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

1 of 3

NEW SOUTH WALES SUPREME COURT

CITATION: Aequitas v AEFC [2001] NSWSC 14

CURRENT JURISDICTION: Equity

FILE NUMBER(S): 5532/91

HEARING DATE(S): 23, 24 & 30 June, 1 & 2 July, 3 August, 1, 20 & 23 September 1999

JUDGMENT DATE: 09/04/2001

PARTIES:
Aequitas Limited and Aequitas No.1 Limited (P)
Sparad No.100 Limited (formerly Australian European Finance Corporation Limited) (D1)
AEFC Leasing Pty Limited (D2)
John Gledhill (D3)

JUDGMENT OF: Austin J

LOWER COURT JURISDICTION: Not Applicable

LOWER COURT FILE NUMBER(S): Not Applicable

LOWER COURT JUDICIAL OFFICER: Not Applicable

COUNSEL:
S Rares SC and N Perran (P)
A J Meagher SC and P Brereton (D)

SOLICITORS:
Cutler Hughes & Harris (P)
Holman Webb (D)

CATCHWORDS:
COMPANY LAW - financial adviser's and promoter's fiduciary duties - directors' duties - breach of duty; EQUITY - negative content of fiduciary duties - remedies for breach of fiduciary duties - where rescission not available - equitable compensation for causally connected but unforeseeable losses; PRINCIPAL & AGENT - secret commission - ingredients - element of inducement - knowledge by principal, where principal is a fledgling company controlled by promoters

ACTS CITED:
Fair Trading Act (NSW) 1984, ss 42, 68
Trade Practices Act (Cth) 1974, ss 52, 82

DECISION:
See last two paragraphs.

JUDGMENT:

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THE SUPREME COURT
OF NEW SOUTH WALES
EQUITY DIVISION

AUSTIN J

MONDAY 9 APRIL 2001

5532/91 AEQUITAS LIMITED & ANOR V SPARAD NO.100 LIMITED (FORMERLY AUSTRALIAN EUROPEAN FINANCE CORPORATION LIMITED) & 2 ORS

JUDGMENT

HIS HONOUR:

Introductory outline

1 Australian European Finance Corporation Ltd ('AEFC') was a merchant bank, owned at all relevant times by the Commonwealth Bank of Australia (51%) and some foreign banks (Banque Nationale de Paris as to 19%, Banca Nazionale del Lavoro as to 15% and Dresdner Bank AG as to 15%). Its general manager and principal executive officer, at all relevant times, was Mr J B Gledhill, who was also a director. In 1984 AEFC entered into a joint venture agreement with Corporate Advisory Services (Operations) Pty Ltd ('CASO'), a company controlled by Mr G E Mullins, to conduct the business of providing corporate advisory services. Under that agreement a company called AEFC Advisory Services Pty Ltd ('AEFCAS'), owned by AEFC (51%) and CASO (49%), was constituted as the manager of the joint venture business on behalf of the venturers.

2 During 1985, following deregulation of the Australian financial markets, AEFCAS (and through it, the joint venture) became involved in a series of transactions relating to the affairs of a building group, the Rendell group. Three of the main individuals involved in the affairs of AEFCAS and the joint venture were Mr Mullins, Mr G L Rees and Mr RG Porteous. During the period between May 1985 and August 1986, Mr Mullins was a director of AEFCAS, Mr Rees was a consultant to AEFCAS and Mr Porteous was a director of AEFCAS. Mr Gledhill, the general manager of AEFC, was a director of AEFCAS, and was also a director of AEFC Leasing Pty Ltd, a wholly-owned subsidiary of AEFC. Mr Mullins, Mr Rees and Mr Porteous were not directors or employees of AEFC, and had no financial interest in AEFC.

3 In July 1985 the joint venture (through AEFCAS) was retained by the Rendell group, then privately owned by the Rendell family, to assist with the restructuring of Rendell's finances. It advised that the Rendell group's interest-bearing debt should be replaced with equity. In October 1985, in consequence of that advice, a company called Rendell Industries Ltd acquired control of the Rendell group from the Rendell family, and AEFC Leasing became the owner of 74.8% of the shares of Rendell Industries. The cash consideration which AEFC Leasing provided for those shares was $250,000. Additionally it was said to have 'procured' AEFC to provide a deficiency guarantee to the ANZ Bank so as to allow the cancellation of some personal guarantees given by the former owner of the Rendell group, and to provide finance facilities to the Rendell group.

4 Mr Mullins became chairman and a director of Rendell Industries, as well as a director of the main operating company, Rendell Industries (Holdings) Pty Ltd ('RIH'). Mr Rees became a director of Rendell Industries, and the deputy general manager of AEFC, Mr J N Gallois, became a director of RIH.

5 The idea was conceived that Aequitas, originally a shelf company, would become a listed company, which would (through a subsidiary eventually known as Aequitas No 1) make investments introduced to it by the joint venture. It is not clear whether the idea came from Mr Mullins, Mr Rees or Mr Gledhill, but it was developed in discussions and memoranda by all three of them. The selected

investments were intended to be desirable investments of a kind too risky to meet the prudential guidelines under which AEFC had to work as a merchant bank.

6 Prior to 16 October 1985, Mr Mullins was the managing director and Mr Rees was a director of Aequitas. From 16 October 1985 Mr Rees was managing director and Mr Mullins continued as a director. Messrs Mullins and Rees and their wives were directors of Aequitas No 1.

7 As it happened, the first and only investment made by Aequitas, through its wholly-owned subsidiary Aequitas No 1, was the acquisition of AEFC Leasing's 74.8% shareholding in Rendell Industries. The purchase price was $960,000, the agreement for purchase being made on 25 November 1985. Of that purchase money $50,000 was to be 'passed through the joint venture accounts'. The plaintiffs say this was a secret commission.

8 Subsequently arrangements were put in place, principally by Mr Rees and Mr V M Kelly (Senior Manager Project Finance, AEFC) acting under the guidance of Mr Gledhill, for shares in Aequitas to be distributed by stockbrokers Bache Cortis & Carr ('Bache'), using a private placement memorandum. Sufficient funds were raised to permit settlement of the purchase of the Rendell Industries' shares to take place on 1 April 1986. AEFC Leasing made a profit of $710,000 (less the $50,000 fee to AEFCAS and some interest costs) on the transaction, having bought the shares for $250,000 in October 1985. AEFC agreed to pay a commission of $69,400 to CASO on receipt of the $960,000. The plaintiffs say this was another secret commission.

9 In June 1986 Rendell Industries was floated on the second boards of the Sydney and Melbourne Stock Exchanges. Very shortly afterwards, its managing director, Mr Griffin, resigned. By August 1986 the Rendell group was clearly insolvent and AEFC appointed a receiver to assets of Rendell Industries. Subsequently the Rendell group failed and Aequitas' shareholding was valueless. The plan for stock exchange listing of Aequitas was abandoned. Amidst recriminations, AEFCAS was dissolved, to prevent it from becoming a defendant in legal proceedings.

10 By a statement of claim filed in 1991 and subsequently amended several times, Aequitas and Aequitas No 1 have sought relief against AEFC (which subsequently changed its name to Sparad (No 100) Ltd), AEFC Leasing and Mr Gledhill. They seek to rely on causes of action based on: the fiduciary duties of financial advisers; directors and promoters; secret commissions; fraudulent misrepresentation; misleading and deceptive conduct; conspiracy; negligence; breach of contract; and (in the case of AEFC Leasing and Mr Gledhill) liability for knowing involvement in breaches of equitable duties.

11 Much of the hearing time was taken up by the submissions of the parties on questions of law relating to the scope and application of the various causes of action asserted by the plaintiffs. The availability of these causes of action depends on a close analysis of the facts.

12 I shall first make some observations about evidentiary difficulties that have arisen in the case. I shall then make my findings of fact under the following headings:

- the formation of AEFCAS and its relationship with AEFC;
- the retainer of AEFCAS to provide corporate advice to the Rendell group;
- the acquisition by AEFC Leasing of 74.8% of the shares in Rendell Industries;
- the acquisition and starting up of Aequitas and Aequitas No 1;
- the acquisition by Aequitas No 1 of the 74.8% shareholding in Rendell Industries;
- the financial difficulties of the Rendell group during the period from 3 October 1985 to 1 April 1986;
- the private placement of shares in Aequitas;
- the capitalisation and preparations for listing of Rendell Industries;
- the listing of Rendell Industries;
- the failure of the Rendell group;
- responses to the Rendell failure within AEFC;
- the effect of Rendell's failure on Aequitas and Aequitas No 1; and
- claims and legal proceedings.

13 I shall then analyse and apply the law with respect to each of the causes of action relied upon by the plaintiffs.

Evidentiary difficulties

14 The case was heard over a relatively short time. Very few affidavits were read and oral evidence was given only by Mr Gledhill. The defendants did not call Mr Kelly or Mr Gallois, who were officers of AEFC involved in the affairs of the Rendell group and the Aequitas companies. It appears that Mr Gallois is in Egypt and the absence of evidence from him can therefore be explained. However, the evidence indicates that Mr Kelly is in Sydney and could have been called. I infer from the facts that his evidence would not have assisted the defendants' case: *Jones v Dunkel* (1959) 101 CLR 297.

15 The position of Messrs Mullins and Rees has given me some concern. They were central players in the affairs of the parties and the Rendell group. Inevitably I must make findings with respect to their conduct. In the nature of this case, my findings must relate to questions of propriety and honesty, as well as prudence. Their conduct has been trenchantly criticised by the plaintiffs, and it has not been in the interests of the defendants to protect or defend them. They are not parties to the present proceedings. However, they are defendants in proceedings 5874 of 1991, in which the defendants in the present proceedings seek to protect themselves by claiming recovery against Messrs Mullins and Rees in the event that I find them to be liable. They have not given evidence in the present case, but given the allegations made against them by the present defendants as plaintiffs in the other proceedings, it is not surprising that they have not been called. They are likely to be seriously prejudiced, in a practical sense, by the findings I shall make against them, even though my findings will not set up any res judicata or estoppel against them. In these circumstances, I have tried to limit my findings against Messrs Mullins and Rees to the matters necessary to be determined for the purposes of the present case.

16 Serious allegations have been made by the plaintiffs against Mr Gledhill, including allegations of dishonesty and participation in fraud. These are archetypally circumstances in which one must bear in mind Dixon J's explanation of the standard of proof in *Briginshaw v Briginshaw* (1938) 60 CLR 337, 362-3. This is a case where the seriousness of the allegations made, and the gravity of the consequences flowing from a finding against Mr Gledhill, are considerations that affect the question whether the issue has been proved to the Court's reasonable satisfaction. As his Honour said, in such matters 'reasonable satisfaction' should not be produced by inexact proofs, indefinite testimony, or indirect inferences. In some older cases, it was said that allegations of fraud must be 'clearly' proved: for example, *Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha and Telegraph Works Co* (1875) 10 Ch App 515, 530. The High Court explained such observations in *Rejfek v McElroy* (1965) 112 CLR 517, 521, observing that 'the 'clarity' of proof required, where so serious a matter as fraud is to be found, is an acknowledgment that the degree of satisfaction for which the civil standard of proof calls may vary according to the gravity of the fact to be proved'.

17 Mr Gledhill gave affidavit and oral evidence. I do not accept his evidence on certain specific points, as I shall indicate during the course of this judgment. My overall impression of Mr Gledhill in the witness box is that he was not consciously dishonest, rather that he had a strong conviction of his innocence in a moral sense of the charges made against him. His recollection of events was highly selective - for example, he clearly recollected an approach by Mr Mullins for purchase of the Rendell Industries shares in November 1985 and what he said in that approach, and he recalled telephoning Mr Griffin to discuss the proposal, and yet he cannot recall why he agreed to the payment of $69,400 to CASO after having already agreed to a commission of $50,000 to AEFCAS. This selective recollection of events appears to have operated, conveniently, in Mr Gledhill's favour.

18 His evidence brings to mind some remarks on the psychology of recollection by Street CJ, in his *Report of the Royal Commission of Inquiry into Certain Committal proceedings against K. E Humphreys* (July 1983):

> 'In the intervening five or six years, rumours waxed and waned. In some cases suspicion underwent subtle change to belief, which itself progressed to reconstruction, which in turn escalated to recollection. No presently stated recollection could be safely assumed not to have progressed upwards and not to be the product of one of these earlier stages. The sheer frailty of human memory of necessity required a most

anxious and critical appraisal of the evidence of the witnesses, no matter how credit-worthy they might be.
It became apparent that in the years since August 1977 the recollections even of those with undoubted first-hand knowledge have in some instances faded, in some instances fermented, and in some instances expanded. Moreover, in many cases the realisation of the significance - indeed, the enormity - of what had occurred has tended to transmute into a more or less cynical acceptance of what had, or was believed or rumoured to have, taken place.'

19 In the present case, I believe that Mr Gledhill's steady conviction about his own innocence fermented to reconstruction, which in turn escalated to selective recollection. I therefore regard his evidence as having little weight, compared with the documentary evidence which, to a substantial degree, speaks for itself.

20 A great deal of documentary evidence was adduced. The plaintiffs' case relies on those documents and invites the Court to construe them and make inferences favourable to their contentions. The Court is asked to reconstruct from the documents evidence which occurred about 15 years ago. The plaintiffs' delay of nearly five years in commencing proceedings, and the further delay of over eight years between the commencement of the proceedings and the hearing, have not been fully explained. (I shall return to this point when considering the availability of interest.) The delays have made my task a difficult one.

21 Courts have frequently warned about the risk of prejudice and injustice that delay in bringing proceedings to hearing may create. For example, in *Herron v McGregor* (1986) 6 NSWLR 246, McHugh JA described the consequences of delay in these words:

> 'Memories fade. Relevant evidence becomes lost. Even when written records are kept, long delay will frequently create prejudice which can never be proved affirmatively.'

He warned that in some cases delay may simply make it impossible for justice to be done.

22 The difficulties presented by such a long delay between the events and the hearing should not be understated. However, in the present proceedings the Court's findings are less dependent on the recollections of witnesses, and therefore the frailties of human memory, than is commonly the case. Although some of the documents are ambiguous, the Court at least has before it, in the documents, the actual words that were used so many years ago. That being so, it appears that it is possible to do justice notwithstanding the long delay, by a process of reconstruction of past events on the basis of and by inference from the documents, and such other evidence as is credible. Except to the extent that claims may be statute barred, I see no ground for preventing the plaintiffs from making out their case simply by reason of the delay.

The formation of AEFCAS and its relationship with AEFC

23 Prior to May 1984, Mr Mullins and others carried on business in the field of corporate advisory services under the registered firm name of 'Corporate Advisory Services'. Their business was acquired at that time by their company, CASO. On 9 May 1984 CASO entered into a joint venture agreement with AEFC and with the company that was to be the manager of the joint venture business, which changed its name to AEFCAS. The agreement recited that AEFC was desirous of becoming involved in the field of corporate advisory services and believed that because of its reputation and standing it could influence and direct business. The agreement established an unincorporated joint venture between AEFC and CASO ('the venturers'), managed by AEFCAS.

The joint venture agreement

24 Some of the key provisions of the joint venture agreement were as follows:

(i) the assets of the corporate advisory business would be owned by the venturers in the proportions, 51% to AEFC and 49% to CASO;

(ii) the venturers would own the issued share capital of AEFCAS in those same proportions, but the board of AEFCAS would reflect equal representation of the venturers and all decisions of the manager would require unanimity;

(iii) the benefits and obligations of the venturers would be separate rather than joint and several;

(iv) the annual income of the joint venture would be shared between the venturers according to a formula, under which AEFC would receive certain priority payments and the remainder of the income would be apportioned in bands, in a ratio which varied from 60% (AEFC) to 40% (CASO) for the lowest band, to 80% and 20% for the highest band;

(v) CASO would provide to the joint venture the services of Mr Mullins and certain others (including, as it happened, the services of Mr Rees as a consultant), and would pay their remuneration;

(vi) AEFC would pay CASO $50,000 for the goodwill of the advisory business and would pay a monthly amount to CASO as consideration for CASO providing the full-time services of Mr Mullins and others;

(vii) AEFC would also pay the reasonable and proper expenses of the joint venture and provide office accommodation and equipment;

(viii) the venturers appointed AEFCAS to act as manager, agent and nominee for them for the purposes of the business, and AEFCAS undertook to provide such agency services as it might be directed by both venturers to provide, and the venturers jointly and severally indemnified AEFCAS in respect of losses which might arise in connection with its management;

(viii) AEFCAS would hold all property assets that came to it, as manager for the venturers as beneficial owners in proportion to their holdings of its issued share capital; and

(ix) the chief executive of AEFCAS would have no power to enter into any contract on behalf of AEFCAS or bind it in any manner, except as may be authorised by resolution of the board of AEFCAS.

25 The joint venture agreement provided for six directors of AEFCAS, with three representing each venturer. The board initially comprised Mr Gledhill (chairman), Mr C E Peysson and Mr C W Gallagher (for AEFC), and Mr Mullins, Mr R G Porteous and Mr K S McMorrine (for CASO).

26 The full-time services of Mr Mullins and Mr Porteous were provided by CASO under the joint venture agreement, 'for purposes of the [corporate advisory] Business and the Joint Venture'. Mr Rees was not a director of AEFCAS, but was a consultant whose services were provided in the same way by CASO under the agreement. Mr Mullins, Mr Porteous and Mr Rees performed their services for the joint venture, rather than for AEFCAS as manager. This is a point of some importance, as I shall explain later.

27 The directors' report of AEFCAS for the year ended 30 June 1986 records that the principal activity of the company was to act as manager, agent or nominee for the purposes of the joint venture for the provision of corporate advice, and that the company had not carried out any operation other than as manager of the joint venture. I infer, therefore, that contractual commitments undertaken by AEFCAS were joint venture commitments, assuming that AEFCAS had the requisite authority of the venturers.

28 At some time late in 1985 or early in 1986, the management of the joint venture prepared a lengthy document entitled 'Proposed Restructuring & 1986 Corporate Plan'. The document reviewed the operations of AEFCAS as manager of the joint venture, after the acquisition of shares in the Rendell group and their subsequent sale to Aequitas. Management recommended to Mr Gledhill that some changes be made to the joint venture agreement, particularly relating to the remuneration of senior executives of the joint venture and the relationship between AEFCAS as manager of the joint venture and the Project Finance Division of AEFC. It was suggested that AEFCAS should contact private clients of AEFC to interest them in equity investment opportunities and that AEFCAS should broaden its activities in various ways, including an extension to underwriting. These proposals led to a written agreement dated 13 March 1986, which varied the joint venture agreement, principally with respect to the distribution of profits.

The retainer of AEFCAS to provide corporate advice to the Rendell group

29 The Rendell group was a private corporate group owned by interests associated with Mr Norman Rendell. In late 1984 and 1985 the group was looking for assistance to overcome what management perceived to be a liquidity problem produced by rapid growth of the group's business. The board had prepared a document entitled 'A Blue Print for Survival & Growth' in November 1984. That and other documents were supplied to AEFCAS. The 'Blue Print' identified a pressing need to rearrange the borrowing structure of the group to lessen the group's dependence on an expensive secondary line of credit.

30 The Rendell group had attained valuations of a property at 55-57 Halstead Street South Hurstville, owned by one of the group companies. On 20 July 1984 Mr J C Elvy of Finch Freeman Associates Pty Ltd had valued the property on a basic land value and replacement cost basis, at 'in the vicinity of' $1.75 million. He expressed the opinion that if the property was sold and leased back 'the property value could be between $1.9 - $1.95 million'. In October 1984 Baillieu Hardie Gorman Pty Ltd had valued the property 'for mortgage purposes' at $950,000, on behalf of ANZ Mortgage Fund.

31 Mr Mullins and Mr Porteous embarked on discussions with the Rendell group which culminated in a retainer for the joint venture. A letter to AEFCAS from the managing director of RIH, Mr R M Griffin, dated 6 June 1985 proposed to retain the services of AEFCAS as corporate adviser to the Rendell group. According to the letter, 'the principal purpose of the appointment [was] to assist with the restructuring of Rendell's finances, improving its leverage and enabling management participation in equity, to assist management in achieving the Board's corporate strategy ..., enabling the company to achieve a Public Listing at an appropriate time'. Mr Mullins responded on behalf of AEFCAS by letter dated 18 July 1985, accepting the appointment and setting out the terms and conditions of the engagement. One of the conditions was that AEFCAS would have the right of first refusal on future fundraising opportunities for the duration of its appointment.

32 On the face of the documents, the entity undertaking to provide corporate advisory services was AEFCAS. However, in contracting to do so, AEFCAS was acting as the agent of the venturers under the joint venture agreement of 9 May 1984. Mr Mullins and Mr Rees, who worked on the Rendell assignment, did so pursuant to their retainer by the joint venture, rather than on behalf of AEFCAS. The principals to the contract for provision of corporate advisory services, apparently not disclosed as such to the Rendell group, were therefore AEFC and CASO.

The acquisition by AEFC Leasing of 74.8% of the shares in Rendell Industries

Development of the restructuring proposal

33 Mr Mullins and Mr Rees set to work on the joint venture's retainer by the Rendell group over the ensuing weeks. It appears that from the outset, the intention of Mr Mullins and Mr Rees was that AEFC would become financier to, and investor in, the Rendell group. On behalf of the joint venture, Mr Rees negotiated with Mr N Rendell and AEFC, with a view to developing a proposal in which AEFC would take a significant equity position in the Rendell group. Once he had substantially negotiated an agreement in principle with Mr N Rendell, he submitted his proposal in written form to Mr Kelly of AEFC.

34 Mr Rees assessed the business of the Rendell group favourably, observing that it had an unbroken history of increasing profitability until 1981, but subsequently some business errors (principally the funding of construction of a grand new head office from retained earnings) had an impact on results. He proposed that the business be acquired by an entity in which AEFC would have the majority interest. This would be achieved in several steps.

35 First, a new company would be formed, majority owned by interests associated with AEFC. An AEFC entity would subscribe $250,000 by way of share capital and share premiums to the new company. The minority interests in the new company would be associated with existing management of Rendell. When the proposal was eventually taken up and acted upon, the new company was formed which was eventually named Rendell Industries Ltd, although it retained its shelf company name (Janam Holdings) for a while and a different corporate name was envisaged at first. For convenience, I shall refer to the new company, at all stages, as Rendell Industries. Next, Rendell Industries would buy all the issued shares in the holding company of the Rendell group (RIH) for $250,000. The purchaser would assume guarantees to the ANZ Bank that had been given by interests associated with Mr N Rendell. Equity up to $500,000 would be offered to staff on commercial terms.

36 Mr Rees developed the proposal for AEFC to make an equity investment in the Rendell group on the basis of information supplied to him by the Rendell group. One of the documents supplied to AEFCAS upon its appointment was an audited balance sheet for the Rendell group as at 31 March 1985, which gave an excess of assets over liabilities of $ 1,607,000, compared with $796,000 as at 30 June 1985. The difference is explained principally by an upwards revaluation of land and buildings from $1,454,000 to $ 2,454,000 and an increase in bank debt.

37 Some discussion notes dated 16 July 1985, the author of which is not identified, appear to have been prepared as a basis for interesting AEFC in the proposal for it to inject equity capital into the Rendell group. The notes refer to the Rendell group as having a net worth on a going concern basis of $900,000 excluding goodwill, according to the managing director's advice. They appear to assume that an asset liquidation would realise $2,320,000, although no attempt was made to justify that figure. Mr Rees' written submission to Mr Gledhill dated 23 July 1985 stated that according to 'preliminary figures', the group had a minimum going concern value in excess of 3.5 times the initial purchase cost ($250,000). Mr Rees envisaged a revaluation and an equity injection of up to $500,000 by employees, leaving AEFC with 50.5% of the restructured group at a value of $910,000.

38 The existing owners were said to be prepared to sell at $250,000 in order to release the burden of personal guarantees. The proposal noted that the plan was to list the new holding company within 12 months, and this would provide liquidity. The implication of 'liquidity' was that AEFC would be able to sell down its interest in the market. The document noted that, in addition to the potential equity return and advisory fees, lending opportunities would be available to AEFC.

AEFC agrees to the proposal

39 Mr Kelly took up the proposal as noted in an internal AEFC memorandum dated 25 July 1985. The memorandum noted that the proposed guarantee of ANZ credit lines would be for an amount of $1.64 million, and that the ANZ credit lines were secured over the freehold property owned by the company which had a book value of $1.9 million and a market value of approximately $2.2 million. These figures are higher than the valuations referred to above. The memorandum noted that the public listing of the company within six to 12 months would provide the opportunity for AEFC to on-sell its shareholding at

a profit. This implies that at 25 July 1985, the early on-sale of the shares to be acquired by AEFC was in contemplation, but through the listing of the Rendell group rather than by sale to Aequitas. The memorandum noted that the guarantee would be terminated within 12 months, either through reduction of the ANZ credit lines or through the sale of the freehold to extinguish the ANZ debt. The memorandum estimated that AEFC could expect to recoup conservatively in the range of $910,000 to $1.234 million from the sale of shares on the market. It observed that approval for AEFC's investment in Rendell would probably be required from the Foreign Investments Review Board.

40 Mr Gledhill added some handwritten notes to Mr Kelly's memorandum on the same day. Mr Gledhill noted that the proposal had been discussed with the chairman of AEFC, who was willing for the investment to be handled under management delegated authority. It was noted that approval was given to the investment of $250,000 on the basis proposed by Mr Rees, subject to resolution with Holman Webb (AEFC's solicitors) of the appropriate investment vehicle. Mr Gledhill's note identified a significant problem with the transaction, namely that it would require Foreign Investments Review Board approval because of AEFC's non-Australian status, but evidently Mr Gledhill believed that the need for approval could be avoided if the investment was appropriately structured.

Implementation of the proposal

41 Having obtained AEFC's approval to the proposal, Mr Rees and Mr Mullins then went about implementing it. Mr Mullins secured the approval of the Rendell group and the vendors, the interests associated with Mr Norman Rendell. Mr Rees sought and obtained the consent of the ANZ Bank to the conversion of the collateral securities into a 'deficiency guarantee' under which ANZ would agree with AEFC to pursue its other securities first (namely its first mortgage on the South Hurstville property and a first floating charge over the Rendell group assets). He and Mr Kelly contemplated that once the deal had been consummated, further approaches would be made to the ANZ to completely extinguish the guarantee (see Mr Kelly's internal memorandum dated 2 August 1985).

42 Early in August 1985 AEFC provided the Rendell group with unsecured short-term financial accommodation of $350,000 to reduce its ANZ overdraft, because the group was experiencing 'liquidity problems'. The facility was provided on the basis that it would be repaid from the proceeds of the issue of Rendell shares to staff, which was anticipated to take place no earlier than late August 1985. Mr Kelly's internal memorandum dated 2 August 1985, which recommended that the facility be granted, calculated that with the additional loan AEFC's exposure to the Rendell group by way of equity investment, loan and guarantee would be $1,171,000. This was on the basis that the borrowings guaranteed to ANZ stood at $2,171,000 and the maximum realisation of the Hurstville freehold under a forced sale would be $1,600,000. Evidently Mr Kelly did not rely on a formal valuation for his estimate of realisation on a forced sale, using instead the book value of the freehold, then recorded as $2 million, and allowing a 20% margin to reflect the forced sale situation. He estimated the net worth of the Rendell group on a 'going concern' basis as $1,454,000.

43 Upon documentation of the purchase transaction on 3 October 1985, AEFC made a revolving term loan of $1.17 million to the Rendell group, charged over the assets and undertaking of the group, to replace an existing external loan of $750,000, retire AEFC's short-term financial accommodation of $350,000 and provide additional working capital to Rendell. This took AEFC's total exposure to the Rendell group to $1,991,000.

44 Holman Webb advised that an AEFC entity should make the investment after obtaining the approval of the Foreign Investments Review Board, on the assumption that the approval would be subject to a requirement that the investing entity divest itself at a later time. But another structural problem arose. If AEFC came to hold indirectly more than 50% of the shareholding in the Rendell group as at 30 June 1986, it would be necessary for the Rendell group to be consolidated into AEFC's balance sheet, and that would ultimately lead to consolidation into the Commonwealth Bank's balance sheet. That was thought to be an undesirable outcome. Therefore, it was proposed that a separate company be set up that would be owned 50% by AEFC and 50% by the management of CASO. But in a handwritten note dated 21 August 1985, Mr Gledhill said that the acquisition should be made through a

wholly-owned subsidiary of AEFC called AEFC Leasing (which was a 'clean' AEFC subsidiary not being otherwise used) and that the ownership of AEFC Leasing could be addressed at a later stage.

45 A shelf company called Janam Holdings Ltd was acquired early in September 1985 and was set up to become the new holding company of the Rendell group. As I have mentioned, it was eventually re-named Rendell Industries Ltd. AEFC Leasing subscribed for 100 shares of $1 each at a premium of $2,499 per share, constituting its investment of $250,000 in the new entity. The company's five other shares were acquired by individuals. The shares were later split into 20 cent shares (some documents in evidence indicate that the share-split resolution was passed on 27 September 1985, while others suggest that the resolution was passed on 3 October 95). A new board was appointed, which included Mr Mullins and Mr Rees. The new board set about implementing the transaction, planning for an issue of shares to employees and a stock exchange listing, and also planning an acquisition with a view to expanding the business to become a conglomerate in the building industry.

Documentation of the purchase by AEFC Leasing

46 Documentation for the purchase of the Rendell group by Rendell Industries was executed early in October 1985. There were three principal agreements. By a Deed of Agreement dated 2 October 1985 Rendell Industries agreed to issue an additional 1,299,895 fully paid shares of $1 each to AEFC Leasing or as it may direct, said to be in consideration of AEFC Leasing procuring short-term financing and a guarantee of the ANZ lines of credit by AEFC. AEFC Leasing directed that 972,645 of the shares be issued to it, 38,500 be issued to AEFCAS, 96,250 be issued to a company related to Mr Griffin called Daranlas Pty Ltd and 192,500 be issued to a company related to Norman Rendell called WNR Nominees Pty Ltd. It was later asserted that the shares issued to WNR Nominees were part of the consideration for the purchase of the RIH shares, and the shares issued to AEFCAS were in lieu of payment of advisory fees.

47 The evidence indicates that this document was drafted at a later time and backdated to 2 October 1985, to reflect a non-written agreement recited in a notice of meeting of the shareholders of Rendell Industries held on 3 October 1985.

48 Secondly, there was a Sale of Shares Agreement dated 3 October 1985. By that agreement Mr Norman Rendell and interests associated with him sold all of the issued shares in RIH to Rendell Industries for $250,000. The agreement provided for the Rendell interests to lend $200,000 to RIH, guaranteed by Rendell Industries and repayable when Rendell Industries raised $500,000 by private placement (contemplated to be made to employees) or on 3 April 1986. Rendell Industries undertook to arrange for the release of the personal guarantees given by the vendors to the ANZ Bank.

49 Thirdly, there was a Shareholders Agreement between the shareholders of Rendell Industries and that company. The agreement set out the final shareholdings in Rendell Industries. AEFC Leasing was to hold 74.83%, AEFCAS 2.96%, WNR Nominees 14.81%, and Daranlas 7.40%. The agreement made provisions for the corporate governance of Rendell Industries and for the constitution of the boards of that company and RIH. It provided for the repayment of a loan account to Mr and Mrs Rendell and the issue of 3,125,000 shares to the employees at par, 16 cents per share payable on application and the balance of four cents per share to be satisfied out of the company's share premium account. (Completion of the issue of the shares would dilute AEFC Leasing's interest to 50.5%.) The proceeds of the share issue would be applied to repay the loan of $200,000 made by the Rendell interests to RIH. The agreement also provided for Rendell Industries to appoint AEFCAS as corporate adviser for the issue of the shares to employees and the admission of the company to stock exchange listing.

The consideration supplied by AEFC Leasing

50 As we shall see, the Rendell Industries shares were later sold to Aequitas No 1 for $960,000. It is therefore of some importance to identify the true consideration paid by AEFC Leasing to acquire the shares. Part of the overall transaction involved Norman Rendell being relieved of his guarantee obligations to the ANZ Bank, by AEFC undertaking liability under what became a deficiency guarantee. Another part of the overall transaction was that AEFC would provide loan facilities to the Rendell

group. In my opinion, these elements of the overall transaction were commercially necessary, in the sense that the acquisition by AEFC Leasing would have been otherwise unlikely. It is somewhat artificial to say, as the Deed of Agreement dated 2 October 1985 does, that AEFC Leasing 'procured' these commitments by AEFC. However, that proposition is true if it simply means that AEFC Leasing's participation in the transaction brought along with it the additional commitments by AEFC. In that sense, AEFC Leasing provided a consideration that was real and not illusory.

51 This is not to say, however, that these additional elements of the consideration are to be offset against the higher sale price obtained by AEFC Leasing, in order to calculate AEFC Leasing's profit on the Rendell transaction. At the time, Mr Kelly's calculations indicated that there was very little risk to AEFC in undertaking the deficiency guarantee, and adequate protection for AEFC in respect of its loan facilities. Events later took a turn decidedly for the worse, but the contemporaneous assessment by Mr Kelly, shared by Mr Gledhill, Mr Mullins and Mr Rees, was that AEFC Leasing stood to make a very substantial profit if could dispose of the Rendell Industries shares for a price reflecting the value they attributed to the shares. This is confirmed by the fact that when the transaction was completed, AEFC Leasing lodged $690,000 in a Lloyds' account as the amount representing the profit on sale of the Rendell Industries shares. That amount was not taken directly to profit, in order to allow 'maximum flexibility in accounting/tax strategies'.

The acquisition and starting up of Aequitas and Aequitas No 1

Mr Gledhill's strategy for AEFC

52 As early as August 1985, before completion of the acquisition of the Rendell group, the joint venture and the management of AEFC were developing plans which ultimately led to the establishment of Aequitas and Aequitas No 1. Mr Gledhill prepared a board paper, dated 2 September 1985, which he presented to the October 1985 meeting of the board of AEFC. The paper outlined a strategy of 'equity investment/funding by specially structured company vehicles'. Several generic situations were identified in which it could be appropriate for AEFC to subscribe for shares, with AEFCAS and the joint venture earning fees on the restructure of the company and AEFC providing loan finance to the restructured group.

53 Mr Gledhill put forward two structures for equity investments. In some cases, it would be appropriate, he thought, for AEFC to make a 'direct' investment. However, where the investment gave rise to a majority holding, it would be necessary to avoid consolidation of the acquired entity in AEFC's balance sheet. This would be done by using AEFC Leasing (to be re-named AEFC Equities) as the investment vehicle, funded by loans from AEFC, and reconstituting that company so that 50% of its shares would be held by CASO, with AEFC holding only 50%. AEFC's shares would have preferred dividend rights and CASO's holding would give it no returns on the investment save for a management fee paid to AEFCAS. I shall refrain from commenting on whether this highly artificial structure would successfully avoid the accounting consolidation requirements of the time, but I note that it certainly would not do so under the legal and accounting requirements in force today.

54 Mr Gledhill noted that management and 'the resources of the Advisory Service' (by which he meant, presumably, the joint venture) were investigating the feasibility of forming a listed public company, for the purpose of medium to long term corporate equity investment, with AEFC having a shareholding of not more than 15% in the public company (the limit apparently being intended to avoid foreign investment problems for the public company). An Australian investment committee would assess the suitability of investment proposals for AEFC Equities and for recommendation to the public company.

55 Mr Gledhill stated:

> 'Management is attracted to the concept of the publicly listed company as it could play an important role in the functions of AEFC Equities, as follows:
> Should an investment proposition be considered unsuitable for AEFC Equities, by the Australian Committee, it could then be referred to the public company whose wider investment criteria might permit acceptance.

AEFC Equities could offer to the public company options over its various investments in order to ensure that its gain from such investments is realised within the short-term, thereby releasing funds for further investments and locking in acceptable rates of return.

The public company would augment the activities of the Advisory Service by providing an alternative repository of equity funds, to assist its advisory clients.

Essentially, the objectives of the public company would be inclined towards long-term returns from stable investment opportunities and would therefore not compete with AEFC Equities. However, it could provide a valuable source of liquidity for AEFC Equities.'

56 Mr Gledhill then noted the foreign investment problem. He observed that each investment made by AEFC Equities would require approval from the Foreign Investments Review Board. He said it was impracticable to turn AEFC Equities into an Australian company for foreign investment purposes, but he noted that the proposed publicly listed investment vehicle would be an Australian company. If it took an option over an AEFC Leasing investment, the case for Foreign Investments Review Board approval would be greatly strengthened.

57 The flavour of Mr Gledhill's discussion of the proposal for a publicly listed investment vehicle was to emphasise the advantages to AEFC and the joint venture, without paying any attention to the attractiveness of the listed vehicle to its potential shareholders, beyond the observation that it would look for long-term returns from stable investment opportunities. It is hard to see how the uses which Mr Gledhill contemplated for the listed entity would assist its board to pursue such an investment strategy.

58 Mr Gledhill's board paper was debated by the directors of AEFC at their meeting in October 1985. It appears, though the evidence is not clear, that the board gave Mr Gledhill's views some cautious support, given they resolved that a further report be prepared for the May 1986 meeting covering developments in this area during the intervening period, impliedly sanctioning the proposition that such developments were authorised.

The formation of Aequitas and Aequitas No 1

59 The publicly listed investment vehicle contemplated by Mr Gledhill's board paper came to life as Aequitas Ltd. Aequitas was originally a shelf company called Elonhay Ltd and its wholly owned subsidiary, Aequitas No 1, was a shelf company called Marktan Nominees Pty Ltd. The cost of acquiring Elonhay was paid by Aequitas itself from an amount of $1,500 advanced to it by a company associated with Mr Mullins and two other companies (probably associated with Mr Rees and Mr Elvy).

60 The shareholders of Aequitas between 10 September 1985 and 10 March 1986 were Mr Mullins and Mr Rees, their respective wives and Mr J Elvy, a consultant provided to Aequitas by CASO. Mr Mullins was appointed managing director on 18 September 1985, and he remained in that position until 16 October 1985, when Mr Rees replaced him. Mr Elvy ceased to be an employee of CASO in February 1986. He agreed with CASO at that time to resign as a director of Aequitas and to transfer his share in it to Mr Porteous or such other person as CASO should direct.

61 On 10 March 1986 Mr H M Rich, a director of various public companies including News Corporation Ltd and Ansett Transport Industries Ltd, became a shareholder. On 12 March 1986 Mr R A Donohoe (a former banker and stockbroker) and Mr A C Pond (a director of various Australian companies including Hunter Douglas and City Mutual Life Assurance Ltd, and by that time executive chairman of Rendell Industries) became shareholders. Companies associated with Mr Mullins and Mr Rees (Shop Two Pty Ltd and Morespeach Pty Ltd respectively) became shareholders on 12 March 1986.

62 Aequitas and Messrs Mullins and Rees and their respective wives were the shareholders in Aequitas No 1 from 31 October 1985. The directors of that company were Messrs Mullins and Rees and their respective wives during the period from 31 October 1985 to 12 March 1986. On 12 March 1986 the wives resigned and Messrs Rich, Pond and Donohoe were appointed directors in their place.

Early decisions

63 The minutes of the meeting of directors of Aequitas held on 18 September 1985 record various decisions of a kind necessary for a newly launched company to take. The minutes indicate that preparatory work had been done by Mr Mullins and Mr Rees. For example, they met with Law & Milne and the board accepted their suggestion that this firm be appointed as lawyers to the company. Mr Rees established a cheque account for the company. Mr Mullins told the board that he would meet with Law & Milne regarding the preparation of an option agreement in respect of the shares held by AEFC Leasing in Rendell Industries. The board agreed that discussions be held with representatives of various accounting firms with a view to the appointment of auditors. It was agreed that Mr Porteous would contact, amongst other firms, Arthur Young & Co, and it was agreed that the accounting firms would be interviewed by Mr Rees and Mr Porteous.

64 Prior to 3 October 1985 someone on behalf of Aequitas (probably Messrs Rees and Porteous) met with representatives of Arthur Young & Co, a firm that was independent of AEFC and AEFCAS. On 3 October 1985 Arthur Young submitted a proposal addressed to Mr Mullins as managing director of Aequitas. The proposal was prepared on the basis that opportunities for business would come to Aequitas from AEFC and from external opportunities; that the business of Aequitas would be separate from but would complement the corporate advisory business of AEFCAS; and that Aequitas would take a longer term view of investments than AEFC, whose investment positions would be taken for only about 6 to 18 months, so there would be opportunities for Aequitas to invest by taking out existing AEFC positions.

65 A meeting of representatives of Aequitas, Arthur Young and Law & Milne took place on 30 October 1985. Messrs Mullins, Rees and Porteous were there. There was discussion about the establishment of Aequitas No 1, and concern was expressed that if the acquisition of the Rendell Industries shares took place after Rendell Industries had distributed shares to staff, the acquisition would be subject to the Companies (Acquisition of Shares) Code, the predecessor of Chapter 6 of the Corporations Law. This was because, after the employee share issue, Rendell Industries would have more than 15 members and would hence be subject to the provisions regulating an acquisition that causes an entitlement to voting shares to exceed 20 percent.

66 Subsequently to that meeting, Aequitas No 1 was acquired and an offer was made to purchase the Rendell Industries shares owned by AEFC Leasing.

67 AEFCAS prepared a brochure which referred to the 'close association' between Aequitas and AEFC, saying that the formation of Aequitas was strongly supported by AEFC and referring to their 'unique relationship'. The brochure quoted Mr Gledhill and referred to a relationship with AEFC 'and it shareholders'. Adjacent to those remarks there was a picture of Martin Place including the Commonwealth Bank head office. Eventually the brochure was withdrawn, after Mr Mullins referred it to Mr Gledhill for review on 15 May 1986.

Did Aequitas retain the joint venture for advisory work, and if so, what was scope of the retainer?

68 A crucial issue in this case is whether the joint venture was ever retained by Aequitas for corporate advisory work, and if it was, what was the scope of the retainer. The principal evidence is in three categories.

69 First, there is a letter from Mr Porteous as a director of AEFCAS to the managing director of Elonhay dated 23 August 1985. It is a submission for the appointment by Elonhay of AEFCAS for a period of 12 months 'to provide specialist advice on structure and approach to the raising of equity, initially by private placement and subsequently through Stock Exchange listing'. At the time, AEFCAS was acting only in its capacity as manager for the joint venture.

70 The defendants submit that this letter must have been prepared after 10 September 1985. This is because the letter was addressed to Elonhay, which was not acquired from the shelf company provider

until 10 September 1985. However, I do not regard this as sufficient for me to find that the letter was not authentic, or (if authentic) was not entered into on the date that it bears. The formation of the public company that became Aequitas was a subject of active consideration by Mr Gledhill, and (I infer) Mr Mullins and Mr Rees as well, in August 1985, since the idea was sufficiently mature to be included in Mr Gledhill's board paper of 2 September 1985. Consistently with the external facts, it would have been open to Mr Porteous or someone else to contact the shelf company provider and ascertain the name of the available shelf company on 23 August, even though the transaction to acquire the company was not completed until 10 September. The evidence provided by Mr Porteous' letter of 23 August implies that this occurred.

71 It appears that no contract of retainer was entered into before 10 September, since the letter of 23 August is an offer rather than confirmation of an existing agreement, and the shelf company provider certified on 10 September that Elonhay had not entered into any agreements or transactions. The letter of 23 August invited the managing director of Elonhay to accept the offer by signing and returning an enclosed copy of the letter. There is no direct evidence that this was done, or that the offer was otherwise formally accepted. The question is whether it was accepted informally, for example by conduct. It is difficult to answer this question, because Mr Mullins and Mr Rees were the principal embodiment of the joint venture, and AEFCAS, and also Aequitas at this time.

72 There is some evidence that Mr Mullins and Mr Rees regarded themselves as providing corporate advice to Aequitas as well as to the joint venture during the period from September to November 1985, and that Mr Gledhill regarded them as doing so. Mr Gledhill's memorandum of 12 November 1985 refers to the Rendell Industries investment, and says that since that time AEFCAS had formed 'an independent equity vehicle to be known as Aequitas Ltd'. The same memorandum refers to the sum of $50,000 being passed through the joint venture accounts of AEFCAS 'in recognition of the part played in structuring the transaction'. Obviously AEFCAS was acting for the joint venture, and was being rewarded accordingly. But the language of Mr Gledhill's memorandum implies that, in his view, AEFCAS was also involved in the formation of Aequitas and the 'structuring' of the transaction from the viewpoint of Aequitas.

73 Similarly, when Mr Kelly wrote to Arthur Andersen & Co for advice as to the tax consequences of the Rendell transaction on 26 February 1986 (a letter specifically approved by Mr Gledhill), he described Aequitas No 1 as a 'public investment company managed by AEFCAS'. An application for approval of an Australian currency facility, directed to AEFC's Sydney office by management (perhaps Mr Kelly) in about January 1986, describes Aequitas as a company formed by AEFCAS. Law and Milne, who had been appointed the solicitors of Aequitas on 18 September 1985, appear to have dealt with Mr Rees at AEFCAS, submitting drafts of the sale of shares agreement to him.

74 Secondly, there is evidence concerning various payments by Aequitas to AEFCAS. On 30 April 1986 Aequitas drew a cheque in favour of AEFCAS for $28,357.12, requisitioned by Mr Rees and approved by Mr Porteous by a cheque requisition which stated that the payment was for AEFCAS' services in negotiating a lease of premises and the employment of Mr Hinton, and for 'general matters and advice'. A memorandum of fees for that amount was directed by AEFCAS to Aequitas on 10 June 1986. It was expressed to be for the period 23 September 1985 to 31 March 1986, for work which included the matters noted on the cheque requisition and also 'general advice in relation to structure of the Aequitas group including composition of Board of Directors, discussions with Lawyers, Accountants and Stockbrokers', and 'advising on the proposed public flotation of Aequitas including private placement to selected institutions'.

75 Two further memoranda of fees were rendered by AEFCAS to Aequitas on 10 June 1986. The first related to advice during May on various matters concerning Rendell and other proposed investments, in the sum of $7,811.20 (including disbursements). The second related to general advice during April regarding fundraising by private placement memorandum, and discussions with brokers and institutional investors, as well as assisting in a marketing program to promote the company's name in the marketplace and preparation of papers on potential equity opportunities for presentation to the directors, in the sum of $3,805 (including disbursements). A cheque requisition dated 16 June 1986 for payment of both accounts was signed by Mr Rees and Mr Porteous. The audited financial statements of AEFCAS for the

year ended 30 June 1986 showed no income or profit for the company, presumably because these receipts were accounted for as joint venture receipts.

76 The defendants draw attention to the fact that the period stated in the memorandum of fees dated 10 June 1986 began five days after the directors of Aequitas, at their meeting on 18 September 1985, resolved to appoint Law and Milne as solicitors to the company and to authorise Mr Mullins to meet with them concerning the preparation of an option agreement over the shares held by AEFC Leasing in Rendell Industries. In other words, they say, the occasion for providing advice with respect to the Rendell Industries acquisition had already passed before the joint venture commenced work for Aequitas. Additionally, they submit, the description of work done in the memorandum of fees makes no specific mention of Rendell Industries, a matter sufficiently important to have been expressly recorded if work had actually been done on it.

77 I do not accept these submissions, having regard to the contrary evidence to which I have referred. The meeting of 18 September 1985 was the first meeting of the directors of Aequitas after the company had been acquired from the shelf company provider and the board had been reconstituted accordingly. The directors did not decide at that meeting to commit the company to the acquisition of the Rendell Industries shares. They simply authorised Mr Mullins to have discussions with Law and Milne. The occasion for corporate advice on the acquisition of the Rendell Industries shares had not expired prior to 23 September, when (according to the memorandum of fees) advisory work commenced.

78 Even if (contrary to my view) the directors of Aequitas decided to acquire the Rendell shares before AEFCAS commenced to provide advisory services to Aequitas, there was still a great deal of advisory work needed, covering the raising of money to permit Aequitas No 1 to complete the purchase of the Rendell shares, the contents of the private placement memorandum to be issued by Aequitas, and the structure of the purchase.

79 It is true that the memorandum of fees did not expressly refer to Rendell Industries, but it would be dangerous to base inferences on the omission, for which there are various possible explanations - for example, given that by 10 June 1986 the acquisition had turned sour and the Rendell group was in severe financial trouble, the drafter of the memorandum of fees may have thought it politic not to refer specifically to that assignment.

80 Thirdly, the private placement memorandum issued by Aequitas in March 1986 contains a section headed 'Company Particulars', with a subheading 'Retained Advisers'. Under those headings AEFC is described as 'Merchant Banker' and AEFCAS is described as 'Corporate Adviser'. This suggests, though not conclusively, that AEFCAS had the status of corporate adviser as a general matter, without the limitations contended for by the defendants. The defendants submit that there is no evidence that AEFC (and more specifically Mr Gledhill) approved or was asked to approve the terms of the memorandum before it was distributed. However, the private placement memorandum contained an open letter by Mr Gleufield on behalf of AEFC, dated 10 March 1986, in which Mr Gledhill referred to the formation of Aequitas by Mr Mullins (whom he described as managing director of AEFCAS) and Mr Rees (whom he described as a consultant to that company). The letter referred to Aequitas as a valuable adjunct to the operations of both AEFC and AEFCAS. At the very least, the letter was an implied endorsement by AEFC of the private placement memorandum, in terms that were consistent with the proposition that AEFCAS was corporate adviser to Aequitas.

81 On balance, I find that the evidence supports the conclusion that Mr Mullins or Mr Rees, on behalf of Aequitas, accepted the AEFCAS offer of 23 August 1985 by their conduct, at some time between 10 and 18 September 1985. Thereafter there was a contract of retainer for the provision of corporate and financial advice between the joint venturers by their agent, AEFCAS, as adviser and Aequitas as client.

82 The defendants submit that if (contrary to their submission) there was a contract of retainer in the terms of the letter of 23 August 1985, it did not extend to advice on investments generally, or on any investment in Rendell Industries. By its terms, the letter was limited to the provision of advice 'on structure and approach to the raising of equity ... by private placement or through stock exchange listing'. In my opinion, if a company with some ideas but no assets seeks advice on its structure and the correct approach to raising equity and listing, advice on the acquisition of assets would be part of an

appropriate and comprehensive response. Such a company would need to acquire one or more businesses or investments to make it attractive to private and public investors. Advice about the kinds of assets likely to appeal to investors would fall within the terms of such a retainer. While such a retainer would probably not require the adviser to seek out investment opportunities, it would be within the scope of the retainer for the adviser to draw the company's attention to an investment opportunity of which it was aware, and make an assessment of that opportunity accordingly.

83 In summary, my view is that the contract of retainer contained an implied undertaking by the joint venturers, by their agent AEFCAS, to provide objective advice on the acquisition of assets appropriate to permit the company to raise equity by private placement or through stock exchange listing, including advice about the kinds of assets likely to appeal to investors, and advice about and assessment of any investment opportunities known to the adviser. I regard such an implied term as reasonable and equitable, necessary to give business efficacy to the contract of retainer, so obvious that it 'goes without saying' capable of clear expression, and consistent with the express terms of the letter of 23 August 1985. Hence the condition stipulated by the Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 283, are satisfied.

84 I do not accept that the further amended statement of claim, which referred only to 'the opportunity to invest in shares in Rendell Industries', was limited so as to prevent the plaintiffs from asserting at the hearing that the retainer covered specific advice about the Rendell transaction. I find that it did.

85 The defendants say that there was no 'opportunity' to invest in the shares in Rendell Industries in October/November 1985, since (according to a memorandum by Mr Kelly dated 10 October 1985) AEFC Leasing was at that time proposing to retain the shares until after the listing of Rendell Industries. However, in my view, AEFC had not made any firm decision on the matter. Mr Gledhill's board paper of 2 September 1985 indicates that the prospect of passing on such an investment to Aequitas was an available alternative.

86 Considered together, the evidence establishes that Aequitas engaged AEFCAS, which acted as manager for the joint venture, to provide corporate advice on matters including the acquisition and financing of the purchase of Rendell Industries shares from AEFC Leasing. The venturers, AEFC and CASO, were liable as principals to supply AEFCAS with corporate advice on these matters, through the personnel of the joint venture.

The acquisition by Aequitas No 1 of the 74.8% shareholding in Rendell Industries

87 On 6 November 1985 Law & Milne, solicitors, submitted to Mr Rees a draft agreement for the sale by AEFC Leasing of its shareholding in the Rendell group to Aequitas No 1 Ltd, which did not include the number of shares to be sold nor the consideration to be paid. A further draft including this information was prepared on 7 November, the draft agreement being dated 8 November. The document envisaged sale for $910,000, of which $1,000 would be paid on settlement not later than 11 November 1985, and the balance would be postponed to 31 March 1986.

Calculations of purchase price

88 Mr Rees made some notes about the purchase price, presumably between the time of the first and second drafts. His notes do not indicate any re-assessment of calculations that had been made for the purpose of the acquisition by AEFC Leasing in the previous month. The notes take the par value of the shares, and make a deduction for dilution, to take into account the proposed employee share issue. The notes identify the price of $910,000 as the figure 'incorporated in the submission'. This appears to be a reference to Mr Rees' submission to AEFC dated 23 July 1985, recommending the initial purchase by AEFC Leasing. Mr Rees' notes give the impression that the purchase price was to be $910,000 because that was the figure AEFC had been encouraged to expect, at that time of AEFC Leasing's acquisition of the shares.

89 On 8 November 1985 Mr Rees prepared an analysis of the value of a 50.5% shareholding in Rendell Industries 'post committed employee issue'. According to that analysis, the 'on market' range

of values of that holding was between $1.768 million and $2.273 million. This suggests that Mr Rees regarded the acquisition price for Aequitas No 1 as below the market price, but on the other hand, the valuation makes some significant though unstated assumptions about the Rendell group being successfully floated by stock exchange listing. It does not appear to have been a rigorous assessment, and does not rely on any external valuation of the Hurstville property.

90 Mr Gledhill gave evidence that he was unaware of these calculations by Mr Rees. The defendants say that in those circumstances, Mr Rees cannot have been acting in the interests of AEFC or the joint venture, because if he were, he would have disclosed his calculations to Mr Gledhill in case Mr Gledhill wanted to increase the purchase price in accordance with them. I do not accept this submission. Given the nature of the calculations, I regard them as part of the planning by Mr Rees to ensure that investors would subscribe for the shares in Aequitas, in order to achieve the overall objectives of AEFC and the joint venture. They formed part of the pattern exhibited, as well, by Mr Rees' analysis dated 18 December 1985, in which he concluded that on the basis of maintainable future earnings after tax, Rendell Industries had a value of between $1.484 million and $1.855 million, and consequently that a revaluation of Aequitas No 1's interest by $700,000 was 'reasonably justified'. Similar calculations were prepared in January 1986.

AEFC's decision to sell to Aequitas No 1

91 At Mr Gledhill's request, Mr Rees prepared a discussion paper dated 11 November 1985, setting out the case for AEFC to sell its shares in the Rendell group as opposed to continuing to hold the shares in the expectation of increased value after listing. In it, Mr Rees observed that the net assets of Rendell had been purchased at a 'steep discount', and calculated that the profit on sale would be 5,400% on an annualised basis. Amongst the advantages of selling, in his view, were that profit would be crystallised before the year-end, releasing funds for further deals and setting a successful example by achieving the 'corporate goal of higher profit from asset base', while giving Aequitas the impetus to raise funds. However, a measure of control over the financing of Rendell would be lost and the possibility of further profits from the investment would be forgone.

92 The assessment by Mr Rees of the threats to the value of the investment in the Rendell group is interesting, especially in light of the information he possessed about Rendell's financial position (discussed below). He observed that the Rendell group was 'one sector based' and the building sector was in decline and carried a stigma with the market, that sub-contractors were high-risk, that there was a loss history, that management was too thin and new, that one debtor (presumably Concrete Constructions, for whom Rendell was doing substantial work) dominated the company's receivables, that Rendell would be listed 'only to allow the investor to sell', that overall the market was in decline, and that there was a high risk from supplier support to Rendell's competitor. He expressed the opinion that the risks would be heavily weighted by the market, and that the role of passive investor (a role, it is noted, that was envisaged for Aequitas) would be easier for AEFC if risks were spread. These observations imply that an equity investment in the Rendell group in November 1985 would be imprudent.

93 On the basis of Mr Rees' notes and a discussion with Rendell's managing director, Mr Griffin, Mr Gledhill prepared an internal memorandum dated 12 November 1985. He noted that AEFC's strategy had been to dispose of the Rendell investment once the company had been floated on the Second Board of the Stock Exchange in 1986. However, AEFCAS had formed Aequitas as the listed investment entity that had been foreshadowed in his board paper for the October 1985 board meeting. He noted that AEFC would not now be a shareholder in Aequitas, but CASO would hold a B class share giving it 60% of the voting rights, and accordingly, management control. A public capital raising for Aequitas was proposed, raising some $5 million, initially to be subscribed to $2 million. Aequitas No 1 had been formed as a wholly-owned subsidiary of Aequitas as part of a strategy to keep Aequitas 'takeover-proof'.

94 Mr Gledhill reported that Aequitas had made an offer to buy AEFC's Rendell investment, the offer being contained in the Sale of Shares Agreement prepared by Law & Milne. He noted that it would be necessary for Aequitas to purchase the shares before the proposed private placement of shares to

management took place, because if the sale to Aequitas was delayed, Aequitas would have to offer to purchase the management shares. I assume this was because the issue of the management shares would take the number of shareholders in Rendell Industries above the threshold at which the takeover legislation of the time would have become applicable.

95 Referring to Mr Rees' background notes and his discussion with Mr Griffin, Mr Gledhill said he was satisfied that it was in the best interests of AEFC to dispose of its shareholding in Rendell and crystallise its profit. He said:

> 'I believe it is it in AEFC's best long-term interests for Aequitas to get off the ground as a viable equity investment company as this will provide the vehicle for the on-selling of equity investments taken by AEFC as they are fed to us by the Advisory Service.'

96 Mr Gledhill decided that AEFC would proceed with the sale subject to the consideration being increased to $960,000, and some slight amending of the draft in other respects. He said:

> 'I have indicated to Mr Mullins that, when settlement takes place, an amount of $50,000 will be passed through the joint venture accounts of AEFC Advisory Services in recognition of the part played in structuring the transaction.'

97 Mr Gledhill gave some evidence, orally and by affidavit, about the circumstances leading up to AEFC Leasing's sale of the Rendell Industries shares to Aequitas No 1. His evidence was that Mr Mullins approached him and proposed 'that the investment company he was forming acquire all the [Rendell Industries] shares held by AEFC Leasing'. He said Mr Mullins had a draft share sale agreement, which provided for a purchase price of $910,000. This appears to be the draft prepared by Law & Milne on 7 November 1985. Mr Gledhill said he responded by suggesting a figure of $960,000, which was closer to the par value of the shares (approximately 4.8 million shares of a par value of 20 cents each), and that he asked Rees for the discussion paper to which I have referred. He said he asked Mr Rees to prepare a discussion paper on the arguments for and against AEFC Leasing holding its equity investment in Rendell Industries.

98 Mr Gledhill's evidence gives the impression that Mr Mullins and Mr Rees were the driving forces behind the formation of Aequitas and Aequitas No 1, and the development of the proposal for Aequitas No 1 to buy AEFC Leasing's shareholding in Rendell Industries, to the exclusion of Mr Gledhill. On this view, Mr Gledhill was in the position of an arm's-length purchaser, and Messrs Mullins and Rees were acting independently of AEFC and AEFCAS in forming Aequitas and developing the purchase proposal. I reject Mr Gledhill's evidence to the extent it creates this impression. It is at odds with the documentary evidence, especially Mr Gledhill's board paper of 2 September 1985 (which shows that Mr Gledhill was closely involved with the development of the concept of Aequitas) and his memorandum of 12 November 1985, in which he regards the formation of Aequitas as a task implemented by the Advisory Service as foreshadowed by the September board paper, and discloses that substantial planning had taken place as to a proposed equity stake in Aequitas for AEFC.

99 I also reject Mr Gledhill's evidence that he increased the purchase price from $910,000 to $960,000 to bring it closer to the par value of the shares. As I have indicated, Mr Rees had previously made calculations in which he took into account the diluting effect of the proposed share issue to Rendell employees. Nothing in Mr Gledhill's evidence indicates that he questioned that calculation. And the increasing purchase price was exactly the amount to be passed through the joint venture accounts, implying that Mr Gledhill made the increase for that purpose.

100 It appears that under the joint venture agreement as it stood at that time, AEFC would receive first $240,000 of the joint venture income after payment of expenses. As at 12 November 1985 the income of the joint venture was at such a level that any profits passed through the joint venture accounts would be for the benefit of AEFC alone. If Mr Gledhill and Mr Mullins were aware of that on 12 November, they would nevertheless have had a motive for passing an amount through the joint venture accounts. By doing so, they would generate a profit for the joint venture and, to that extent, justify its activities more effectively than by simply increasing the price payable to AEFC Leasing.

Settling the text of the sale of shares agreement

101 Mr Gledhill handed over to Mr Kelly the responsibility for finalising the draft contract on behalf of AEFC Leasing. In his memorandum dated 12 November 1985, Mr Kelly recommended a variation to the terms of the proposed agreement, to the effect that if the ANZ Bank would not release AEFC from its deficiency guarantee, the new shareholder should take over the guarantee. Mr Kelly also made a number of comments on the drafting of the agreement, and he recommended that advice be sought from Holman Webb. However, Mr Gledhill added a handwritten note dated 14 November 1985 to Mr Kelly's memorandum accepting Mr Kelly's comments but saying that he was 'still prepared to regard this as an in-house matter and rest on understandings reached with Geoff Mullins' and therefore clearance of the document with Holman Webb was not required. The 'understandings' were not explained.

102 I have received conflicting submissions on the significance of Mr Gledhill's handwritten notes. In my view, the notes imply that Mr Gledhill trusted Mr Mullins to act consistently with the interests of AEFC. This implies, in turn, that, to the extent that AEFC and Aequitas might have had divergent interests, Mr Gledhill expected Mr Mullins to prefer the interests of AEFC. His statement that a clearance was not required from Holman Webb was not, in my view, an acknowledgment by him that Law & Milne were not acting for AEFC Leasing. It suggested only that there were some corporate governance arrangements within AEFC requiring certain matters to be reviewed by Holman Webb as the designated solicitors for that purpose. This would not prevent other solicitors from being appointed to represent the interests of AEFC or a subsidiary in a particular transaction.

103 Mrs Mullins and Mr Rees met on about 15 November 1985 to 'review progress and plan future action and strategy' for Aequitas. At some time in the next few days there were exchanges between Mr Rees and Mr Kelly with respect to the contents of the draft contract. There does not appear to have been any process of negotiation between them, but instead, the increased purchase price and other amendments suggested by Mr Kelly (including an amendment to require the purchaser to assume responsibility for the ANZ guarantee) were incorporated in the new draft. On about 19 November Mr Rees instructed Law & Milne with respect to the agreed amendments to the draft. A re-engrossed draft was submitted by Law & Milne to Mr Rees on 19 November 1985.

104 It does not appear that anyone in the drafting process thought to protect the interests of the proposed investors in the purchaser by including a right of rescission or review of the terms of purchase after the appointment of independent members to the board of directors of Aequitas. Indeed, clauses 4(f) and (g) of the draft agreement, which would have been warranties by AEFC Leasing that there was no material dispute with any governmental authority and that Rendell Industries had paid its taxes, were deleted from the final draft. Some pencil notes on the draft suggest that AEFC was not prepared to give those warranties. There is nothing to show that there was any negotiation about them. The plaintiffs complain that such clauses might have protected Aequitas No.1's interests given the difficulties experienced by the Rendell group in respect of the Australian Defence Force Academy site in Canberra and the difficulties with respect to payment of group tax in December 1985. Mr Gledhill says that the contract would not have been enforced had Aequitas decided not to go ahead, after the appointment of independent directors. That evidence is implausible and inconsistent with the documents, and there is no independent foundation for it. I reject it.

The sale of shares agreement

105 The agreement was executed on 25 November 1985 and provided for the settlement date to be the same day. In summary, the key terms were:

- the purchase price was $960,000;
- $1,000 was payable by Aequitas No 1 to AEFC Leasing on the settlement date, at which time the shares would be transferred to Aequitas No 1 (although in fact the shares were not transferred until the balance of purchase money was paid);
- payment of the balance of the purchase price was postponed to 31 March 1986 or such other date as the parties might agree, but if a later date was agreed, interest would be payable as from the settlement date;
- payment of the balance of the purchase price was secured by a fixed charge over the shares;

- Aequitas No 1 agreed, if requested by AEFC Leasing, to assume liability under the deficiency guarantee to the ANZ Bank and indemnify AEFC Leasing and AEFC against any claims made under the guarantee;
- until the due date for payment of the balance of the purchase price, the nominee of AEFC Leasing on the board of RIH (Mr Gallois) was to retain his position, and Mr Mullins was to be the nominee of Aequitas No 1 at all meetings of Rendell Industries.

106 The net effect of this transaction was that AEFC Leasing disposed of its Rendell shares on 25 November 1985 for $960,000, having paid only $250,000 for them on 3 October 1985. $50,000 went to AEFCAS as a fee, the resulting profit being $660,000 less interest costs on the $250,000 investment. It is true that the October documentation referred to AEFC Leasing providing consideration by procuring finance from AEFC for the Rendell group. Indeed, on 26 February 1986 AEFC wrote to Arthur Andersen & Co for taxation advice as to whether AEFC Leasing had made a deductible loss out of the transaction, on the basis that the consideration which it provided for the acquisition of the shares included $1,671,000 in loan finance. However, as I have said, contemporaneous assessments by AEFC and AEFCAS were to the effect that the commitments undertaken by AEFC in connection with the transaction were not costs - indeed, they were regarded as an opportunity for AEFC to do some lending business, collaterally realising a profit on the equity investment.

107 The defendants seek to make something out of the fact that the position of Mr Gallois on the board of RIH was expressly protected by the agreement, but there was no similar protection in respect of the AEFC nominees to the board of Rendell Industries. But at the time of the agreement the only directors of Aequitas were Mr Mullins, Mr Rees and Mr Elvy, all of whom were provided to the joint venture by CASO. It appears that there was no perceived need to protect their positions, because they were expected to remain loyal to the joint venture.

The role of Law & Milne

108 There was a dispute at the hearing as to the role of Law & Milne. The evidence does not clearly indicate the identity of Law & Milne's client. There does not appear to have been any written retainer, and the evidence from company minutes and memoranda of fees is inconclusive.

109 Minutes of directors' meetings of Aequitas show that Law & Milne were appointed solicitors to the company shortly after 18 September 1985, and the minutes of a board meeting of 12 March 1986 referred to them as having drafted the share sale agreement as the lawyers of Aequitas. This evidence establishes that they were acting for Aequitas No 1 on the share sale agreement, but does not show that they were not acting for AEFC Leasing as well.

110 Law & Milne's account dated 17 April 1986 was directed to AEFC Leasing. However, the party to whom the account was addressed was changed by hand (evidently by Mr Rees) to Aequitas No 1 and the account was paid by that company. The narrative to the account indicates that Law & Milne were acting for the purchaser or acquirer of the shares from AEFC Leasing. Other accounts rendered by the firm were directed to and paid by Aequitas.

111 There is no evidence to show that the solicitors took the normal precaution of establishing their retainer in clear terms from the outset: generally, see *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1, 48ff. They dealt directly with Mr Mullins and Mr Rees, but they cannot have believed that their clients were Mr Mullins and Mr Rees in their personal capacities. They must have believed that Mr Mullins and Mr Rees were representing some entity or entities. On the face of it, they appear to have taken their instructions from AEFCAS. The first draft was forwarded to Mr Rees care of AEFCAS, and at the time Aequitas was still a shelf company with no independent board.

112 AEFCAS occupied the dual roles of manager of the joint venture and promoter (as we shall see) of Aequitas. The transaction proceeded without the involvement of any other lawyer, as Mr Gledhill decided on behalf of AEFC that the transaction was an in-house one and so it was unnecessary for the sale agreement to be vetted by AEFC's usual external lawyers, Holman Webb. The lack of any specific

retainer arrangements, and the solicitors' willingness to deal with Messrs Mullins and Rees alone, suggest that they shared Mr Gledhill's notion that the transaction was 'in-house'.

113 I note that in about November 1986 the firm accepted instructions to advise Aequitas and Aequitas No 1 concerning potential recovery from, amongst others, AEFC Leasing and AEFCAS. The firm gave some advice by letter dated 27 November 1986. The defendants submit that if Law & Milne had acted for AEFC Leasing in the share transaction, one might reasonably assume that the firm would not have undertaken to advise Aequitas and Aequitas No 1 of possible actions against it. But the advice was given a year later than the execution of the agreement, and in my view those facts are less significant, in overall terms, than more contemporaneous events - such as, for example, the fact that the firm saw fit to direct its account of 17 April 1986 to AEFC Leasing.

114 All in all, the circumstances lead me to conclude that Law & Milne were acting for the joint venture, AEFC and AEFC Leasing, and also the Aequitas group in the transaction.

Payment of $69,400 to CASO as a 'commission'

115 A report to the May 1986 board meeting of AEFC noted that a commission would be payable to CASO after 1 July 1986 on the purchase and sale of the Rendell shares of approximately $70,000. Early in July 1986 Mr Porteous sent a memorandum to Mr Gledhill drawing attention to a provision in the joint venture agreement between AEFC and CASO, according to which AEFC was required to pay CASO 10% of the pre-tax net profit earned and collected by AEFC during the immediately preceding fiscal year, which resulted directly or indirectly from business introduced by AEFCAS. Mr Porteous said that the amount due to CASO under the joint venture agreement for AEFC Leasing's profit on the sale of its Rendell shares was $71,000, since AEFC had made a profit of $710,000. Mr Gledhill endorsed the memorandum in a handwritten note dated 2 July, saying he had no problem with the claim but a 'cost of funds' factor on the $250,000 invested should be taken into account. In a memorandum dated 10 July 1986 AEFC's company secretary calculated the cost of funds factor and consequently CASO's 10% fee. The fee as calculated was $69,400. That amount was paid by a cheque requisitioned on 14 July 1986.

The financial difficulties of the Rendell group during the period from 3 October 1985 to 1 April 1986

116 When AEFC and AEFCAS first became involved with the Rendell group, it became apparent that the group was suffering from 'liquidity problems'. The sale of the group for $250,000 (a price thought by AEFC to be low) by interests associated with Norman Rendell was said to be attractive to Mr Rendell because AEFC would relieve him of his guarantee obligations to the ANZ Bank. This suggests that Mr Rendell may have been concerned about the solvency of the group in mid-1985. Some confirmation of this is found in an internal memorandum prepared by Mr Kelly of AEFC on 10 October 1985, shortly after the documentation of the purchase of a majority shareholding from the Rendell group by AEFC Leasing. In that memorandum Mr Kelly, explaining the purchase transaction, said 'Mr Rendell had incurred considerable personal liabilities for the company's debts, which he was anxious to see removed, when it became apparent his group was heading towards insolvency'.

117 It appears that the management of AEFC and AEFCAS believed that the purchase transaction would alleviate the liquidity problem and enable the Rendell group to enhance its profit and to expand. However, in a memorandum dated 7 November 1985 the managing director of Rendell Industries, Mr R M Griffin, reported to his board that management was concerned with the group's high rate of growth, because of the strains it placed on liquidity and the risk of increased payroll costs. He said that the company was vulnerable to even a minor downturn in the industry, and that 25% of the group's overheads were funding costs.

118 Concern about the financial viability of the Rendell group seemed to increase during November 1985. In his internal memorandum analysing the proposed sale to Aequitas, dated 14 November 1985, Mr Kelly referred to AEFC's exposure to the Rendell group as a lender. He observed that the term loan

of $1.17 million was 'reasonably secured although the security could not be regarded as strong bearing in mind the financial position of the Rendell group and the current tight cash position'.

119 That was the context in which the Rendell group approached the ANZ Bank for an increase of $105,000 in its overdraft (which would take the overdraft to $200,000) and a short-term increase in a bill facility of $500,000, taking that facility up to $1.55 million. The group also approached AEFC for additional loan funds. The bank wrote to Mr Griffin on 27 November 1985 approving the increased facilities on certain conditions, one of which was that AEFC must consent as guarantor to the increased arrangements before drawdown.

120 Mr Griffin reported to the board of RIH as managing director on 27 November 1985, at a meeting attended by Mr Gallois and Mr Rees. He said that the industry was extremely buoyant, but margins remained low. The company's revenue and profits were above budget, but the high level of activity continued to place a severe strain on the company's liquidity. (In some discussion notes which appear to have been prepared by Mr Griffin for the board meeting, there is a reference to management's attempt to 'stretch creditors now to a dangerous position'.) None of the major builders was prepared to provide meaningful assistance to the company, while they were nonetheless pressing Rendell to perform in excess of contract requirements. Concrete Constructions, a large client, had a present debt in excess of $1.2 million which was growing, and further work with that company would be declined unless they reviewed their payment policy. The activity of the company would be wound back to a more acceptable level, about 75% of current activity. Arrangements were also being implemented to reduce the size of the management team, at an annual saving of $550,000.

121 It does not appear that Mr Griffin's written report, or any of the other reports by management to the board meeting of 27 November, made reference to the proposed increased borrowing from ANZ. However, some concern was expressed at the board meeting, probably by Mr Griffin, that AEFC may not be dedicated as a shareholder of the Rendell group.

The financial crisis of December 1985

122 AEFC did not give its consent as guarantor to ANZ's proposed increase in lending to the Rendell group, as requested by the bank. ANZ then refused to provide the additional financial accommodation. Late in November ANZ informed Rendell that it would not meet a substantial payment to the Australian Taxation Office because AEFC was not complying with the arrangements as understood by ANZ. This caused considerable disruption to the Rendell business and created disquiet amongst Rendell's senior staff, who were then considering whether to take equity positions in the company.

123 Evidently by 2 December 1985 something of a financial crisis had developed in the Rendell group. AEFC wrote to ANZ proposing that it be released from its guarantee, and that instead ANZ take a second-ranking mortgage debenture over the assets and undertaking of the group. AEFC would give that second-ranking mortgage debenture priority over its first mortgage for up to $2.4 million, so that ANZ would have, in effect, a first ranking security up to that amount.

124 The bank's area manager, Mr Austin, responded to AEFC's offer with puzzlement. He said he did not understand why AEFC was unwilling to provide a letter of consent as guarantor, given that it was considering an increase in its direct financial assistance to the group. He asked for the reason why AEFC requested to be released from the guarantee, so soon after the guarantee arrangements had been re-negotiated. These views were communicated at a meeting Mr Austin had with Mr Griffin, Mr Kelly, Mr Rees, Mr Gallois and a Mr Gray on 3 December 1985, and in writing to Mr Kelly on the same day. Mr Austin withdrew the bank's offer of increased facilities.

125 By 3 December, therefore, the management of the Rendell group was in a very serious situation. A large tax payment would shortly become due, and cash was needed for salaries and other payments. Notwithstanding positive responses by both ANZ and AEFC to the group's request for additional funding in mid-November, no funding had materialised from either source. The issue was bound to be a topic for debate at the board meeting of Rendell Industries which was due on 5 December.

126 On 4 December 1985 Mr Rees prepared some notes analysing AEFC's exposure under the deficiency guarantee. The notes took into account the Turner valuation of the Hurstville building (discussed below), which substantially increased AEFC's exposure, but Mr Rees developed a sale and lease back proposal that would improve the position. He concluded that AEFC's exposure was still under $2 million, and contemplated a further cash injection of $500,000 by AEFC if ANZ would agree to rearrange its facilities to take a mortgage debenture in substitution for the guarantee. In hindsight, his assessment seems to have been excessively optimistic.

127 Mr Rees also prepared some notes about the Rendell group's cash flow crisis on the same day. He noted that creditors were pressing, and tax and salary payments had to be made. He pointed to low morale of management, and to the adverse consequences if additional funds were not made available. One of these was that the emphasis on cash generation would cut profits and make the proposed float of the group less attractive.

128 Also on that day Mr Rees made a file note of his telephone conversation with Jose Blanco, a solicitor who was a director of RIH. Mr Blanco expressed the view that the directors must look at every available source to raise funds, if they believed the company to be profitable. He was concerned that creditors may claim against the directors if matters were to deteriorate.

129 AEFC eventually yielded to pressure on 5 December 1985, the day of the Rendell Industries board meeting, after a conference attended by Messrs Gledhill, Gallois, Rees and Kelly on that day. It agreed to grant a secured short-term money market facility of $525,000 to the Rendell group immediately. But it continued to press ANZ with the proposal to replace the deficiency guarantee with a mortgage debenture.

AEFC declines to re-negotiate the deficiency guarantee

130 Eventually on 19 December 1985 ANZ wrote to Mr Kelly saying that it had agreed to release AEFC from the deficiency guarantee subject to a number of conditions, broadly on the lines of AEFC's proposal for a mortgage debenture and priority agreement. But AEFC did not implement the transaction. This appears to have been partly because Mr Rees and Mr Kelly were making increasingly optimistic assessments of AEFC's exposure under the deficiency guarantee, and perhaps they were correspondingly unwilling to give ANZ the substantial advantage of a priority security over the assets and undertaking of the business; and partly because concern about the deficiency guarantee became less pressing when Aequitas granted an indemnity in respect of it as part of the sale of the Rendell Industries shares. The bank followed up the matter in March 1986, and after discussions it was arranged that AEFC would write to ANZ saying that the proposed arrangement was no longer relevant and that the deficiency guarantee was still in force.

131 Mr Kelly wrote to ANZ on 8 April 1986, saying that because ANZ was not prepared to release the guarantee upon substitution of the new security (meaning, I take it, that ANZ was imposing conditions), AEFC would prefer to allow the current security arrangements to stand. ANZ had sought confirmation from AEFC that the deficiency guarantee continued to apply to the funding arrangements for the Rendell group. Instead, Mr Kelly merely said that 'the deficiency guarantee was forwarded to your office on 3 October 1985'.

132 That statement caused some consternation within the bank. The bank drew the inference from the letter that in AEFC's view, the deficiency guarantee was limited to the extent of the overdraft facilities as they stood at 3 October 1985. In the meantime the overdraft had increased from $95,000 to more than $200,000. Mr Austin of the bank wrote to Mr Kelly on 11 April 1986, setting out the history of the matter and the bank's concerns, and seeking formal confirmation that the guarantee could continue to be relied upon to cover all liabilities of the Rendell group to the bank on a deficiency basis, 'to ensure that the progress of the current financial reorganisation of the group is not stifled'. But AEFC did not give the bank the repty it sought, and the disagreement between them was not resolved until December 1997, after extensive negotiations in the wake of the Rendell collapse.

The Turner report

133 In November 1985 Ian Turner & Partners (NSW) Pty Ltd, property consultants ('Turner'), were engaged to assist the Rendell group to decide whether to re-develop the Hurstville site. They produced a 'status report' dated 26 November 1985. The report discussed a range of options available for development or disposal of the Hurstville property. It stated that if Rendell Industries desired to liquidate its investment in the site, the most appropriate course of action would be to sell the property 'as is', and it could be expected to realise between $750,000 and $1 million. This estimate was dramatically below the previous valuations, the book value of the site ($2 million) and even AEFC's estimated recovery on realisation by forced sale ($1.6 million).

134 Turner's report was considered at the board meeting of Rendell Industries on 5 December 1985, when Mr Griffin advised that the report did not correspond to the brief that was given, and after discussion the board agreed that the group would not proceed with the re-development of the site and that the brief of Turner would be terminated. After Mr Griffin had instructed Turner to cease any further work on the assignment, Mr Turner wrote a letter dated 24 December 1985 to Mr Kelly at AEFC, explaining that their report had been a first interim report and they had expected to present a second interim report and a final report. The letter enclosed an invoice directed to AEFC. Mr Kelly forwarded the invoice to AEFCAS with a request for them to arrange for payment by the Rendell group.

135 The evidence does not indicate the terms of Turner's retainer, nor how it could be said that their report did not correspond with their brief. However, there is at least a ground for strong suspicion that the true reason for cancellation of the retainer was that Turner's estimated value of the Hurstville property was very inconveniently much lower than the valuation on which AEFC and AEFCAS had based their assessments of risk exposure to the Rendell group.

AEFC's information about Rendell in December 1985/January 1986

136 Mr Griffin made three reports to the board of Rendell Industries on 5 December. He called the first a 'special report'. Given the crisis that had just been averted for the time being, the report was amazingly positive. It asserted that improvements that had commenced in the last quarter of the 1985 financial period were being sustained. It referred to reductions of cost of sales, debtors and creditors and management costs, and increases in revenue and margins, as well as the making of profits after two years of losses. The report said that there had been insufficient funding to cover cash losses prior to October 1984 and during the December-February period in 1984/85, when the Centrepoint project impacted on cash flow. It expressed the opinion that bridging finance was required.

137 The second report was Mr Griffin's report as managing director with respect to the October trading results for the Rendell group. He recorded that revenue and profits exceeded budget, and staff had been reduced by 14 with an additional reduction of 30 anticipated before Christmas. Revenue funding requirements had exceeded resources, and arrangements were being made with AEFC and ANZ to provide relief. He remarked that earlier commitments made by AEFC had not been met, and the effect had been very damaging.

138 The third report was a brief description of the difficulties encountered in attempting to raise short-term finance from ANZ and AEFC. The report noted that concerns had been expressed at the meeting of the board of RIH on 27 November that AEFC may not be dedicated as a shareholder, and it suggested that the Rendell Industries board should consider whether there was a conflict of interest on the part of AEFC as principal shareholder and substantial lender to Rendelt.

139 At the board meeting Mr Rees responded to the allegation of conflict of interest by explaining the investment policy of AEFC, and by informing the board that AEFC's shares had been purchased by Aequitas. He explained the reasons for setting up Aequitas and the position in relation to the deficiency guarantee. He reported that AEFC had put $525,000 into the group earlier that day on a short-term basis. Mr Griffin responded by saying that $1.5 million was needed to fund the company effectively, and that management felt there was a lack of shareholder support. Mr Rees said that AEFC and AEFCAS had to take some of the responsibility for the recent funding problems, and explained that AEFCAS had left the

negotiation of the funding arrangements directly to Rendell and AEFC. He agreed to meet with key management staff of Rendell, who were said to be very disillusioned.

140 It is clear that Mr Gledhill, Mr Gallois and Mr Kelly were closely following the events at Rendell, and were well aware of the information communicated to the 5 December board meeting. Mr Kelly's internal memorandum of 6 December 1985 referred to the 'considerable liquidity pressures' on Rendell. Nevertheless he made a very optimistic assessment of AEFC's exposure. He explained that AEFC had agreed to provide an additional $525,000 pending rearrangement of Rendell's finances, because it was not in AEFC's interest or the interest of Aequitas to increase the ANZ facilities while the guarantee still applied. He supported Mr Rees' suggestion of a sale and lease-back arrangement which would provide $1.9 million in cash to Rendell, which could be used to extinguish the cash facilities provided by ANZ. He calculated AEFC's exposure to the Rendell group on a basis that eliminated the equity investment of $250,000 because of the sale to Aequitas, and eliminated the deficiency guarantee as a risk exposure. Mr Gledhill appears to have accepted Mr Kelly's very optimistic assessment.

141 Mr Griffin reported to the board of RIH on 16 December 1985, dealing with the trading results for the five months ended 30 November 1985. Once again, profits and revenue exceeded budget, but the revenue included $875,000 of contract claims, without which revenue and profits would have been substantially reduced. The company's liquidity problems continued and the number of days outstanding for the company's debtors increased from 57.1 in October to 67 in November. He anticipated poor results for December and January.

142 On the same day Mr Griffin wrote a memorandum to management establishing a task force for cash control in order to avoid a 'constant cash shortfall'. He said that the company was owed $3.5 million and that it owed $2.3 million, but it was falling behind on collections. The task force would communicate daily and would implement some drastic remedies - for example, cash would only be paid on Fridays.

143 Mr Griffin's report on trading results to the board of RIH on 17 January 1986 continued this theme. Revenue and profits were both said to have exceeded budget, but management was under considerable pressure because of a negative cash position caused by inadequate funding and substantial growth. However, the board papers for the January 1986 meeting contained some ominous information about difficulties with suppliers, who had cancelled credit to Rendell and refused trade discounts. Clearly the company's liquidity problem was seriously damaging its business. Indeed, on 13 February 1986 Colin Campbell, a senior executive of the company, endeavoured to quantify the financial impact of the delay in meeting the company's equity funding requirements, and came up with the figure of $148,403. His report was considered at the February 1986 meeting of the board of RIH.

144 Mr Griffin continued to press Concrete Constructions to address its unpaid account of well over $1 million. Eventually Concrete Instructions offered to pay by instalments, and that offer was accepted.

145 Mr Griffin's optimistic assessments of profit appear to have been based on a fragile foundation. A memorandum to the executive committee from the accountant dated 18 December 1985 stated that, according to the November accounts, the group had made a loss to date for the financial year of $759,597.90. If advance billings were taken into account, the trading loss would be $1,227,957.90. While it is clear that Mr Gledhill and Mr Kelly, as well as Mr Rees and Mr Mullins, were aware contemporaneously of the information contained in documents presented to the Rendell Industries and RIH boards, the evidence does not show that they were aware of the accountant's calculations.

Rendell's further decline in February/March 1986

146 By 17 February 1986 even Mr Rees was noting that 'excess debt is eroding profit margins' and affecting senior staff morale. In the same memorandum he observed that there were no net assets and that cash starvation was inhibiting the business. He said that an investment of $1.5 million in equity was needed. He discussed his assessment with Messrs Gledhill, Kelly and Gallois on 18 February. They considered possible short-term support by AEFC but decided that this would be conditional upon a positive response to the underwriting of Rendell's flotation, and the outcome of discussions with

Concrete Constructions. At that meeting an assessment was made of Rendell's short-term cash needs and short-term cash flow expectations. The cash needs included tax and salaries, insurance and payments to 'difficult' suppliers. The shortfall by the end of February was calculated at approximately $495,000.

147 Mr Griffin's report dated 18 February 1986 on January trading results, made to the February board meeting of RIH, was more guarded than his previous board reports. He reported that revenue and 'gross margin' exceeded the forecast figures but he noted that the forecasts may have been distorted because they were calculated on an annual basis. Administration costs exceeded budget figures. He reiterated the need for better cash flow and noted that Rendell's pricing on quotes in recent months had exceeded the available market price. He said that the 'over-aggressive' collection methods used by the company were impacting adversely in the market place, and resistance was developing between builders and Rendell. Suppty had been stopped on a number of jobs, with catastrophic effects.

148 According to the minutes of the meeting of 26 February 1986 at which he delivered that report, the board was advised that group tax payments were three months in arrears and that payroll tax was also considerably in arrears, and Mr Griffin said that the company's financial position had become 'parlous'. Mr Rees said that AEFC would not let Rendell down, but it was waiting for an underwriting agreement before making any commitment for further funding.

149 In about late February 1986 (but presumably after Bache's letter of 26 February 1986 offering to underwrite the Rendell fundraising) AEFC considered an application by Rendell for an extension of loan facilities from $1,695,000 to $2,700,000. An undated and unsigned memorandum, evidently prepared within AEFC, recommended that the additional facilities be granted. This was on the basis that the exposure to ANZ on the deficiency guarantee was negligible, since the net recovery on the Hurstville property would be $1.9 million. That memorandum was followed by a memorandum by Mr Kelly dated 3 March 1996 for the May meeting of the Australian Committee of AEFC. Mr Kelly recommended that loan facilities be extended to a total of $2,500,000 (disregarding the equity investment of $250,000), secured by a charge over the assets and undertaking of the group. The recommended facilities were a revolving term loan of $2 million for working capital and a bridging loan of $500,000 for short-term funding pending receipt of the proceeds of the public float. Mr Kelly noted that the proposed share issue upon flotation had been underwritten, and that the underwriter expected that the listing and capital raising should be completed within six to eight weeks.

150 Mr Kelly's recommendations were approved and implemented on 5 March 1986, evidently under executive authority. $700,000 was credited to Rendell's account and some $95,000 was withheld to cover unpaid interest, unpaid AEFCAS fees and other expenses.

151 Mr Griffin's report dated 26 March 1986 to the board of Rendell Industries on trading results to February 1986 said that both revenue and profit had fallen below forecast levels for February. He expressed concern that the forward sales program had not been achieved because Rendell had priced itself out of the market, and he also identified a lack of performance by the marketing manager. He said that the forecast year end results were becoming more difficult to achieve, although there was a better than even chance of success.

152 Mr Rees conceived the idea that the Rendell group balance sheet would be improved if AEFC's term loan of $2 million could be converted into preference shares. This would reduce interest costs and enable Rendell to use tax losses more effectively. He wrote a memorandum to Mr Kelly on the subject on 2 April 1986, but Mr Kelly annotated the memorandum to the effect that Mr Gledhill had already approved the conversion of the term loan to preference shares, and that appropriate documentation shoutd be prepared. Another short-term loan of $200,000 repayable at call was obtained by Rendell from AEFC on 3 April 1986.

The private placement of shares in Aequitas

Planning for capital raising

153 Once Aequitas had contracted to purchase the Rendell Industries shares from AEFC Leasing, Mr Mullins and Mr Rees moved towards raising capital for Aequitas. Thus, Mr Mullins met with partners of Law & Milne on 11 December 1985 to discuss the proposed capital structure for Aequitas and the steps to be taken in any Aequitas capital issue. It appears that at that time, Messrs Mullins and Rees were proposing to subscribe for substantial quantities of shares in Aequitas, but AEFC was not.

154 Mr Mullins and Mr Rees engaged Charlton & Charlton, media consultants, to assist Aequitas. They reported some preliminary thoughts to Mr Mullins on 9 December 1985, seeing it as a principal objective to prepare the media, investors, the public and the financial community for the launch of Aequitas. They had discussions with Arthur Young, and with potential underwriters and directors. It appears that they were careful to do so on behalf of Aequitas rather than AEFCAS.

155 Versions of a document called 'Aequitas Limited Background Briefing Paper' were prepared in January 1986. According to the first version, Aequitas management were to retain 60 percent voting control of Aequitas. By the time of the second version, Messrs Rich, Pond and Donohoe had been proposed as independent directors and the investment proposed for Messrs Mullins and Rees was for a more limited number of fully and partly paid shares. Each version of the paper refers to opportunities available to Aequitas as a result of its association, through its directorate, with AEFC, which would 'initially provide a significant stream of opportunity for investment'. The paper claimed that potential investments would be closely evaluated, with commentary by Arthur Young.

156 Planning reached a level of maturity during January 1986. By the time of the board meeting of Rendell Industries on 29 January 1986, Mr Rees was able to report that Aequitas would be floated on the Primary Board of the Sydney Stock Exchange, and he advised on the board composition and the high profile that the company would have.

157 As previously mentioned, Bache agreed on 26 February 1986 that they would underwrite a rights and options issue for Rendell Industries immediately after its listing. Mr Rees also explored with Bache the possibility of an underwriting for Aequitas, and when Bache responded favourably, an information memorandum was drafted for review. A draft was submitted by AEFC to Bache on 5 March 1986. On 6 March 1986 representatives of Bache and Law & Milne met with Messrs Mullins and Rees (representing AEFCAS) and Mr Gallois (representing AEFC). The purpose of the meeting was to plan for the listing of Rendell and also for the listing of Aequitas. A draft information memorandum for Aequitas was reviewed.

158 Mr Rich became a director on 10 March 1986, and Messrs Pond and Donohoe became directors on 12 March. There was a board meeting of Aequitas on 12 March at which there was discussion about Mr Rees' proposal to revalue the holding of Rendell Industries shares by Aequitas No 1 by $72,000, and it was decided that the advice of Arthur Young as auditor be sought. The Aequitas board resolved to revalue its shareholding in Aequitas No 1 by $72,000 on 1 April 86, although Arthur Young's report of 12 March 1986 recorded that this had already taken place.

The Aequitas private placement memorandum

159 The Aequitas information memorandum was finalised no earlier than 12 March 1986, since it contains a report by Arthur Young bearing that date. It was described as a 'private placement memorandum' for an equity capital raising of $5 million. The document was expressed to be for limited circulation to institutions and private clients of Bache whose ordinary business included buying and selling securities. It was said not to be an offer to the public. Hence the document did not purport to comply with the prospectus requirements of the day.

160 It contained a directors' statement which said that Aequitas had been formed to provide opportunities for small to medium sized commercial companies to expand their equity base prior to listing. Aequitas had already purchased equity in companies which met its objectives and had plans in train for the listing of one of its purchases (presumably Rendell). An advantage said to be enjoyed by Aequitas was the sourcing of opportunities through its special relationship with AEFC, which would provide valuable referral business flows. It was said that Aequitas intended to raise $5 million by way