs Mullins and Rees was Mr Gledhill's plan to develop an equity investment business for AEFC, through the establishment of a joint venture corporate advisory business and a publicly listed vehicle to which AEFC's short-term equity investment could be sold. Whether the idea was conceived by Mr Gledhill or someone else, it was clearly

developed by him very actively, in his board paper of 2 September 1985 and subsequently. Mr Gledhill's plan was inherently defective, because inevitable irretrievable conflicts of interest were built into it. One of those inevitable conflicts arose out of the position in which Messrs Mullins and Rees were placed, working for the corporate advisory business of the joint venture, becoming involved in directorships of target companies such as the companies of the Rendell group, providing corporate advice to Aequitas, and in all of these activities seeking to secure their future welfare by producing handsome profits for AEFC.

395 My analysis of the facts demonstrates that Messrs Mullins and Rees, influenced by their desire to produce profits by AEFC, took an over-optimistic view of the potential position of the Rendell group during this whole period, failed to make proper disclosure of the Rendell group's difficulties to the Aequitas companies, failed adequately to protect those companies, and failed to make proper disclosure of relevant matters in the private placement memorandum. The consequence was that the Aequitas companies did not receive an independent judgment to which they were entitled.

396 It is undeniable, in my view, that Mr Gledhill induced, assisted and (to a degree) procured these breaches of duty. As I have said, the breaches flowed from structural deficiencies in Mr Gledhill's own plan for the expansion of the business of AEFC, a plan which he actively promoted and implemented. He was well aware of the position in which Messrs Mullins and Rees were placed, and he took no steps to ensure that the independent directors and potential investors in Aequitas were fully informed of all the facts and circumstances. On the contrary, he contributed an open letter to the misleading private placement memorandum.

397 The more difficult question is whether Mr Gledhill's conduct was 'dishonest' in the relevant sense. Mr Gledhill knew all the facts that constituted the breaches of fiduciary duty by Messrs Mullins and Rees as a result of their overall conduct during the period from November 1985 to March/April 1986. But I do not believe that, in developing his plan for AEFC to make equity investments, and in contributing his letter to the private placement memorandum, he intended to deceive anyone.

398 A plan involving such obvious conflicts of interest was improvident, but it was not developed to serve an ulterior purpose of conferring a personal interest on Mr Gledhill, who would benefit from the success of the plan only in his capacity as general manager of AEFC. However, in my view Mr Gledhill's plan showed a kind of moral obtuseness, in disregard for the rights of potential investors in Aequitas. Its structure ensured that the interests of those investors would be subordinated to AEFC's desire to make short-term profits. Though Mr Gledhill believed that the Rendell Industries shares were not overpriced, he knew that their valuation depended on assumptions that had not been independently verified and were increasingly open to question.

399 However, looking at the circumstances objectively but taking into account Mr Gledhill's characteristics as a observed in the witness box, I do not regard him as having acted dishonestly. His was an abject failure to act prudently and with due diligence, a but it was not so reckless as to be tantamount to dishonesty. His conduct may have rendered him liable to his company for want of care (it is not for me to decide that question), but it di not render him an accessory to the breaches of fiduciary duty of others.

400 I turn now to consider whether Mr Gledhill has accessory liability in respect of other breaches of fiduciary duty. I have found that AEFC (as well as AEFCAS and CASO) was in breach of the fiduciary duty of a corporate or financial adviser, and that AEFC and AEFC Leasing (as well as AEFCAS and CASO) were in breach of the fiduciary duty of promoters. But I have taken the view that Mr Gledhill did not personally occupy a fiduciary position, even though his conduct and omissions were amongst the facts which gave rise to the fiduciary duties of AEFC and AEFC Leasing and their breach. Those findings raise for consideration the question whether Mr Gledhill is liable as an accessory to those breaches of fiduciary duty.

401 In my opinion the inevitable result of my findings is that Mr Gledhill procured or induced the breach by AEFC of its fiduciary duty as a corporate or financial adviser, as a principal in the joint venture. But he did not do so dishonestly. My reasoning with respect to Mr Gledhill's accessory liability for breach of directors' duty is equally applicable here. He was in a position to ensure that the

private place memorandum was not misleading, although he was not directly responsible for or involved in drafting it. Had he done so, AEFC would have avoided liability for breach of its fiduciary duty. But his failure to intervene to correct and perfect the document was a failure to act prudently or carefully, rather than a failure to act honestly. While there were grounds for serious concern about the Rendell group's future solvency, the evidence does not indicate that he in fact held those concerns and deliberately suppressed them. He appears to have believed, though without any solid foundation, that the price paid by Aequitas No.1 for the Rendell Industries shares was fair, and that the group would overcome its financial difficulties.

402 Mr Gledhill also procured or induced the breaches of fiduciary duty by AEFC and AEFC Leasing. His conduct was an important ingredient in the circumstances leading these companies to be promoters. Again, he was not dishonest, although his conduct was highly improvident.

403 Although the plaintiffs were given ample opportunities to amend the statement of claim, their pleading of Mr Gledhill's accessory liability was, until the end, limited to accessory liability for breach of the fiduciary duty of Messrs Mullins and Rees as directors. I have nevertheless considered whether Mr Gledhill has accessory liability with respect to the breaches of the fiduciary duties of AEFC as corporate adviser and promoter, and of AEFC Leasing has promoter. As it happens, I have regarded it as open to me to find against Mr Gledhill on these matters, although in the end I have not done so. In *Gray v New Augarita Porcupine Mines* [1952] 3 DLR 1, the pleadings alleged fraud in the sense of deceit or misrepresentation, rather than breach of fiduciary duty. But the Privy Council took the view that enough was said in the statement of claim to show that special reliance was intended to be placed upon the defendant's obligations as a director and upon his breaches of fiduciary duty, and consequently a claim based on 'equitable fraud' was open on the pleadings. Their Lordships said (at 13-14) that 'what matters is that a defendant should have had adequate warning by the pleadings as to the issues of fact that are to be raised against him ...'. In my opinion, the further amended statement of claim gave Mr Gledhill ample warning of the issues of fact in this case. The question of his potential accessory liability, with respect to the breaches of fiduciary duty by AEFC and AEFC Leasing, does not raise any new issues of fact, especially given that the pleadings alleged that Mr Gledhill was a primary fiduciary along with AEFC and AEFC Leasing.

404 The accessory liability of AEFC and AEFC Leasing also depends upon establishing that they have been dishonest. Although Mr Gledhill was not the directing mind and will of those companies, he was their primary agent in all relevant matters. I have found that he was not dishonest. It follows that neither of the companies was dishonest, and consequently they have no accessory liability for the breaches of directors' duty by Messrs Mullins and Rees. But I have found them to be liable as primary fiduciaries.

Fraudulent misrepresentation and misleading or deceptive conduct

405 The further amended statement of claim alleges that AEFC and Mr Gledhill failed to disclose various matters with respect to the financial condition of the Rendell group, allowing representations to be made to Aequitas and Aequitas No 1 which they knew to be false. Thereby, it is alleged, they engaged in conduct which amounted to deceit at common law and fraud in equity, and conduct which was misleading and/or deceptive or likely to mislead or deceive contrary to s 52 of the Trade Practices Act 1974 (Cth) and s 42 of the Fair Trading Act 1987 (NSW).

406 To succeed in an action of deceit, the plaintiffs must prove, inter alia, that Mr Gledhill and AEFC knew that the misrepresented material was false, or did not care whether it was true or false: *Derry v Peek* (1889) 14 App Cas 337. I have found (for the purposes of accessory equitable liability) that Mr Gledhill was not dishonest, but he acted very imprudently, and even showed a kind of moral obtuseness, both with respect to making a realistic assessment for himself of the position of the Rendell group, and ensuring that the true position was disclosed to Aequitas and its external investors. He appears to have believed that the Rendell group would survive and that the private placement memorandum was not misleading. Assuming that he can be said to have made the representations alleged in the pleading, he neither knew that those representations were false, nor made them without caring whether they were false or true. Consequently the ingredients for deceit have not been made out. The position is no different with respect to the allegation of equitable fraud in the active sense, as opposed to the extended

category of equitable fraud which includes breaches of fiduciary duty: RP Meagher, WMC Gummow and JRF Lehane, *Equity Doctrines and Remedies* (3rd ed, 1992), p 335.

407 The action based on statutory misleading or deceptive conduct must fail, in my opinion, because it is clearly statute barred. Section 82(1) of the Trade Practices Act says a person who suffers loss or damage by conduct of another person that was done in contravention of, inter alia, s 52, may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention. The equivalent provision in the Fair Trading Act is s 68(1), relating to proceedings based on contravention of s 42. That is the cause of action asserted in the pleading.

408 Section 82 (2) (s 68 (2) of the Fair Trading Act) states that an action under subsection (1) may be commenced at any time within 3 years after the date on which the cause of action accrued. In this case the losses suffered by the misleading conduct arose out of payments made by Aequitas and Aequitas No 1 during the period from 25 November 1985 to 15 July 1988, allegedly induced by the defendants' misleading conduct. The most recent of these payments was more than three years before the proceedings were commenced on 6 November 1991. The cause of action was complete when the loss was ascertained and quantified: *Wardley Australia Ltd* v *State of Western Australia* (1992) 175 CLR 514.

409 In my opinion, the evidence is that the plaintiffs' loss in respect of its equity investments had been ascertained and quantified, at the latest, when a provisional liquidator was appointed on 18 August 1986, shortly after the appointment of a receiver and manager and the delivery by Arthur Young of their preliminary report, which demonstrated that Rendell Industries was insolvent. By virtue of those events, it had become clear that there would be nothing available for contributories. There may have been some slight prospect for Aequitas and Aequitas No 1 to receive a distribution in the winding up of Rendell Industries in respect of their loans after those events, but it appears on the evidence that this prospect faded outside the three-year limitation period. I therefore conclude that the misleading conduct claims are statute-barred.

Conspiracy

410 I have found that the payment of $69,400 by AEFC to CASO on 14 July 1986 was not a bribe or secret commission because it was not paid or promised as an inducement for a breach of fiduciary duty. Nevertheless the plaintiffs submit that the agreement to pay that amount was a conspiracy to defraud at common law, relying on *Mayor & c of Salford* v *Lever* [1891] 1 QB 168, 176. This is because, they say, the corporate adviser of Aequitas (and for that matter, the Rendell group) was being paid a secret profit without giving Aequitas the opportunity of knowing that AEFC Leasing only wanted to retain about $890,000 of the price for the shares in a transaction in which AEFCAS was also, openly, charging over $28,000 in fees to Aequitas. Similar allegations are made with respect to the payment of $50,000.

411 The defendants say there was no agreement to pay AEFCAS any secret commission to procure the purchase by Aequitas No 1; that Messrs Mullins and Rees entered into the share sale agreement because they regarded it to be in the best interests of Aequitas No 1, and did not regard it as improvident or the purchase price as excessive. They say that AEFCAS did not withhold any information from Aequitas or engage in fraud or misleading or deceptive conduct, and that AEFC by itself or its agent AEFCAS did not procure Aequitas No 1 to enter into the share sale agreement.

412 In my opinion, the claim based on conspiracy is unsuccessful, even though I have found the payment of $50,000 to be a bribe or secret commission. I am not persuaded on the evidence that the payment of $50,000 was related to the agreement, even in an extended sense. It appears to have been the product of a unilateral decision by Mr Gledhill. As regards the payment of $69,400, I have found that it was not related to the share transaction because it was made after that transaction was completed, and the evidence is insufficient to link the two events.

Breach of contract

413 Since the contract between the joint venturers and Aequitas was for the provision of advisory services, it contained an implied term that the venturers would, by their agent AEFCAS, exercise reasonable care in the performance of those services: *Astley v Austrust Ltd* (1999) 73 ALJR 403, 414. Although in November 1985 Aequitas was a captured entity, wholly under the control of Messrs Mullins and Rees, they and Mr Gledhill intended that Aequitas would attract independent investors and have a relatively independent board in due course. In those circumstances, the joint venturers were required by the implied contractual term to give advice as corporate advisers (to be discharged by advice given to Aequitas by Mr Mullins and Mr Rees) with respect to whether, before the transaction of 25 November 1985 was entered into, it would be prudent for Aequitas No 1 to enter into it. They should also have considered, and probably implemented, arrangements to enable the contract to be reviewed once an independent board was in place.

414 The evidence does not provide an adequate basis for justifying a price of $960,000 for the Rendell Industries shares as at 25 November 1985, given that the shares had been acquired seven weeks earlier for $250,000. Nothing in the evidence indicates that Mr Mullins or Mr Rees, or anybody else at the time, conducted the kind of 'due diligence' investigation that would have established a fair price payable by an independent third party. The defendants submit that no basis has been established in the evidence for the conclusion that the transaction was not in the interests of Aequitas No 1, other than by reference to what happened after the event. But this submission misconceives the contractual duty of a corporate or financial adviser whose retainer extends to advice on a particular transaction. Knowing that AEFC Leasing had acquired the shares for a cash payment of only $250,000 seven weeks earlier, Mr Mullins and Mr Rees should have taken care to advise as to whether the proposed higher price was fair.

415 The pricing of the transaction seemed to have emerged from the work carried out in June and July 1985, principally (it seems) by Mr Rees. Thereafter, it appears, the figure of $910,000 was treated without further analysis as the amount that AEFC expected to realise from the sale of its investment, either after the stock exchange listing of Rendell Industries or by private agreement. It appears that Mr Rees adhered to his calculations during the period from July 1985 to April 1986, even though his assessment can only have been based on assumptions about the financial viability and prospects of the Rendell group that were placed under increasing strain.

416 Since the purchaser did not raise funds to complete the purchase until late March 1986, the implied contractual obligation of the joint venturers required them to keep the transaction under review until that time. An important component of the valuation of the Rendell group was the valuation of the Hurstville property. Messrs Mullins and Rees were aware that the status report by Turner of 26 November 1985 estimated that the property could be expected to realise between $750,000 and $1 million. This was much lower than the book value of the site, and also lower than the figure previously used by Mr Rees in his calculations. Mr Rees incorporated the lower end of the Turner estimates in his subsequent calculations (see his notes of 4 December 1985), but gave the high end of the valuation range as $1.9 million, and then proceeded on the basis that the high end of the range could be achieved through a sale and lease back. None of Mr Gledhill, Mr Mullins and Mr Rees saw the Turner estimates as raising an issue for further investigation, requiring an independent property valuation. Indeed, they acquiesced in the Rendell board sweeping the Turner report under the carpet.

417 I do not find that Mr Rees disbelieved his own calculations of value. The problem was that neither he nor Mr Mullins or Mr Gledhill considered the question of Rendell's value from an objective viewpoint. The evidence shows that they considered the transaction primarily from the viewpoint of AEFC.

418 The plaintiffs are highly critical of the conduct of Messrs Gledhill, Kelly, Mullins and Rees during the period from November 1985 to March 1986. They allege that AEFC's strategy was to support the Rendell group, even though they were aware of its financial difficulties, solely in order to keep it afloat until adequate funds had been raised by Aequitas to permit the settlement of the sale of shares to Aequitas No 1. That is too strong a proposition, but it is true that during this period, they were acutely aware of the connection between providing the Rendell group with sufficient funding to meet its pressing obligations, and deriving a substantial profit through the sale of shares transaction once Aequitas was put in funds by investors. Thus, in his memorandum dated 3 March 1986 to the Australian Committee of AEFC, recommending an increase in the Rendell facilities, Mr Kelly noted that it was

'critical that AEFC now provide further support to RIH pending the proposed share issue', and that 'the commercial risks associated with AEFC's involvement with Rendell are tempered by the substantial profit to be made from the equity investment transaction'.

419 My conclusion, on balance, is that during the period prior to the sale and up to completion Messrs Mullins and Rees, the principal executives of the joint venture who were responsible for the provision of financial advice to Aequitas, failed to give proper consideration to the interests of Aequitas, which are in substance to be equated with the investment interests of its potential investors. Moreover, in my opinion, no reasonable corporate advisers in the position of Messrs Mullins and Rees, and thus in the position of the joint venturers, could have concluded that the transaction was in the interests of Aequitas in this sense.

420 Mr Gledhill was in a position to direct their attention to the issues upon which Aequitas needed to be given advice, but he did not do so, because he saw Aequitas as an entity that had been created to serve the interests of AEFC. In the circumstances, through the failings of Messrs Mullens, Rees and Gledhill AEFC and CASO, and their agent AEFCAS, breached their implied contractual duty to exercise reasonable care in the performance of their advisory services.

Negligence

421 My finding with respect to breach of contract provides a remedy for Aequitas against AEFC, but there is no contractual remedy for Aequitas No 1 against AEFC, because Aequitas No 1 was not a party to the advisory contract. However, in my opinion AEFC, as principal in the advisory contract (a focus of which was a purchase of shares by Aequitas No 1) owed a duty of care to that company: *Hawkins v Clayton* (1988) 164 CLR 539. In the circumstances, the content of the duty was equivalent to the content of the contractual duty of care: *Astley v Austrust Ltd*, 73 ALJR at 413. The duty of care of a corporate or financial adviser is relevantly broader than the duty of a solicitor retained on a particular conveyancing transaction: cf *Citicorp Australia Ltd v O'Brien* (1996) 40 NSWLR 398; see *Waimond Pty Ltd v Byrne* (1989) 18 NSWLR 642.

422 In a sense, my findings with respect to breach of contract and negligence are academic because, as I shall explain, the measure of recovery in equitable compensation for breaches of fiduciary duties is more favourable to the plaintiffs.

Measure of recovery

423 I have found that

- AEFC breached its fiduciary duty as principal in a corporate and financial advisory relationship with Aequitas and Aequitas No 1;
- AEFC and AEFC Leasing breached their fiduciary duty as promoters of Aequitas and Aequitas No 1;
- AEFC Leasing paid a bribe or secret commission of $50,000 to AEFCAS for the benefit of AEFC;
- AEFC breached its contractual duty of care to Aequitas under its contract for the provision of corporate and financial advice;
- AEFC breached its common law duty of care to Aequitas No 1.

424 I turn now to the question of remedies with respect to those breaches. The prayers for relief in the further amended statement of claim seek damages, equitable compensation and an account of profits. Rescission is not sought. However, the plaintiffs directed some submissions to relief by way of rescission, and there is a question whether damages or equitable compensation can be ordered where rescission is available. Moreover, in a case such as this, an appreciation of the scope and limits of the remedy of rescission is an important part of understanding why a decree of equitable compensation is appropriate, and how far the compensation may extend into consequential losses. I shall therefore first consider the availability of rescission (although I do not intend, for reasons I shall give, to grant that remedy), and then turn to equitable compensation damages.

Rescission

425 I have already noted that, where a transaction is induced by the giving of a bribe, rescission of that transaction is an available remedy in equity. Rescission in equity is also available in respect of breach of an adviser's fiduciary duty (*Maguire v Makaronis*, at 467) and of a promoter's fiduciary duty (as in *Tracy v Mandalay*). Rescission is not available in respect of a breach of contract or the duty of care.

426 Rescission in equity does not require precise restitution in integrum. A court of equity can require adjustments to be made inter parties of a kind not available to a court of common law: *Alati v Kruger* (1955) 94 CLR 216, to 223-4; *Maguire v Makaronis* (1997) 188 CLR 449, 467. The Court's decree is moulded to achieve 'what is practically just': *Spence v Crawford* [1939] 3 All ER 271, 288 per Lord Wright. Once a breach of fiduciary duty has been established, 'the nature of the case will determine the appropriate remedy available for selection by a plaintiff': *Maguire v Markaronis*, at 467; see also *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218, 1278-9; *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 182 CLR 102, 113-5.

427 Rescission in equity is a more flexible tool than rescission at common law. The common law required the plaintiff to return *in specie* that which he had received under the contract, in the same condition as it was in when he received it; equity, having the means the common law lacked to ascertain and provide for adjustments necessary to restore the parties substantially to the status quo, was able to see the possibility of restitution in integrum in a much wider variety of cases: *Alati v Kruger*, at 223. In that case, the High Court found that rescission was available even though the business that was the subject of the contract of sale had effectively been destroyed when the landlord subsequently re-entered into possession of the business premises. In the present case, it is not clear to me on the evidence whether Rendell Industries has been dissolved, so that its shares no longer exist. However, if the shares do exist they are worthless, and as I understand the evidence, shareholders in Rendell Industries have not received any distribution in its winding up, and will not do so. Therefore 'restitution' would not involve the transfer of anything of value from the plaintiffs to the defendants, and consequently the effect of an order for rescission would be very similar (except with respect to the measure of recovery) to an order for the payment of money. On the authority of *Alati v Kruger*, these considerations would not prevent the Court from ordering restitution in this case, if it were otherwise appropriate to do so.

428 There is a question whether equitable compensation is available, as an alternative remedy, in a case where rescission might be sought. *Tracy v Mandalay* is authority for the proposition that, if the property on which the profit was made was acquired by the promoter before he or she became a promoter, there can be no claim for recovery of the profit, nor, it seems, for equitable compensation. By extension of that reasoning, if rescission is unavailable in such a case, neither is an account of profits or equitable compensation: cf *Ladywell Mining Co v Brookes* (1887) 35 Ch D 400. The reasoning appears to be that if the company elects to affirm the purchase, it would be unjust for the Court to intervene to 're-write the bargain between the parties'. Although it has an established pedigree (*Re Kape Breton Co* (1885) 29 ChD 795; *Jacobus Marler Estates v Marler* (1913) 85 LJPC 167n; *Cook v Deeks* [1916] 1 AC 554), I respectfully suggest that the reasoning underlying these cases is unsatisfactory, especially where rescission has become impossible. In such a case refusal of an account or compensation would work serious injustice: see *Gower's Principles of Modern Company Law* 6th ed by P L Davies, (1997) p137-8. In such a case an order for an account of profits or equitable compensation is not directed to re-writing the contract, but to addressing the consequences of conduct of the defendant that was collateral to the contract.

429 Moreover the reasoning is inconsistent with the modern approach to remedies, articulated in *Maguire v Makaronis* (at 467) and other cases, that 'the nature of the case will determine the appropriate remedy available for selection by the plaintiff'. In any case, the older cases acknowledge that the position is different if the promoter acquires property after he or she has become a promoter, and sells it to the fledgling company. That was the case here, since AEFC and AEFC Leasing had become promoters before 25 November 1985.

430 Another question is whether equitable compensation might be combined with an order for rescission. An examination of the relief granted in *Tracy v Mandalay* (at 245-6, 247) shows that an order for rescission of a contract may be accompanied by ancillary orders which enable the plaintiffs to recover costs that they have properly incurred in connection with the contract. In that case, the plaintiff

was indemnified 'against all debts and liabilities (if any) whether for land tax, municipal water rates or in respect of proceedings against the plaintiff or otherwise for which the plaintiff has or may become liable to pay ...'. Similarly, in *Maguire v Makaronis* (at 467-8) the High Court observed that, in some circumstances, a purchaser seeking rescission of a contract for the purchase of a business, by reason of a vendor's fraudulent misrepresentations, may be entitled to an indemnity for trading losses incurred, both before the purchaser disavowed the transaction and thereafter whilst the business was maintained for the benefit of the vendor; but the indemnity will extend only to that part of the trading losses which were 'directly occasioned' by the falsity of the vendor's representations.

431 The plaintiffs say that if the Court orders the rescission of the contract for purchase of the Rendell Industries shares, it may couple that order with an order for equitable compensation for the further moneys which they invested in or lent to the Rendell group, subject to an assignment to the defendants of the loan securities and shares obtained by the plaintiffs when they made those further investments. As noted below, the further investments and loans amount to approximately as much as the purchase price for the initial shareholding. In their written submissions, the plaintiffs say that this would be 'restorative relief - Rendell Industries was benefited by - and strengthened by - these injections of money, albeit that they amounted to drops in a drain in the end'.

432 I would be going somewhat beyond the present case law if I were to order both rescission and equitable compensation in any general sense. As I understand the cases, the compensation orders that have accompanied a decree of rescission have been specific orders ancillary to the primary decree, directed to ensuring that the primary decree achieves its restitutionary purpose. It is not clear to me that I can both order that a contract be rescinded, and also make a series of specific orders for equitable compensation, if the theory underlying the compensation orders is only that the losses would not have been occurred but for the wrongdoing. Orders for compensation in respect of trading losses ancillary to rescission of a contract for the sale of the business, and in respect of taxes and duties ancillary to rescission of a contract for the sale of land, are much more closely related to the primary relief, than what is proposed by the plaintiffs in this case.

433 If, however, I order equitable compensation but not rescission, the law requires that the compensation be measured by reference to losses that would not have been incurred but for the breach. The relevant case law is discussed below. According to the *Warman International* case, the plaintiffs have the option of selecting the remedy of equitable compensation to the exclusion of rescission. They have exercised that election in the further amended statement of claim.

The plaintiffs' losses

434 The plaintiffs claim damages or equitable compensation in the total sum of $2,569,651.90, together with interest to be calculated at Schedule J rates. Interest has not been calculated, but it will be substantial, since the losses were payments made during the period 1985-1988, now irrecoverable because of the collapse of the Rendell group. The capital sum comprises total losses suffered by Aequitas in the sum of $965,821.10, and total losses suffered by Aequitas No 1 in the sum of $1,603,830.80. The plaintiffs have broken down their claims into categories, in their written submissions. For the purposes of this judgment, the following summary will suffice:

(1) the *purchase price* of $960,000, of which Aequitas paid $1,000 and Aequitas No 1 paid $959,000;

(2) *purchase costs* in the sum of $11,296.50, relating to legal fees and stamp duty, paid by Aequitas No 1;

(3) *further share purchases* on 3 June 1986 in the sum of $486,375 paid by Aequitas;

(4) *costs of further share purchases* (stamp duty) in the sum of $ 1,911.10 paid by Aequitas;

(5) *loans* to Rendell Industries and others related to the Rendell group, in April, June and July 1986, totalling $450,000 by Aequitas and $575,000 by Aequitas No 1 (the plaintiffs' schedule contains a typographical error in which the figure $400,802.80 should be $400,302.80);

(6) *cost of loans* (stamp duty) in the sum of $ 3,291 paid by Aequitas No 1;

(7) *cost of enforcement against Rendell Industries* (investigating accountants and solicitors) totalling $11,000 paid by Aequitas and $25,436.15 paid by Aequitas No 1;

(8) *flotation costs* (accountants and solicitors) in the sum of $15,535 paid by Aequitas; and

(9) *extra payments* to ANZ Bank in the sum of $29,807.24, paid by Aequitas No 1 in July 1988 (arising out of settlement of a claim by the Bank on a guarantee executed by Aequitas No 1 in favour of the Bank on 26 June 1986, of the indebtedness of Rendell Industries (NSW) Pty Ltd).

435 The defendants do not dispute these figures, except as to two matters. On these points I agree with the plaintiffs. First, the defendants say, as to category (5), that there is insufficient evidence of the circumstances surrounding the making of a loan of $11,200 to Mr Turner, to warrant any finding that they could be liable for this sum. But the evidence indicates that the loan was made at the direction of the Rendell Industries board. It is therefore a payment which Aequitas No 1 would not have made, but for its involvement with the Rendell group. Secondly, the defendants say, as to category (8), that there is insufficient evidence to warrant recovery of a payment of $3,000 to Law & Milne. It seems to me probable, however, that this account related either to the proposed flotation of Aequitas or to advice given by that firm on potential areas of recovery. In either case, it is a payment that would not have been made but for the involvement of Aequitas with the Rendell group.

436 Some of the plaintiffs' categories of loss are directly the result of the wrongful conduct of AEFC and AEFC Leasing. Some are categories of foreseeable loss. While it is doubtful in others whether the loss was foreseeable.

437 Thus, clearly categories (1) and (2) are recoverable as losses directly consequent upon the breaches of duty. Category (8) is recoverable as a foreseeable loss, since Aequitas No 1 was induced by breaches of duty to enter into a contract to purchase the Rendell Industries shares and it was foreseeable that, in consequence of that transaction, Aequitas would incur costs in preparing for flotation and stock exchange listing. The costs in category (7) were also foreseeable, since it could be predicted that if Aequitas No 1 became a major shareholder in Rendell Industries, which was known by the defendants to be in difficult financial circumstances and subsequently failed, it would be likely to incur some accounting and legal costs in connection with that failure, regardless of whether it also made loans to the group.

438 However, I do not regard the acquisition of further shares (categories (3) and (4)) or the making of loans to the Rendell group (categories (5), (6), and (9)) as foreseeable consequences of the defendants'

wrongdoing. It is true that these events would not have occurred but for Aequitas No 1 becoming involved with the Rendell group in consequence of the purchase of shares induced by two of the defendants' breaches of duty. But it was not, in my view, foreseeable that Aequitas and Aequitas No 1 would voluntarily choose to make further investments in the Rendell group. At most, it could be foreseen that they would be under some pressure or temptation to do so.

439 To the extent, therefore, that the plaintiffs' entitlement to damages is limited by considerations of foreseeability, I would limit their recovery to categories (1), (2), (7) and (8). It thus becomes necessary to consider whether there is a basis for recovering the additional categories of loss in a manner that sidesteps the requirement of foreseeability. It appears, for reasons I shall now set out, that the plaintiffs are entitled to recover the additional categories of loss because of the fact that the wrongdoing of two of the defendants amounted to breaches of fiduciary duty entitling them to equitable compensation, not merely torts and breaches of contract entitling them to common law damages.

Account of profits

440 It appears to me that the plaintiffs' submissions elect, in effect, to pursue equitable compensation rather than an account of profits. This they are entitled to do: *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 559. In view of my findings concerning the consideration, there would be a recoverable profit on the sale of shares, measured by the difference between the purchase price of $960,000 and the amount paid by AEFC Leasing for the acquisition, less a cost of funds component for that amount. Mr Gledhill calculated the profit at $90,000, and the Court would accept that calculation. However, by seeking equitable compensation rather than an account for profits the plaintiffs will recover the whole $960,000, and much more besides.

Measure of recovery at common law and in equity

441 Leaving aside the question of exemplary damages, the measure of loss for negligence is the restoration of the plaintiffs to the position they would have been in but for the defendants' tort: see, for example, *Livingston v Rawyards Coal Co* (1880) 5 App Cas 25, 29 per Lord Blackburn. The measure of damages for breach of contract is different in formal terms, since it includes expectation loss, but it produces a result identical in substance with the tort measure of damages in the present case. Both in tort and contract, the defendants are liable for the foreseeable consequences of their conduct: *Wagon Mound (No 1)* [1961] AC 388, 426.

442 Equity intervenes in a case of breach of fiduciary duty, not so much to recoup a loss suffered by the plaintiff as to hold the fiduciary to, and vindicate, the high duty owed to the plaintiff: *Maguire v Makaronis* (1997) 188 CLR 449, 465; *Warman International Ltd v Dwyer* (1994) 182 CLR 544, 557-8. Nevertheless breach of an equitable duty may lead, in an appropriate case, to an order for the payment of compensation rather than specific relief such as rescission. Equitable compensation, to be distinguished from common law damages, is available in the case of breach of the fiduciary duty of an adviser or promoter: *Nocton v Lord Ashburton* [1914] AC 932, 956; *Warman International Ltd v Dwyer* (1994) 182 CLR 544, 556-7. The order for the payment of compensation is designed to make good a loss in fact suffered by the person to whom the duty is owed and which, using hindsight and commonsense, can be seen to have been caused by the breach: *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 439. Like the tort measure of damages, an order for the payment of equitable compensation is designed to restore the plaintiffs to the position they would have been in but for the defendants' equitable wrongdoing: *Target Holdings*, at 432. But it appears that there are some differences in the principles for the assessment of loss. Foreseeability and remoteness in the common law sense, and the doctrine of novus actus interveniens, are not applied in assessing equitable compensation: *Maguire v Markaronis*, at 470; *Target Holdings Ltd v Redferns*, at 434; *O'Halloran v R T Thomas & Family Pty Ltd* (1998) 45 NSWLR 262, 275.

443 It is essential, however, that the losses made good are only those which on a common sense view of causation, were caused by the breach: *O'Halloran*, at 273 per Spigelman CJ (citing *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR (4th) 129, 163 per McLachlin J, dissenting). The Court must identify 'the criteria which supply and adequate or sufficient connection between the

equitable compensation claimed and the breach of fiduciary duty': *Maguire v Makaronis*, at 473; *O'Halloran*, at 276. The rules for recovery of equitable compensation are still developing, and there is a normative aspect to the determination of issues of causation: *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1, 90.

444 In some cases of equitable compensation, the courts adopt what Spigelman CJ referred to as 'a stringent test to the selection of those events preceding loss which are to be taken as causing the loss': *O'Halloran*, at 276-7. Where the fiduciary is a trustee who has been disloyal or has failed to observe the rules for due administration of the trust, the trustee must replenish the trust fund by restoring the assets that have been lost by reason of the breach, or compensation for the loss of those assets: *Target Holdings Ltd v Redferns*, at 434; *Maguire v Makaronis*, at 471. In this context, losses will be taken to have been caused by the breach if, but for the breach, the loss would not have occurred (*Target Holdings Ltd v Redferns*, at 434; *Maguire v Makaronis*, at 470), and no closer connection between the loss and the breach will be required.

445 The approach taken to trustees is also taken where a company director uses a power to dispose of company property for improper purposes, since in both cases the beneficiary of the duty is in the position of vulnerability: *O'Halloran*, at 277. An even stricter approach to causation was taken in *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465. In that case Brickenden was a solicitor who acted for both a proposed mortgagor and a proposed mortgagee, in a transaction from which he would personally gain. He was found to have breached his duty by non-disclosure of material facts. The Privy Council held (at 91) that Brickenden could not 'be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the [client's] action would be solely determined by some other factor ...'. Their Lordships continued: 'Once the Court has determined that the non-disclosed facts were material, speculation as to what course the [client], on disclosure, would have taken is not relevant.'

446 If *Brickenden's* case governs the circumstances, it is not even relevant to inquire whether, but for the non-disclosure, the transaction would have been entered into. It might therefore be thought that *Brickenden's* case has dispensed entirely with the requirement of causation. However, in *Beach Petroleum* (at 91-94) the Court of Appeal carefully analysed the judgments at all levels in *Brickenden*, and concluded that it is not authority for the general proposition that in cases of breach of fiduciary duty, the Court cannot consider what would have happened if the duty had been performed. They said (93):

> '*Brickenden* was concerned with a chain of events in which the alleged default of the fiduciary was a necessary component. The information which the solicitor was obliged to disclose was the very information upon which the third party had to act. It was such an act, necessarily linked to the performance of the fiduciary duty, about which 'speculation' was said to be inappropriate.'

447 In *Maguire v Makaronis*, at 470-4, the High Court did not express a concluded view on *Brickenden's* case, but took the view that there is no need to apply it to cases of rescission, where the equity to set aside the transaction is immediately generated by the breach of duty, and questions of causation do not arise.

448 The same 'but for' test of causation is applied to claims for equitable compensation for consequential loss. Here the courts do not hesitate to consider what the beneficiary of the duty would have done had there been no breach. Questions of foreseeability, remoteness, and novus actus interveniens are irrelevant. Thus, in *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390, 395, customers of the Bank relied on the Bank's advice as to the value of a hotel and its financial viability, and consequently purchased the hotel. It was held that the Bank had breached its fiduciary duty in giving the advice, because it had conflicting duties to the purchaser and seller of the hotel, the seller also being a bank customer. The court awarded the purchasers damages measured by the difference between the amount paid for the hotel and its true value, plus interest. The purchasers' claim for damages for consequential loss, measured as the difference between what the purchasers would have received had they stayed in the employment which they held immediately before purchasing the hotel, and the net profits of the hotel, was rejected. This was because the purchasers had already decided to leave their employment and conjecture as to what their position would have been had they not purchased the hotel was pure speculation.

449 In the present case, the breaches of fiduciary duty by AEFC and AEFC Leasing relate to conflicts between interest and duty. AEFC stood to derive substantial indirect benefits (through the increase in value of its subsidiary, AEFC Leasing, and through eventual receipt of the $50,000 commission), and AEFC Leasing stood to gain a substantial direct benefit (its profit), from the sale of the Rendell Industries shares to Aequitas No 1. AEFC was a principal of the joint venture which undertook to provide corporate and financial advice to Aequitas, and both AEFC and AEFC Leasing were promoters of Aequitas and Aequitas No 1. They did not make timely disclosure of all material facts relevant to the transaction, to the independent directors or potential investors. The undisclosed material facts included the profit that AEFC Leasing stood to gain on the transaction, and the declining financial circumstances of the Rendell group. They allowed a materially false and incomplete private placement memorandum to be issued.

450 Accurate and full disclosure to the Aequitas board prior to the sale transaction would not have prevented Aequitas No 1 from contracting to buy the shares, since at the date of the contract it was under the control of Messrs Mullins and Rees, who were aware of all relevant matters. Accurate and full disclosure immediately after the appointment of the independent board would probably not have brought the transaction to an end, since there was no right of review for termination in the contract and it was too late at that stage for the independent directors to have any influence over the content of the private placement memorandum. A fortiori, such disclosure as was made to Mr Pond in the second half of March 1986, for the purpose of preparation of his report, would not have brought the transaction to an end, even assuming that the same information was fully available to Messrs Rich and Donohoe. But in my opinion, it is very likely that accurate and full disclosure in the private placement memorandum would have dissuaded investors from applying for shares in Aequitas, as disclosure would have informed them that Aequitas No 1 would be paying much more for the Rendell Industries shares than had been paid by the vendor seven weeks before the contract of sale, and that the Rendell group was suffering from chronic and acute cash flow difficulties. Indeed, an accurate and full private placement memorandum would effectively have amounted to a warning against investment.

451 Aequitas No 1 would not have been able to complete the purchase transaction if investors had been discouraged from subscribing for shares in Aequitas. If that had occurred, it is unlikely that AEFC Leasing would have sought to enforce the contract against Aequitas No 1, but if it had done so, Aequitas would have had by that time sufficient independent directors that it could have taken proceedings for rescission of the contract for breach of duty. It is probable that, instead of completing the purchase transaction on 1 April 1986, the plaintiffs would have terminated the purchase by no later than that time. Consequently, Aequitas and Aequitas No 1 would not have suffered loss through the Rendell Industries transaction, but for the breaches of duty by AEFC and AEFC Leasing failing to ensure that accurate and full disclosure was made in the private placement memorandum.

452 These factual conclusions lead me to hold that the breaches of fiduciary duty by AEFC and AEFC Leasing caused Aequitas and Aequitas No 1 to suffer the losses of which they complain. It is not necessary for me to rely on *Brickenden's* case. However, it seems to me that the present facts fall within *Brickenden's* case, even on the narrow ratio ascribed to that case by the Court of Appeal in *Beach Petroleum*. In other words, in this case the element of causation between breach and loss is satisfied, for the purposes of equitable compensation, whether or not *Brickenden* remains good law in Australia.

453 On the state of the authorities, the plaintiffs are entitled to be restored to their position prior to 25 November 1985, and to recover all of the losses that they would not have incurred but for the defendants' breaches. If the breaches had not occurred, the plaintiffs would not have completed the purchase transaction on the 1 April 1986 and would have terminated the contract by that time. Therefore, they would not have made the short-term loan of 3 April 1986 or any of the subsequent loans, and they would not have made the loan of $486,375 and converted it into equity. All those steps have led to losses of the amounts invested, and consequential losses. They are all recoverable as equitable compensation.

454 The defendants say that contributing fault is to be taken into account when making a determination of the amount of equitable compensation to which a plaintiff is entitled: *Duke Group Ltd (in liq) v Pilmer* (1999) 31 ACSR 213, at 383-391, especially at 389. Assuming that this statement of principle is

correct (notwithstanding dicta to the contrary, to which his Honour refers), it has no application in the present circumstances. There was no contributing fault, on the part of the plaintiffs, to their own loss.

455 It is true that, from late March 1986, the directors of Aequitas had available to them the information supplied by Mr Pond for the purposes of his report. That information showed the acute financial difficulties of the Rendell group, but (as I have said) it did not establish that the company was insolvent. It was open to a person in the position of Mr Pond, expert in the affairs of the building industry, to take the view that the problems of the Rendell group were cash flow problems (acute though they were), which could be overcome by the injection of additional funds. That, in effect, is the view Mr Pond in fact took. I have also found that the information supplied to Mr Pond provided grounds for serious concern about the solvency of the Rendell group in the future. But consistently with that finding, it was open for Mr Pond to believe, as he did, that the injection of further funds by Aequitas and others would enable the problem to be solved. Potential investors, as I have found, would be likely to take a more conservative view.

456 It follows, in my opinion, that while the plaintiffs would be entitled to recover the losses in categories (1), (2), (7) and (8), but not the losses in categories (3), (4), (5), (6), and (9) as common law damages for tort and breach of contract, all nine categories of loss are recoverable as equitable compensation for breaches of fiduciary duties.

Interest

457 The plaintiffs seek interest at Schedule J rates on all of the losses recoverable by them from the time when the losses were incurred until the date of my orders. The defendants' submission on interest is as follows:

> 'Given that 'an order for the payment of interest at commercial rates extending for long periods into the past is prima facie productive of unfairness to the defendant', it would be inappropriate for the Court to make an order requiring the defendants to pay interest as from the dates on which the plaintiffs say they incurred the losses: *Simonius Vischer & Co v Holt & Thompson* [1979] 2 NSWLR 322 at 388 per Moffitt P; see also *Anderson's (Pacific) Trading Co Pty Ltd v Karlander New Guinea Line Ltd* [1980] 2 NSWLR 870 at 878.'

458 The defendants claim that the plaintiffs were responsible for the delay from 1986 to 1991, when the proceedings commenced. They point out that Aequitas resolved to obtain a review of 'litigation opportunities' in relation to Rendell Industries in September 1986, and Law & Milne identified AEFC Leasing and AEFCAS as possible targets in their letter of 27 November 1986. The defendants say no satisfactory explanation has been offered as to why proceedings were not commenced until 6 November 1991. In the circumstances, they say it would be unfair to impose interest with respect to the entire period from 1986 to date.

459 There is some evidence that, after the collapse of the Rendell group, Aequitas went about selling investments that had been made on the recommendation of AEFCAS, but none of them proved to be readily saleable. It appears that asset realisations were delayed by the receivership of the Rendell group, which was concluded in 1989. On 2 March 1990 a Mr Doolan was asked by the directors of Aequitas to investigate and report on the facts and circumstances of the purchase of the Rendell Industries shares. He reported on 13 June 1990, recommending that legal advice be obtained. The plaintiffs' solicitors were then retained and a statement of claim was filed on 6 November 1991.

460 While this evidence tends, to a degree, to explain the delay between 1986 and 1991, it does not justify that delay. It would not be fair, in my view, to require the defendants to pay interest in respect of the period beginning when, on a fair view of the circumstances, the plaintiffs might reasonably have been expected to commence proceedings, and 6 November 1991, when the proceedings in fact began. In my then, given that Law & Milne notified them of the prospect of recovery from AEFC Leasing and AEFCAS on 27 November 1986, the plaintiffs might reasonably have been expected to commence their proceedings by mid-1987. I would therefore not allow interest in respect of the period from 1 July 1987 to 5 November 1991 inclusive.

461 Interest is recoverable, in my view, in respect of the period from the date of incurring each individual loss (the respective dates of payment) and, in each case, 30 June 1987. The plaintiffs will have to make some calculations, with which (one hopes) the defendants will be able to agree, to avoid contention on matters of detail.

462 After the commencement of the proceedings, much of the delay seems to have been caused (perhaps not surprisingly) by the process of discovery. The plaintiffs' solicitors provided particulars on 13 April 1992, a verified defence was filed on 6 August 1992, and the defendants filed their first list of documents on 19 October 1992. The list did not include some important material. The defendants filed their second list of documents on 31 October 1995, comprising 185 pages specifying a total of 2,072 documents. Their third list of documents was filed on 14 February 1997, specifying that out of the total list of documents, 1017 documents were the subject of a claim of privilege. The defendants filed answers to interrogatories on 19 August 1997. Various amendments were made to the pleadings, and other interlocutory issues were addressed. The case was entered into the general list in April 1998.

463 As far as I can see, there is nothing in this chronology to suggest that the plaintiffs delayed the proceedings after they had been initiated. It is not inappropriate that the sum recoverable by the plaintiffs should bear interest during the period commencing on 6 November 1991, when the statement of claim was filed.

464 The further amended statement of claim seeks interest but does not specify whether the interest should be simple or compound. Generally interest is awarded at simple interest rates, even in cases where the plaintiff claims violation of equitable rights. However, compound interest may be ordered against a defaulting fiduciary: *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669; *Commonwealth of Australia v SCI Operations Pty Ltd* (1998) 192 CLR 285, esp at 316-7. I do not regard the plaintiffs' submission for compound interest as too late. The defendants had the opportunity to respond to it, and did so. In my opinion, during those periods where interest is appropriate, I believe this is a case where compound interest should be ordered. The breaches of fiduciary duty that I have found to exist are serious breaches, although I have not found that Mr Gledhill was motivated by dishonesty. One of the breaches involves the giving of a bribe, a matter which the cases treat particularly seriously, as I have shown.

Exemplary damages

465 The plaintiffs submit that the evidence demonstrates an attitude of contemptuous disregard of the plaintiffs' rights by Messrs Mullins, Rees, Gledhill, and AEFCAS, AEFC and AEFC Leasing. They draw attention to what they allege to be gross and serious breaches of fiduciary duty, and lay particular emphasis on the secret commission. They say that the conduct of the defendants merits punishment, citing *Lamb v Cologno* (1987) 163 CLR 1, 8-9. They say the defendants' behaviour is akin to the conduct in *Gluckstein v Barnes* [1900] AC 240, which, according to Lord Macnaghten (at 255), should have caused penal interest to be charged.

466 I disagree with these submissions. Although I regard AEFC and AEFC Leasing as having committed serious breaches of fiduciary duty, principally through the actions of Mr Gledhill, I do not regard their conduct as meriting punishment beyond the remedies that I have found to be available.

Conclusions

467 Aequitas and Aequitas No 1 are entitled to recovery against AEFC for breach of its fiduciary duty as a corporate and financial adviser, and against both AEFC and AEFC Leasing for breach of their fiduciary duties as company promoters. They are also entitled to recovery in respect of a bribe or secret commission of $50,000 paid by AEFC Leasing to AEFCAS for the benefit of AEFC. In addition, Aequitas is entitled to recovery against AEFC for breach of its contractual duty of care, and Aequitas No 1 is entitled to recovery against AEFC for negligent advice. None of the other claims for recovery against AEFC and AEFC Leasing succeeds. No claims for recovery succeed against Mr Gledhill.

468 Aequitas and Aequitas No 1 are entitled to equitable compensation in the capital sums of $965,821.10 and $1,603,830.80, in the total sum of $2,569,651.90. Compound interest is to be ordered from the dates of individual payments to 30 June 1987, and from 6 November 1991 to the date of my orders. I shall direct the plaintiffs to prepare short minutes of orders and stand the matter over to a convenient date for the purpose of making orders and hearing argument as to costs.

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