JUDGMENT : Barrett J : Equity Division Supreme Court of New South Wales. 24th August 2005

The proceedings and relevant persons

1 By originating process filed on 14 October 2003, the plaintiff (ASIC) sought declarations pursuant to s.1317E of the **Corporations Act** 2001 (Cth) to the effect that the defendants, Malcolm Leslie Edwards and Leonard George Jones, contravened s.588G(2) of that Act in that they failed to prevent Murray River Limited ("MRL") from incurring debts in 1999. The proceedings against Mr Jones were compromised. The proceedings against Mr Edwards (who, for convenience, will be referred to simply as "the defendant") were heard by me over 17 days: 14 to 18, 22 to 25 and 28 February and 1 to 3, 21 to 23 and 24 March 2005. Written submissions were filed on 18 April, 13 May and 1 June 2005. I reserved judgment on the last of those days.

2 It will be necessary to traverse a large quantity of evidence. It is appropriate, at the outset, to refer to and identify a number of relevant persons and companies, noting that the evidence is concerned wholly with activities of MRL in and about the partial construction of a resort complex and efforts to obtain finance for that project:

"**AFS**": Australian Financial Solutions Pty Limited – a financial intermediary;

"**BDO**": BDO Nelson Parkhill – a firm of chartered accountants retained by MRL for the purposes of a proposed prospectus;

"**Mr Beattie**": Gregory Beattie, a partner of Eakin McCaffery Cox, solicitors for MRL;

"**Mr Branagan**": Adrian Branagan – a consultant to DMF;

"**Mr Chamberlain**": Christopher Chamberlain – a chartered accountant who became administrator and eventually liquidator of MRL;

"**CJC**": Colin Joss & Co Pty Ltd, a building contractor based in Albury;

"Club": Mulwala & District Services Club Ltd – the owner of the leasehold site intended to be the site of the resort development; party with Essington to the memorandum of understanding dated 4 May 1998 and the joint venture agreement of 22 December 1998;

"**Mr Curtis-Smith**": James Curtis-Smith – solicitor for the Club;

"**DMF**": Direct Mortgage Funding Pty Ltd – a financial intermediary;

"**Essington**": Essington Asia Pacific Pty Limited, a company owned by the defendant and members of his family; party with the Club to the memorandum of understanding dated 4 May 1998 and the joint venture agreement of 22 December 1998;

"**Mr Fernandez**": John Fernandez – a director of Urwin & Fernandez Pty Ltd, a venture capital firm;

"**Mr Gamble**": Baxter Gamble – an officer of AFS;

"**Mr Haralambis**": Constantine Haralambis – the solicitor for Leigh

"**Mr Hargreaves**": Trevor Albert Hargreaves – a director of the Club and of MRL;

"**HGR**": Herbert Geer Rundle, Melbourne solicitors representing potential providers of mortgage finance;

"**Mr Hickie**": David Hickie – an employee of Mercator;

"Mr Jones": Leonard Paul Jones – co-director with the defendant of MRL;

"**Mr Paul Joss**": Paul Joss – son of Colin Joss and an officer of CJC;

"**Mr Joss**": Colin Joss – the principal of CJC;

"**KCC**": Knapman Clark & Co Pty Ltd – a firm of quantity surveyors;

"**KCMS**": Knapman Clark Management Services Pty Ltd – a project manager;

"**Leigh**": Leigh Superplan Pty Ltd – a lender;

"**Mr Male**": A.W. Male – a registered valuer practising in Albury and the principal of A.W. Male & Associates Pty Limited;

"**Mr McKay**": Peter McKay – an employee of DMF;

"Mr McNamara": Kenneth McNamara – a director of KCMS and the sole director of KCC.

"**Mercator**": Mercator Funds Management Limited – a financial intermediary;

"**Mr Mullarvey**": Michael Mullarvey – chief executive officer of the Club and secretary of MRL;

"**NAB**": National Australia Bank Limited;

"Mr Nieuwenhout": Anton Nieuwenhout – a director of the Club and of MRL;

"**Mr Radcliffe**": Murray Radcliffe – an officer of WAMC;

"**Mr Reid**": Martin Reid – a project manager employed by CJC;

"**Mr Robinson**": Trevor Robinson – an officer of AFS;

"**Mr Sloan**": James Sloan, the solicitor for CJC;

"**Mr Smith**": Greg Smith – an officer of AFS;

"**Mr Tait**": Robert Tait – a director of the Club and of MRL;

"**WAMC**": Water Administration Ministerial Corporation – the lessor to the Club of the site of the proposed resort development;

"**WLB**": Wolski Lycenko & Brednock – a firm of architects.

ASIC's case

3 ASIC's case against the defendant is that he contravened s.588G by failing to prevent MRL from incurring each of several debts. ASIC thus relies on s.588G(2) which, referring to a person, a company, a debt, the incurring of the

debt and the time of such incurring (some of which are elucidated by ss.588G(1) and 588G (1A)), states that the person contravenes s.588G by failing to prevent the company from incurring the debt if one of two conditions is satisfied: either the person is aware at the time of the incurring that there are grounds for suspecting that the company is insolvent or would become insolvent by the incurring of the debt (s.588G(2)(a)); or, alternatively, that a reasonable person in a like position in a company's circumstances would be so aware (s.588G(2)(b)). A person is within the purview of this section if he or she is a director of the relevant company at the time that company incurs the relevant debt: s.588G(1)(a). The incurring of a particular debt is relevant for the purposes of the section if, first, the company is insolvent at the time of the incurring or becomes insolvent by incurring that debt (or debts including that debt) (s.588G(1)(b)); and, second, there exist at that time reasonable grounds for suspecting that the company is insolvent or would become so insolvent (s.588G(1)(c)).

4 Another condition of applicability of these provisions is that the time of the incurring of the debt is at or after the commencement of the **Corporations Act** 2001 (Cth). That commencement occurred on 15 July 2001, more than two years after most of the acts and events on which ASIC relies in this case. By virtue of s.1400, however, those acts and events may be so relied upon, where those acts and events gave rise to an equivalent liability under a provision of the **Corporations Law** as in force before 15 July 2001. It is submitted by ASIC and not denied by the defendant that this transitional provision applies in the present case. The correctness of that conclusion is, in any event, clearly indicated by both ***R v Frawley*** (2005) 52 ACSR 461 and ***Kennedy v Australian Securities and Investments Commission*** (2005) 52 ACSR 301.

5 If ASIC is to succeed in establishing a contravention of s.588G by the defendant by reason of the incurring of a particular debt by MRL, ASIC must show (in addition to the incurring of the debt):
(a) that the defendant was a director of MRL at the time of the incurring of the debt;

(b) that MRL either
  (i) was insolvent at the time of the incurring of the debt; or
  (ii) became insolvent by incurring the debt (or debts including the debt);

(c) that there existed, at the time of the incurring of the debt, reasonable grounds for suspecting
  (i) that MRL was insolvent; or
  (ii) that MRL would become insolvent by incurring the debt (or debts including the debt).

(d) that the defendant failed to prevent MRL from incurring the debt; and

(e) that either
  (i) the defendant was aware, at the time of the incurring of the debt, that there were grounds as referred to in (c) above; or
  (ii) a reasonable person in a like position in a company in MRL's circumstances would have been so aware.

6 The matters to which I have referred emerge from ss.588G(1) and 588G(2):
"*(1) This section applies if:*
  (a) a person is a director of a company at the time when the company incurs a debt; and
  (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
  (c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
  (d) that time is at or after the commencement of this Act.
(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:
  (a) the person is aware at that time that there are such grounds for so suspecting; or
  (b) a reasonable person in a like position in a company in the company's circumstances would be so aware."

7 Even if ASIC succeeds in establishing the elements contemplated by s.588G the defendant will not be held to have contravened s.588G if he establishes one of the defences made available by s.588H:
"*(1) This section has effect for the purposes of proceedings for a contravention of subsection 588G(2) in relation to the incurring of a debt (including proceedings under section 588M in relation to the incurring of the debt).*

(2) It is a defence if it is proved that, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(3) Without limiting the generality of subsection (2), it is a defence if it is proved that, at the time when the debt was incurred, the person:
  (a) had reasonable grounds to believe, and did believe:
    (i) that a competent and reliable person (the other person) was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and
    (ii) that the other person was fulfilling that responsibility; and
  (b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(4) If the person was a director of the company at the time when the debt was incurred, it is a defence if it is proved that, because of illness or for some other good reason, he or she did not take part at that time in the management of the company.

(5) It is a defence if it is proved that the person took all reasonable steps to prevent the company from incurring the debt.

(6) In determining whether a defence under subsection (5) has been proved, the matters to which regard is to be had include, but are not limited to:
(a) any action the person took with a view to appointing an administrator of the company; and
(b) when that action was taken; and
(c) the results of that action."

MRL and the project in brief

8 MRL came into being on 16 June 1998. It became a public company and adopted its present name on 21 August 1999. Its original name was Murray River Pty Limited. The time at which it was converted to a public company and adopted the name "Murray River Limited" is of no consequence. I shall refer to it as "MRL" whether or not its name had been changed at the relevant time.

9 ASIC records show that the defendant became a director of MRL on 19 July 1998 and remained in office until 31 March 2000. It was not suggested in the course of the proceedings that this is incorrect or that the defendant was not a director during any part of that period. At the times material to the proceedings, the issued share capital of MRL consisted of two fully paid shares, one held by Essington Asia Pacific Pty Ltd ("Essington") and the other by Mulwala & District Services Club Ltd ("the Club"). There were five directors: Mr Hargreaves, Mr Tait and Mr Nieuwenhout from the Club and the defendant and Mr Jones from Essington.

10 The Club and Essington entities were the parties to a memorandum of understanding dated 4 May 1998. That memorandum set out a framework within which Essington and the Club would pursue a plan to develop an apartment hotel on land on the shores of the lake on the Murray River at Mulwala/Yarrawonga. The arrangements foreshadowed by the memorandum of understanding were in due course embodied in a joint venture agreement made on 22 December 1998 among MRL, the Club and Essington. Those parties agreed that MRL would undertake the conduct and management of a project involving the development of the relevant land. That land (Lot 29 in Strata Plan 37724) was held by the Club as lessee under a lease from the Water Administration Ministerial Corporation ("WAMC"). The lease was for a term ending on 31 October 2036. The joint venture agreement made provision with respect to this leasehold interest (which it designated "the Property") as follows:

"***3.3 Transfer of Property***

Either party may by notice in writing to the other require the Property to be transferred to the Company for the Purchase Price conditional on the following:-
(a) the Company paying all stamp duty and other fees or charges associated with the transfer of the Property;
(b) the extension of the current strata leasehold estate held by Mulwala in the Property so as to increase the term of the strata leasehold estate to a term not less than 99 years or such other term acceptable to the Company or such term as negotiated between the Company and Water Administration;
(c) the notification of the Development Consent by the relevant authority in respect of the Property in a form acceptable to the Company;
(d) the approval of the proposed strata plan of subdivision of the Property by Owners Corporation SP 37724.

3.4 Mulwala Finance

The Purchase Price will be notionally paid by the Company to Mulwala by the Company at the time of Transfer of the Lease simultaneously handing to Mulwala a registrable first Mortgage secured over the Property for the full amount of the Purchase Price. Mulwala will execute a deed of priority to postpone its mortgage in favour of a mortgagee financing the Project and otherwise as resolved by the Company and with the consent of Mulwala first had and obtained in writing to postpone its priority, the Mortgage shall remain a first charge and encumbrance on the Property until discharged in full.

*The Mortgage given by the Company to Mulwala shall provide for the principal sum secured thereunder (**the 'Purchase Price')** to be repaid by instalments of not less than 10% of the Purchase Price every six months, the first of such payments to be made six (6) months from the date the property is transferred in accordance with clause 3.3, or six (6) months from the date of this Agreement, whichever date is first and a final payment (if not already paid) such that the whole of the Purchase Price is paid not later than the expiration of 24 Months from the date of this agreement (**the 'Repayment Date'**). In the event that a mortgagee financing the project does not agree to any repayments of the principal prior to completion of the Project or the Repayment Date, then the Company must pay interest at the Interest Rate to Mulwala for the period commencing from the due date of the first instalment to the actual date of payment of the principal secured under the mortgage."*

11 The joint venture agreement also made provision in relation to the capital structure of MRL (the Club and Essington were to have one share each) and management of, decision-making within and funding of MRL. The last-mentioned matter was dealt with as follows:

"***5.1 Sources of Funding***

EAP must ensure that the Company has sufficient working capital to conduct the Project from:-
(a) loans by the Parties to the Company or;

(b) borrowings by the Company.

5.2 Loans from Parties

(a) EAP and Mulwala upon the signing of this Agreement shall be entitled to present to the Company, accounts relating to expenditure incurred by both parties collectively and individually in connection with the formation of this Agreement and as set out in Schedule 3 hereto, and that such accounts shall thereafter be treated as loans to the Company by EAP and Mulwala respectively. Such loan shall not attract interest but otherwise be repaid in the manner set out in sub-clause 5.2(b).

(b) Any loan by a Party to the Company shall be repaid on reasonable notice and the Company must pay interest at the interest Rate to the Party at the end of each month from the date of receipt of the loan until the date of repayment.

5.3 Guarantee Payments

If a Party has to make payments under a guarantee of the Company's borrowings then, the Company must treat those payments as a loan by that Party to the Company governed by clause 5.2 above.

5.4 Other Sources of Funding

A decision of the Company to meet funding requirements by means other than referred to in this clause will be by unanimous resolution of all the Parties entitled under the Articles to vote."

12 Although the joint venture agreement was made on 22 December 1998, the parties had before that date taken tangible steps to pursue the plan of action encompassed by it. In July 1998, there had been prepared a project co-ordination manual. The author was Knapman Clark Management Services Pty Ltd and ("KCMS"). The manual said that EAP had retained Wolski Lycenko & Brednock ("WLB") to provide architectural and consultancy services to MRL for a new resort at Mulwala. Also involved was a firm of quantity surveyors, Knapman Clark & Co Pty Ltd ("KCC"). The defendant and Mr Jones had been business associates in the property development field for some time. The defendant had been active in property development for many years. Mr Jones was an architect by profession. They were both located in Essington's office premises at North Sydney and saw one another virtually every working day. It was their habit to have coffee together on a daily basis. They often lunched together and had drinks after work. Their offices were almost adjoining. Each would regularly call unannounced at the other's office when the need arose.

13 KCMS was located in the same building as Essington. Mr McNamara had an ongoing relationship with Essington and had worked on other projects with the defendant and Mr Jones.

14 The Club was a registered club with premises at Mulwala. Its activities included the operation of a motel (or modest resort) on Lot 29. Demolition of those premises formed part of the project with which these proceedings are concerned.

The contraventions alleged by ASIC

15 ASIC's case is that the defendant contravened s.588G on six occasions, in that six separate and distinct debts were incurred by MRL in circumstances attracting the operation of the section vis-à-vis the defendant. The creditor, in respect of each such debt, was Colin Joss & Co Pty Ltd ("CJC"), a building contractor. ASIC maintains that each of the six debts became owing, due and payable by MRL to CJC either pursuant to a building contract between MRL and CJC or upon a quantum meruit, in either case for work done by CJC. There is no dispute that CJC carried out work on and in relation to Lot 29. Nor is there any dispute that Lot 29 was, at all material times, a leasehold property of which the Club was the registered proprietor.

16 The six debts alleged, and the dates on which ASIC says they were contracted by MRL were:

1. $ 390,000 - 27 April 1999
2. 635,000 - 10 May 1999
3. 1,340,000 - 20 May 1999
4. 859,370 - 18 June 1999
5. 183,889 - 22 July 1999
6. 181,772 - 24 September 1999

17 ASIC says that the first two debts were paid in full, that the third was paid as to $365,000 and that the other three were not paid.

The defendant's contentions

18 I should, at this point, refer to the matters raised by the defendant in his points of defence filed on 24 February 2004. Those matters go to both the elements that ASIC must prove and matters arising from s.588H. The defendant says that

(a) at all material times, MRL was objectively solvent;

(b) the alleged debts were not due and payable in that
(i) CJC, by its conduct, was estopped from enforcing any debt owing by MRL;
(ii) CJC assumed a risk in continuing to work on the project; and
(iii) any breach of contract did not give rise to a debt incurred by MRL

(c) even if a debt was incurred, MRL has a right of indemnity from another entity for the debt or is the beneficiary of a constructive trust or resulting trust and the right of indemnity or beneficial interest is an asset of MRL;

(d) at all material times, the defendant had no reasonable belief that MRL was insolvent or would become insolvent;

(e) the defendant had reasonable grounds to expect and did expect that MRL was solvent and would remain so even if it incurred debts as alleged by ASIC;

(f) the defendant had reasonable grounds to believe that MRL would be able to rely on resources outside its balance sheet to meet its debts and liabilities;

(g) the obtaining of finance by MRL was continually frustrated by the Club which acted in breach of the joint venture agreement;

(h) at all material times the defendant had reasonable grounds to believe and did believe
(i) that competent and reliable persons were responsible for providing him with adequate evidence about MRL's solvency;
(ii) each of those persons was fulfilling that responsibility; and
(iii) on the basis of information provided to him by those persons, that MRL was and would remain solvent even if the alleged debts were incurred;

(i) at all material times, the defendant was only one of six directors of MRL which he did not control and which was not his alter ego;

(j) no moneys came out of MRL to the defendant's personal favour, nor did he prefer his own interests or those of associates or attempt to enrich himself at the expense of MRL or its shareholders or creditors;

(k) at no time did the defendant wilfully contravene any provision of the ***Corporations Act*** *or disregard his responsibilities or duties as a director of MRL.*

19 Finally, the defendant prays in aid the dispensing powers of the court under ss.1317S and 1318.

20 As stated in written submissions filed after the hearing, the defendant's contentions are:
(i) that ASIC has failed to prove any contravention of s.588G(2) by the defendant;
(ii) that at all material times relied upon by ASIC, MRL was objectively solvent and was not proved otherwise to the requisite standard;
(iii) that the defendant is entitled to the defences provided by ss.588H(2) and (3);
(iv) that, at all material times, the defendant had no reasonable belief that MRL was insolvent or would become insolvent;
(v) that the defendant had reasonable grounds to expect and did expect that MRL was solvent and would remain solvent even if MRL incurred the debts as alleged by ASIC and any other debts incurred by MRL at that time;
(vi) that the defendant had reasonable grounds to believe and did believe that MRL would further be able to rely upon resources and assets outside MRL's balance sheet to meet its debts and liabilities as and when they were incurred;
(vii) that the obtaining of finance, transfer of the relevant land and giving of the security for MRL were continually frustrated by one of the joint venture partners, being the Club;
(viii) that the Club's actions at all material times were such as to permit a finding by the court that it was a shadow director of the Company, which by those actions was squarely responsible for the predicament in which MRL found itself in 1999;
(ix) that it was the egregious breach of its contractual and fiduciary obligations by the Club as a joint venturer under the joint venture agreement of 22 December 1998 that demands the closes analysis in order that the total context of this matter be properly understood to enable the defendant to be exonerated as he should be; and
(x) that the approach adopted by ASIC in both the running of the case and its written submissions is and was "altogether too simplistic, blinkered, selective and characterised throughout by a failure to grapple with important concepts such as the law relating to the content of fiduciary and contractual obligations in the context of a joint venture relationship such as that which came into effect in this case on 22 December 1998."

21 In its submission in reply, ASIC contended that the defendant had made no submission in support of the aspects of the points of defence summarised at items (b), (c), (h), (i), (j) and (k) above. That point is well taken and I approach the matter on the footing that the defendant's defence is based wholly on items (a), (d), (e), (f) and (g) as explained and supplemented in items (i) to (x). The defendant does, however, submit that ASIC has failed to discharge its onus of proving a central element, namely, the incurring of the relevant debts by MRL. That matter is squarely in issue, together with the elements going to solvency of MRL at the relevant times, reasonable grounds for suspecting insolvency at those times and the state of the defendant's awareness of such grounds (or the hypothetical awareness of a reasonable person in a like position) – in other words, the several matters emerging from ss.588G(1)(b) and (c) and 588G(2)(a) and (b).

Evidence relevant to contract formation and progress claims

22 The alleged debts in question (see paragraph [16] above) were, as I have said, debts said by ASIC to be owing, due and payable by MRL to CJC either under a contract or upon a quantum meruit. Since the two are mutually exclusive (in that there can be no quantum meruit claim if a contract requires payment), the first step must be to determine whether a contract for the provision of building services by CJC to MRL for reward came into being. That makes it necessary to review a body of evidence.

23 ASIC contends that a contract for the design and construction of 142 units on Lot 29 came into existence between MRL and CJC on or some time after 4 February 1999. Relevant actors on behalf of MRL, in ASIC's submission, were Mr McNamara (of KCMS) and Mr Jones. ASIC says that, although no formal building contract was executed by both MRL and CJC, a contract came into existence under the first or second category in ***Masters v Cameron*** (1954) 91 CLR

353 or the so-called fourth class identified in ***Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd*** (1986) 40 NSWLR 622 as derived from ***Sinclair Scott & Co Ltd v Naughton*** (1929) 43 CLR 310, the existence of which has recently been confirmed by the Court of Appeal in ***Helmos Enterprises Pty Ltd v Jaylor Pty Ltd*** [2005] NSWCA 235.

24 CJC received, through KCMS an invitation to tender to which it responded. A draft building contract was submitted by KCMS to CJC on or about 19 November 1998. It was expressed to relate to a "new 142 room resort development at Mulwala for Murray River Pty Ltd" and contained the invitation to tender. The draft nominated a commencement date of 3 February 1999. CJC submitted a tender on or about 16 December 1998. It referred to a tender price of $15,975,760. There was subsequent discussion between Mr Joss and Mr McNamara about reducing the price. As a result, Mr Reid of CJC informed Mr McNamara on or about 22 December 1998 that savings of $1,701,168 could be achieved. (There was a subsequent addition of $80,000.) On 20 January 1999, Mr McNamara informed Mr Reid of CJC that CJC was the successful tenderer and gave him a list of things needed for the preparation of the contract. On or about 8 February 1999, CJC confirmed in writing to KCMS that the final contract price was $14,483,447. The items identified by KCMS as required from CJC included "completed bond form in the amount of $1,000,000". Letters of particular importance were brought into existence on 1, 2, 3 and 4 February 1999.

25 On 1 February 1999, Mr Reid of CJC wrote to Mr McNamara as follows: *"Demolition is programmed to commence on Thursday 4th February, 1999.*

Prior to Thursday could your [sic] please organise a formal letter of intent, subject to finalising Contract Sum and the Contract as documented in our correspondence dated 7th December, 1998."

26 The letter of 2 February 1999 is a letter from Mr Jones to Mr Joss saying: *"The issue of contract for the construction of project The Lake Resort by Colin Joss & Co has been delayed due to paperwork required by the Club's bankers giving clear title to the land.*

The Club have been assured by the bank this is purely a procedural matter, however, we cannot conclude our documentation until the matter is finalised."

27 The letter of 3 February 1999 is a letter from Mr McNamara to Mr Jones: *"Mr Martin Reid, of Colin Joss, rang at 455pm today stating that the letter of intent has not yet been received and they cannot give the Demolition subcontractor the OK to proceed for tomorrow until they have this letter.*

Your urgent attention would be appreciated."

28 This prompted a response by Mr Jones, in the form of a handwritten endorsement, as follows:
"To: Ken McNamara
I spoke to Colin Joss yesterday and advised a letter would be sent today. Also advised there were outstanding matters on the contract documents which I understand you have addressed with Martin Reid.
Len Jones"

29 The letter of 4 February 1999 is also from Mr Jones to Mr Joss. It reads as follows: *"We confirm that it is the intention of Murray River Pty Limited to enter a contract with Colin Joss & Co to construct a new resort on site known as Lake Resort, Melbourne Street, Mulwala.*

We understand there are some contractual matters to be soughted [sic] out with Knapman Clark Management Services before contract documents can be finalised.

We also have some procedural matters to finalise with the Club regarding the transfer of the lease on the site as mentioned."

30 This letter of 4 February 1999 followed on from a letter of 14 January 1999 from Mr Jones to Mr Joss in which Mr Jones confirmed that it was in order for CJC's engineers to prepare engineering drawings for the foundation and said: *"We have few formalities to complete before we are able to send you a letter of appointment ...*

31 The position at about the time of the sending of that letter is reflected in the minutes of the eleventh meeting of the Project Control Group held on 18 January 1999. That meeting was attended by representatives of the Club, Mr Jones and Mr McNamara. The minutes record: *"**Building Program***
Colin Joss & Co were recommended as the builder although negotiations were proceeding to reduce the construction price further.
Attention was drawn to on completion maintenance and service charges from Sub-Contractors.
Construction figure approved as a Maximum Fixed Price $14,430,597.00.
Construction to commence with site hand over 4th February 1999."

32 It is thus clear that Mr Jones' letter of 4 February 1999 was intended to convey concurrence in the commencement of work by CJC on that date. It is also clear that the letter of 4 February 1999 was intended to confirm the existence of the relevant intention to contract despite the message in Mr Jones' letter of 2 February 1999 regarding delay in the issue of a contract because of a "purely procedural matter" raised by the Club's bank, which matter was referred to again in the final paragraph of the letter of 4 February 1999. The letter of 4 February 1999 was expressly sought by CJC. Mr Reid made it clear in his letter of 1 February 1999 that he wished to have such a letter before allowing the demolition subcontractor to begin work on Lot 29 on 4 February 1999.

33 After sending Mr Joss the letter of 4 February 1999, Mr Jones wrote to Mr Mullarvey on the same day saying: "*We have advised Colin Joss & Co that it is the intention of Murray River Pty Limited to enter a contract with Colin Joss & Co to construct the new resort.*

We have also advised that there are some procedural matters regarding the transfer of the lease which have to be completed before the funding is finalised and the contracts signed.

He seems relaxed that these matter will be soughted [sic] out in the near future."

34 On 23 February 1999, Mr Reid wrote to Mr McNamara. The letter, headed "Mulwala Resort", began: "*Significant contractual issues still remain outstanding mainly ...*"

35 On 1 March 1999, however, CJC submitted to KCMS "Progress Claim No 1" in the sum of $581,723.92 referring to a "Contract total" of $14,483,447 and "Variations" of $100,000 making up a "Revised contract total" of $14,583,447. KCMS wrote to CJC on 2 March 1999 acknowledging receipt of the progress claim and referring to a KCMS letter of 8 February 1999 "which confirmed the requirements of the Contract that require to be conformed with before we can process your claim". CJC sent a long letter dated 5 March 1999 in reply to a letter of 3 March 1999 which, from the terms of the CJC letter, was distinct from the KCMS letter of 2 March 1999. I mention the letter of 5 March 1999 only because of the reply dated 8 March 1999 from KCMS beginning: "*We are in receipt our [sic] your letter of 5th March and whilst appreciative of the efforts to date by your company advise that we are merely servants of the Contract Documents which we must adhere to being the agreement between your Company and Murray River Pty Ltd.*"

36 On 19 March 1999, KCMS prepared a document designated "Volume Three – Fifth (5th) Schedule – Sundry Information for inclusion in Building Contract". It included a list of "sundry information for inclusion in building contract", including seven items referable to a letter from CJC dated 16 March 1999. That letter is a letter from CJC to KCMS referring to "Mulwala Resort" and commencing "*As requested in your facsimile dated the 16th March 1999, please find enclosed two copies of the following documentation required for the preparation of a contract on the above project.*"

37 On 26 March 1999, Mr Jones (signing as executive director of Essington) wrote to Mr Joss enclosing a letter from KCMS, addressed to MRL, which Mr Jones described as a letter which "indicates we can accommodate your request to waive the necessity of a performance bond".

38 CJC's second payment claim ("Progress Claim No 2") was submitted on or about 31 March 1999, the date it bears. Like the first, it was addressed to KCMS. The sum claimed was $847,437.13. The claim referred to a revised contract total of $14,583,447.00 and to a total of $1,429,161.05 referable to various heads of activity, less the prior claim of $581,723.92.

39 On 9 April 1999, Mr Jones wrote to Mr Joss saying: "*The signed contract documents will be couriered back to you today.*"

40 On 12 April 1999, Mr McNamara of KCMS wrote to Mr Reid of CJC as follows: "*I have been advised by Mr Jones that the contract has now been executed by Murray River P/L.*

I am currently preparing the payment certificate for progress claim No. 1 and this will be faxed to you tomorrow.

Mr Jones has advised me that notwithstanding the contract processing time he is doing his utmost to expedite payment a.s.a.p. (ie. this week)."

41 The next day, however, there was a meeting of the directors of MRL (attended by the defendant, Messrs Hargreaves, Tait, Jones and Mullarvey) at which Mr Jones is reported to have said that the contract had been signed by CJC "*and advice was being sought from Knapman Clark Management Services that all compliance items had been completed by the Builder before Murray River signed*". The meeting resolved that Mr Jones "*be authorised to sign these documents once KCMS approval had been received*". On the same day, Mr McNamara (for KCC) issued a certificate addressed to MRL stating that "a drawdown of $390,000.00 (excluding Capitalised Interest) is in order for payment to Colin Joss & Co Pty Ltd". The certificate referred to "*Value of Contract*" and said that the development was on target "*to achieve the contractural [sic] practical completion date*". Attached was a reconciliation of the $390,000 certified with the $581,723.92 in Progress Claim No 1".

42 On 14 April 1999 Mr Reid of CJC wrote to Mr McNamara of KCMS complaining about delay in payment of the first payment claim. The next day, Mr McNamara sent to Mr Joss a copy of a letter from Mr Jones referring to arrangements for payment.

43 On 26 April 1999, KCC issued a second certificate addressed to MRL. The certificate stated that a drawdown of $635,000.00 was in order for payment to CJC. This related to Progress Claim No 2.

44 On 27 April 1999, Mr Jones wrote to Mr Mullarvey a comprehensive letter about the status and affairs of MRL. Under a heading "Funding", Mr Jones said:

"*The builder has submitted two claims:*
Payment No. 1 approved $390,000
Payment No 2. approved $635,000

Payment No. 1

Although payment No. 1 was delayed by documentation, the builder had not in fact complied with all conditions of contract which would have delayed his payment No. 1. Payment has been directed to Colin Joss bank account.

Payment No. 2
Certificate of payment No. 2 has been received today. This payment is due for payment in 10 working days. This is being processed.

Claim No. 3 is expected on 4th May 1999 amounting to $1.35m, payment is due by 24th May 1999.

Funding is bring [sic] arranged by AFS as offered as follows:

Amount: Date:
1. Draw-down No. 1 $ 440,000 26/4/99
2. Draw-down No. 2 $ 2,500,000 5/5/99
3. Draw-down No. 3 $16,800,000 19/5/99

Draw-downs 1 and 2 are from lawyers funds to be repaid out of draw-down No. 3 from a bank (traditional funding).

Essington has been negotiating an underwriter for the prospectus and end purchaser for the whole development."

Mr Jones also said that the signed building contract "*will be handed over to the Contractor with the first payment*". Mr Jones' letter was a response to a letter of the same date from Mr Mullarvey seeking information on a number of matters.

45 Progress claim No 3 was issued by CJC on 30 April 1999. Like the earlier claims, it was addressed to KCMS. The sum claimed was $1,090,194.15. On 7 May 1999, KCC certified that a drawdown of $1,340,000 was in order for payment to CJC. The revised contract total was shown as $12,594,475.00. Items totalling $2,519,355.20 were claimed, with credit given for the prior claims of $1,429,161.05.

46 On 13 May 1999, KCMS replied to a letter of the same date from Mr Reid of CJC headed "*Payment of Progress Claim Nos. 1, 2, & 3/Breach of Contract*". Mr Reid's letter of 13 May 1999 set out in detail the steps in relation to the proposed contract and payments for work from 19 November 1998 to 13 May 1999. Mr Reid also said that KCMS and others had "*breached the Contract and Colin Joss & Company Pty Ltd reserve the right to seek damages and pursue the relevant default procedures*". KCMS said in its reply that payment No 1 had been made, that payment No 2 was two days late and that payment No 3 was not yet due. It then went on to quote the "*Conditions of Contract, Clause 19.4*" and to refer to remedies available under the "*Contract*".

47 Mr Joss and the defendant met in Canberra on 16 May 1999. It will be necessary to say more about the meeting in due course. I mention it now because, on 21 May 1999, Mr Joss wrote a letter to the defendant referring to the meeting and to an understanding he had gained from it that the second and third payments would be made on 25 May 1999, an understanding that he had thought the defendant was going to confirm. The letter complained about delay in payment and requested confirmation of the payment date by 24 May 1999. The letter sought to implicate Essington as well as MRL. The defendant did not reply at once to this letter. But there was a reply dated 21 May 1999 from Mr Marriott, company secretary of Essington: "*We refer to the meeting between Mr Colin Joss (for Joss & Co) and Malcolm Edwards (for Murray River Pty Limited) at Canberra on 16th May 1999.*

We do not proposed [sic] to comment on your letter 21st May 1999 or your purported chronology of 13th May 1999 in detail, other than to draw to your attention the following salient facts:

1. At all times and at all stages, it had been made quite clear to your Company that Essington Asia Pacific Pty Limited's (EAP) involvement is a shareholder of Murray River Pty Limited and has a contract from it for certain project works. You seem to be under the mistaken belief that EAP has some contractual building contract with you. This is incorrect. It is evidenced by the fact that any contract is with Murray River Pty Limited not Essington Asia Pacific Pty Limited.
2. Essington rejects that any fundamental breach of contract has taken place. As we understand it, you have been kept fully advised as to the funding situation and timing of any progress payments.
3. You commenced construction work on this site without the executed building contract with Murray River Pty Limited. You were fully aware of this commercial risk. We trust co-operation between Murray River Pty Limited and your firm will continue to allow commercial issues between them to be resolved."

48 The defendant wrote to Mr Joss two days later, on 23 May 1999: "*Dear Colin*

I refer to our meeting in Canberra on 16th May. The principal concern from your position being the delayed payment for the project and my concern was the order of works that had been carried out prior to execution of the building contract.

Following our range of discussion including bond issues I indicated that payments on advice then available would be between 3 and 4 weeks late. I also informed you that the representatives of the lender to Murray River Pty Limited expected that a payment could be made on or about 24/25th May. I suggested that should a delay be experienced it would be appropriate that you meet with Ken McNamara and Len Jones to work out an alternative work program and cashflow while they were at Mulwala on 17th May. I realise that was not possible as you planned to remain in Canberra. As at 21st May I had not received the expected further advice despite many attempts to clarify the arrangements. I have been assured by Mr Baxter Gamble of AFS, Sydney that he and your Mr Martin Reid had spoken at least twice up to Thursday and when challenged Mr Gamble made the comment that because of other commitments and his belief that Mr Reid would be informing you he had not as you are aware returned numerous of my calls. Contrary to your suggestion it seems it was me they chose to ignore.

As advised on Friday night, I am meeting with Mr Gamble on Monday and will contact you thereafter. Thank you for your cooperation."

49 There was another exchange of letters on 24 May 1999 between Mr Joss and the defendant regarding payment. Mr Joss's letter of that date read as follows: *"Received your letter this morning where you noted several points of our conversation that took place in Canberra on 16th May, 1999.*

- *You were right in your recollection that I was concerned by late payments by Murray River Pty Ltd.*
- *You were correct as my recollection was also that we could expect payments on 24/25th May, 1999.*
- *Discussion regarding bond issues as you noted was vaguely discussed in part at our meeting. This was your problem how you sought finance – not mine, although we are very interested.*
- *I am puzzled as in your letter you say you indicated to me that payments on advice then would be available between three and four weeks late. I do not recall this discussion – please elaborate.*
- *Regarding Site Meeting held at Mulwala 17th May, 1999.*

  My recollection of financial matters regarding late payments was that this topic would be best left out of discussion during this meeting as Directors of the Mulwala Club would be in attendance.

  Note: At the meeting of the 17th May when it became apparent that there were no Directors of the club in attendance, it would have been appropriate that Ken or Len could have raised the issue of an alternative work program and cash flow with Martin Reid.
- *I would not be able to be in attendance as I had continued business in Canberra on the 17th May, 1999.*

  We note that as from today payment of Progress Claim No. 3 is due. Therefore we would expect that the full amount of both claims for March and April will be forwarded as one payment for a total sum of $1,975,000.00.

  We await your response."

50 Progress Claim No 4 was issued by CJC to KCMS on 31 May 1999. The sum claimed was $935,017.91. It referred to items totalling $3,454,373.11 against which credit was allowed for the prior claims totalling $2,519,355.20. The next day, 1 June 1999, MRL (Mr Jones) wrote to Mr Reid of CJC saying among other things: *"**PAYMENT***
We have received approved progress certificates from KCMS for $1,975,000.
We are informed that Mr Gamble has advised you that they are finalising payment details as discussed and will keep you advised."

51 On 4 June 1999, KCC issued Drawdown Certificate No 4 addressed to MRL. It certified that $859,370.00 was "in order for payment to Colin Joss & Co Pty Ltd".

52 On 7 June 1999, Mr Sloan, a solicitor instructed by CJC, wrote to MRL, the defendant and others stating that MRL was trading while insolvent and threatening proceedings. On 10 June 1999, Mr Sloan wrote to MRL giving notice, on behalf of CJC, that the works had been suspended and would not recommence until all moneys due had been paid.

53 The defendant wrote to Mr Sloan on 11 June 1999 as follows: *"Dear Mr Sloan*

I have your letter dated 7th June 1999.

I deny that Murray River Pty Limited is 'attempting to use your client to finance the project'. I also deny emphatically any purported insolvent trading, breach of contract or breach of the Corporations Law.

It seems to me unhelpful to embark on expensive time consuming and public litigation which at the end of the day will not provide any more satisfactory resolution than commercial arrangement for any of the parties involved in this case. You will appreciate that as a result of your communications, I have asked the solicitors of Murray River Pty Limited to examine the contractual position between the Company and your client.

On 16th May 1999 I met with your client in Canberra, it was accepted at that time that any payments scheduled during the next two months from 16 May 1999 were likely to be delayed for three to four weeks on the assumption of current advice from financiers and that Mr Joss acknowledged that position. In fact Mr Joss indicated that he was not in favour of my suggestion of slowing the work and revising the cash programme as that might have other consequences for Joss & Co. I am surprised that he has chosen to engage you to write to me and other directors of Murray River Pty Limited but understand his concerns which we have discussed in detail.

I am informed that Murray River Pty Limited will respond to your client shortly with a proposal to resolve all our outstanding disputes. If you have any further need to write to me please write to my lawyer Mr Andrew Sutherland at Eakin McCaffery Cox, St Martins Tower, Market Street, Sydney, phone: 9265 3000, fax: 9261 5918."

54 The cessation of work caused alarm at the Club. A meeting took place at CJC's office in Albury on 16 June 1999 to discuss the matter. A detailed account of who said what at the meeting is in evidence. Among those present were the defendant, Mr Joss, Mr Reid, Mr McNamara, Mr Mullarvey and solicitors for MRL, the Club and CJC. The account of the meeting records Mr Reid as asking when CJC was to be paid, the CJC solicitor adding that CJC is owed $3 million. The defendant is recorded as saying that he was aware of the matter "*which is regrettable*" but that a payment schedule would be given to CJC on 21 June. In response to a question what guarantee CJC had that they would be paid, the defendant reportedly said, "*None, only my word*".

55 Mr Mullarvey wrote to the defendant on 24 June 1999 expressing the ongoing concern of the Club about the position that had been reached and asking for information and reassurance. This made it clear that a "schedule" (presumably the payment schedule foreshadowed for 21 June 19999 at the meeting on 16 June) had been submitted to CJC but had been rejected. The letter reads in part as follows: *"You will recall my comment yesterday that even with Colin Joss & Co paid, we will not want to let him back to site until we are satisfied with the ongoing*

arrangements. You have a copy of the schedule put to Colin Joss & Co Pty Limited, which was rejected as, was the suggestion that the builder and the project manger [sic] discuss a compromise. A letter suggesting the alternative has been sent to Mr Joss following my discussions with financiers yesterday. A copy is attached."

56 Progress Claim No 5 was issued by CJC to KCMS on 30 June 1999. It was in the sum of $815,619.40, representing work items totalling $4,039,989.40 less previously certified claims of $3,224,370.00. KCC issued its fifth certificate on 8 July 1999. It certified that a drawdown of $183,889.00 was in order for payment to CJC. On 28 July 1999, CJC wrote to MRL saying that it required payment of $3,447,657.85 before recommencing on the site. This represented the aggregate of the first five KCC certificates plus interest calculated by CJC.

57 Under cover of a letter dated 23 August 1999, the defendant sent Mr Mullarvey a copy of the balance sheet of MRL at 30 June 1999 with a copy of the profit and loss account for the year to that date. He asked that Mr Mullarvey circulate it to the directors of MRL, noting that it would be necessary for the directors, at their next meeting, to authorise signing of the accounts. The balance sheet recorded as a current asset cash at bank of $1,358.46 and as a non-current asset "*Buildings – Mulwala Resort*" of $4,848,600.66, making up total assets of $4,849,959.12. Two liabilities were recorded, both being non-current liabilities. One ($470,000) reflected a loan obtained from Leigh Superplan Pty Ltd. The other ($4,225,972.16) was designated "*Creditors Control*". Accompanying or attached to the accounts was a schedule headed "Aged Payables" reflecting a total of $4,495,089.17 and a handwritten adjustment (by way of deduction) of $269,117.01 referring to five marked items dated July 1999 and therefore not relevant to the position at 30 June 1999. The adjusted total of $4,225,972.16 corresponds with the "*Creditors Control*" item in the balance sheet. The "*Aged Payables*" schedule includes seven items (disregarding eliminated items of July) referable to CJC. These total $2,872,013.46, of which $635,000.00 is recorded as 90 days plus, $1,340,000.00 is recorded as 31 to 60 days and the balance is recorded as current. As will be seen presently, subsequent reconciliation of this balance sheet with the accompanying trial balance suggests that the sum owing to CJC should have been recorded at $2,834,370: see paragraph [93] below.

58 On 31 August 1999, CJC issued to KCMS Progress Claim No 6 for $1,383,761, being work items of $4,792,020.61 less $3,408,259.00 previously certified. KCC issued to MRL on 10 September 1999 certificate No 6 certifying that a drawdown of $181,772.00 was "*in order for payment to Colin Joss & Co Pty Ltd*".

Decision on contract formation

59 It is not clear that a formal building contract was ever executed by both MRL and CJC and dealt with in such a way as to be binding on them. It is more likely than not, in my view, that it was not. There is in evidence a copy of a form of tender dated 16 March 1999 bearing an impression of the common seal of CJC and the signatures of Mr Paul Joss and Mr Reid. The date 26 March 1999 appears in the attestation clause. On the following page appears an impression of the common seal of MRL and the signatures of Mr Jones and a Mr Burke who does not purport to be an officer of MRL but merely, it seems, a witness to Mr Jones' signature. The date 3 May 1999 appears under Mr Burke's signature. But it is not clear that this is in reality a single document executed by both parties. It may be something that was put together after the event. Nor is there anything to show to the requisite standard that parts executed by the respective parties were ever exchanged.

60 Indeed, Mr Jones said in evidence that he never delivered to CJC the part of the contract he had signed ostensibly on 3 May 1999 and that this was at the defendant's suggestion or direction.

61 The impression I have just stated is strengthened by Mr Reid's letter of 13 May 1999 to Mr Jones setting out steps in relation to the proposed contract and payments from 19 November 1998 to 13 May 1999. The last entry (for 13 May 1999) is, "*11.27 am. Signed (TBC) contract documents picked up*". This suggests that contract documents supposedly signed by MRL were to be picked up by CJC on 13 May 1999 (the date of the letter) but that it was not confirmed that they were in fact signed. ("*TBC*" means, I assume, "*to be confirmed*").

62 It is nevertheless clear, in my view, that from 4 February 1999 or thereabouts, there was a consensus that CJC should perform work for MRL and that MRL should receive the benefit of that work. Certain basic facts are clear: KCMS was, at all material times, acting for and in the interests of MRL; the contractual negotiations were between CJC and MRL; Mr Jones acted for MRL when, on 4 February 1999, he confirmed in writing to Mr Joss that "*it is the intention of Murray River Pty Limited to enter a contract with Colin Joss & Co to construct a new resort on site known as Lake Resort, Melbourne Street, Mulwala*"; CJC began work on the site on or about 4 February 1999 and progress claims were thereafter submitted by CJC to KCMS for work done and materials provided, which progress claims were received by KCMS, discussed by it with MRL and, in due course, assessed and processed as if the proposed contractual terms had been in force between CJC and MRL. It is significant that, in the letter of 8 March 1999 to CJC, KCMS described themselves as "merely servants of the Contract Documents which we must adhere to being the agreement between your Company and Murray River Pty Limited".

63 CJC did work. MRL, through KCMS, received and acknowledged payment claims. KCC issued drawdown certificates. These certificates were addressed to MRL. The sums in the first two certificates were paid by MRL, as was part of the sum in the third certificate. MRL never disputed its liability for any of the certified sums. The balance sheet of MRL as at 30 June 1999 forwarded by the defendant to Mr Mullarvey for circulation among the directors of MRL was accompanied by the "*Aged Payables*" list clearly acknowledging a liability of $2,872,013.46 to CJC.

64 At all material times on and after 4 February 1999, CJC obviously considered itself entitled to perform and charge for work and MRL, in turn, obviously considered itself entitled to the benefit of such work and bound to pay for it. There had been, in fact, a consensus on price before 4 February 1999, although with some peripheral matters still to

be concluded. Work began under the supervision of KCMS who were acting for and with the authority of MRL. KCMS proceeded as if the contract documents governed the relationship. CJC submitted payment claims as provided for in the contract documents. KCMS treated them as received under the contract documents. KCC performed an evaluating function as if the contract documents applied. And MRL, by both payment and acknowledgment of liability, acted on the footing that payment certificates issued by KCC required payment by it.

65 Even though certain aspects contemplated by the contract documents were never settled, MRL and CJC obviously embraced and acted in accordance with at least so much of the documents' intent as envisaged the performance of work by CJC and the mechanisms for payment claims, assessment of work completed and payment against progress certificates issued by quantity surveyors. All this shows that the parties were content to abide by, at the least, the provisions of clause 19 of the contract documents which contained typical provisions with respect to submitting of monthly claims by the builder, checking and assessment by the employer's representative and the issue by that representative of certificates. Clause 19 says that "the amount so certified shall forthwith become a debt due from the Employer to the Contractor and shall be paid within ten days after the date of issue of the certificate ...". These provisions, viewed in the light of the several certificates issued by KCC, would, if applicable, have given rise to debts due by MRL to CJC in the amounts and on the days stated in paragraph [16] above.

66 ASIC contends that a contract came into existence within the first, second or fourth category associated with ***Masters v Cameron*** *and* ***Baulkham Hills Private Hospital***. The first and second classes were described by Dixon CJ, McTiernan and Kitto JJ in ***Masters v Cameron*** as follows: *"[The case] may be one in which the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have the terms restated in a form which will be fuller or more precise but not different in effect. Or, secondly, it may be a case in which the parties have completely agreed upon all the terms of their bargain and intend no departure from or addition to that which their agreed terms express or imply, but nevertheless have made performance of one or more of the terms conditional upon the execution of a formal document."*

The fourth class, as described by Knox CJ, Rich and Dixon JJ in ***Sinclair Scott & Co v Naughton****, covers the case where "the parties were content to be bound immediately and exclusively by the terms which they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms".*

67 In assessing the present case, it is, I think, important to recognise that while, on 8 March 1999, Mr McNamara described KCMS as "*merely servants of the Contract Documents which we must adhere to being the agreement between your Company [ie CHC] and Murray River Pty Ltd*", Mr Reid of CJC had, on 23 February 1999, written to Mr McNamara: "*Significant contractual issues still remain outstanding mainly ...*". There followed reference to two matters, "*Confirmation of Contract Sum*" and "*Security from Murray River Pty Ltd*". There was not, thereafter, explicit agreement on either of the matters explicitly mentioned, although the parties' conduct showed some form of acceptance of (or, more precisely, non-rejection of) the contract sum that formed the basis of the CJC payment claims, the KCC certificates and such payments in response to such certificates as were actually made by MRL. But even so, the fact that certain terms were recognised as in need of agreement but were never agreed militates against a conclusion that the case is within the first or second of the ***Masters v Cameron*** classes. The first class covers cases in which "the parties have reached finality in arranging ***all the terms of their bargain***" [emphasis added]. The second covers cases where "the parties ***have completely agreed upon all the terms of their bargai***n". Such a situation cannot exist where any aspect of the bargain is recognised as not agreed, even though there may be a core of agreed terms.

68 The fourth class, by contrast, relates to cases where "*the parties were content to be bound immediately and exclusively by the terms which they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms*". An essential element here is recognition by the parties that the existing terms are to be binding "*immediately and exclusively*", the matter of additional terms lying merely in the realms of expectation. In the present case, I do not think that the parties committed "*immediately and exclusively*" to part only of the envisaged totality of terms. There was, in my view, an ongoing recognition that not all terms were settled. What the parties did was to act in accordance with part of the envisaged totality of terms, their expectation being that there would in due course be a contract including the core terms to which they gave a form of advance effect.

The quantum meruit alternative

69 Although, for these reasons, I do not consider it possible to bring this case within any of the classes of contract for which ASIC contends, it by no means follows that MRL did not become indebted to CJC in the way ASIC argues. If there was no contract, the case is one in which MRL asked CJC to undertake work and CJC agreed to do so, with both of them expecting, at that point, that a contract would be entered into between them. MRL's intention, at inception, was made explicit in Mr Jones' letter of 4 February 1999. The letter was, in terms, a true "letter of intent".

70 As was observed by Allsop J in ***Evans Deakin Pty Ltd v Sebel Furniture Ltd*** [2003] FCA 171 (a case concerning a tender for the construction and supply of seats for railway rolling stock), the "*letter of intent*" is a known instrument in tender cases, one function of it being "*to assist the recovery of money expended in the interim by the tenderer or supplier if contractual arrangements cannot be reached*". His Honour referred to the decision of Robert Goff J in ***British Steel Corporation v Cleveland Bridge and Engineering Co Ltd*** [1984] 1 All ER 504 where a claim upon a quantum meruit by supplier of cast iron nodes was upheld. Claims in contract failed because no contract had been formed, although negotiations had taken place, a quantity and price had been agreed and the defendant (buyer) had issued a letter of intent confirming the price and identifying the form of contract that was to be used. Discussion about the terms of contract and perceived uncertainties in the specification followed but, despite these matters being

outstanding, it was agreed that the plaintiff (supplier) should go ahead with the manufacture of the first cast. Further correspondence followed and difficulties experienced by the plaintiff in producing satisfactory items were overcome. Although contractual negotiations were still in progress, the plaintiff went ahead with the casting and delivery of nodes in stages. After six months or so of discussions and difficulties, all but one of the nodes had been delivered, with a contract still not signed. The last node was delivered after a further four months. The plaintiff claimed for the price of the goods. The defendant claimed damages for late delivery.

71 To the extent that the plaintiff's claim was contract-based, it failed. The court found that no contract had been made. But a quantum meruit claim succeeded. I quote from the judgment of Robert Goff J: *"In my judgment, the true analysis of the situation is simply this. Both parties confidently expected a formal contract to eventuate. In these circumstances, to expedite performance under that anticipated contract, one requested the other to commence the contract work, and the other complied with that request. If thereafter, as anticipated, a contract was entered into, the work done as requested will be treated as having been performed under that contract; if, contrary to their expectation, no contract was entered into, then the performance of the work is not referable to any contract the terms of which can be ascertained, and the law simply imposes an obligation on the party who made the request to pay a reasonable sum for such work as has been done pursuant to that request, such an obligation sounding in quasi contract or, as we now say, in restitution. Consistently with that solution, the party making the request may find himself liable to pay for work which he would not have had to pay for as such if the anticipated contract had come into existence, eg preparatory work which will, if the contract is made, be allowed for in the price of the finished work (cf* ***William Lacey (Hounslow) Ltd v Davis*** *[1957] 2 All ER 712, [1957] 1 WLR 932). This solution moreover accords with authority: see the decision in* ***Lacey v Davis****, the decision of the Court of Appeal in* ***Sanders & Forster Ltd v A Monk & Co Ltd*** *[1980] CA Transcript 35, though that decision rested in part on a concession, and the crisp dictum of Parker J in* ***OTM Ltd v Hydranautics*** *[1981] 2 Lloyd's Rep 211 at 214, when he said of a letter of intent that 'its only effect would be to enable the defendants to recover on a quantum meruit for work done pursuant to the direction' contained in the letter. I only wish to add to this part of my judgment the footnote that, even if I had concluded that in the circumstances of the present case there was a contract between the parties and that that contract was of the kind I have described as an* ***'if '*** *contract, then I would still have concluded that there was no obligation under that contract on the part of BSC to continue with or complete the contract work, and therefore no obligation on their part to complete the work within a reasonable time. However, my conclusion in the present case is that the parties never entered into any contract at all."*

72 The present case is, on my analysis, one of a contract that failed to materialise. The principles applicable to such a case were discussed by Einstein J in ***ABB Engineering Pty Ltd v Abigroup Contractors Pty Ltd*** [2003] NSWSC 665. His Honour said (at [159] to [162]): *"The particular principles which require to be applied in the present case concern contracts which do not materialise. The matter is dealt with in Mason & Carter,* ***Restitution Law in Australia,*** *Butterworths 1995 at [1033] et seq.*

It is plain enough as the learned authors point out [1033] that "*in all cases in order to rely on restitution, a plaintiff must establish both enrichment and injustice* [it being] *insufficient merely for a plaintiff to assert that a request to do work was relied upon, or that there was a legitimate expectation that contract would be agreed*". The authors go on to add *"[t]herefore, work done in preparing to perform a contract, such as in preparing a tender, generally cannot be made the subject of a claim for reasonable remuneration. Such expenditure is an overhead expense to be recouped, if at all, from payments under the contract".*

Abigroup particularly relies upon this last passage but, as will be seen from the discussion which follows, the matter must always be governed by the particular facts, matters and circumstances.

Mason & Carter also make the point that: *'It is perhaps correct to say that the courts were less willing, when applying the implied contract rationale, to regard work done in anticipation of a contract which fails to materialise as liable to be remunerated in a restitutionary claim, than are the courts today in applying the unjust enrichment rationale. In part this is a response to a not uncommon feature of modern contracting. This is that the contracting process often lags behind performance. Documents such as heads of agreement and letters of intent are executed as agreements preliminary to contracts which are, in fact, never signed'* [1033]."

73 The case before Einstein J was, as here, what Mason and Carter, in the work cited, called *"the more difficult case where there is not only a failure to conclude an agreement, but the work done does not amount to full execution of what was contemplated as being done under the contract"*. Einstein J then referred to the approach taken by Mason and Carter to such a case: "As part of the treatment given by the learned authors to this second-class, they comment on the decision by Sheppard J in ***Sabemo Pty Ltd v North Sydney Municipal Council*** [1977] 2 NSWLR 880. Mason & Carter make the point that in its dealings with Sabemo, a point was reached where the Council was requesting work for which it knew Sabemo expected payment, and the Council came under a duty to say that it would not pay. The authors express the view that "*in failing to advise Sabemo that it had no intention of paying, it accepted the benefit of the work and came under an obligation, imposed by the law of restitution, to pay for the work done* [1035]"

74 Einstein J then quoted from the judgment of Byrne J in **Brenner v First Artists' Management Pty Ltd** [1993] 2 VR 221 (at p.259): *"This will involve proof that the services were not provided as a gift:* ***Pavey's Case,*** *at 227 to 228. Furthermore, it will be necessary for the plaintiff to establish, where a certain event has not occurred, that the services were not provided on the basis that they were not to be paid for unless that event came to pass. In this category will fall cases where a tenderer carries out estimating or other work in response to an invitation to tender for a contract. It is understood in such cases that, in general, the tenderer takes the risk that the tender will be unsuccessful and that, as a consequence, the work will be unrewarded. It may be, however, that, even in such a case, an obligation to pay the*

tenderer will arise where the contract is not entered into by reason of a change of heart on the part of the proprietor: ***Sabemo's Case****; or* ***where the work done falls outside that normally expected of tenderers: William Lacey's Case;*** *or where the work performed is of particular benefit to the proprietor:* ***British Steel Corp v Cleveland Bridge and Engineering Co Ltd*** *[1984] 1 All ER 504*."

75 The present case cannot possibly be regarded as one in which CJC intended to act gratuitously or MRL expected (or had any reason to expect) that CJC was acting gratuitously. The work CJC began on 3 February 1999 was not work related to the preparation of the contract or work preliminary to that envisaged by the building contract the parties had in contemplation. It was work which, if a contract of the description contemplated by them were in force, would be work clearly and directly referable to the contract, in the sense of being required by the contract to be performed in return for the contracted monetary reward.

76 Nor can the situation be viewed as one in which there was a mutual expectation that there would be no payment unless and until the entire task was completed. The parties showed this by embracing and implementing at an early stage and on a continuing basis, the regime under the contemplated contract for progress claims, assessment of them, the issue of certificates by KCC and payment against those certificates.

77 I am therefore of the opinion that CJC was (and was recognised by MRL to be) entitled to reasonable reward for work actually done. The foundation is a right which is the obverse of *"an obligation to pay a reasonable remuneration or compensation for a benefit actually or constructively accepted":* ***Pavey & Matthews Pty Ltd v Paul*** (1987) 162 CLR 221 at p.157 per Deane J. CJC performed work at the request of MRL in advance of the formation of a contract between them, although in circumstances where both of them envisaged and actually followed certain procedures for ascertaining reasonable remuneration on an ongoing basis. The restitutionary claims of CJC may therefore be seen as appropriately quantified by that process. The process was not itself a product of any contractual term. It was merely part of the surrounding circumstances in which both acceptance of benefit is to be recognised and reasonable remuneration for that benefit is to be given.

Incurring of the quantum meruit debts

78 The relevant concept of "incurring", as applied to debts, was considered in the context of s.588G in ***Powell (as Liquidator of Noelex Yachts Australia Pty Ltd) v Fryer*** (2001) 37 ACSR 589. Olsson J (with whom Duggan and Williams JJ concurred) referred to the decision of the Court of Appeal of this court in ***Hawkins v Bank of China*** (1992) 26 NSWLR 562, a case arising under an analogous provision of earlier legislation. Olsson J said: "*In speaking of the concept of incurring a debt, in the setting under consideration in* ***Hawkins,*** *Gleeson CJ made the point that the words 'incur' and 'debt' are not words of precise and inflexible denotation ... they are to be applied in a practical and common sense fashion, consistent with the context and with the statutory purposes. That dictum is no less apposite to the construction of s 588G.*"

79 Olsson J next referred to the decision of the Full Court of the Supreme Court of Western Australia in ***Commissioner of State Taxation (WA) v Pollock*** (1993) 11 WAR 64 where Ipp J observed that the normal meaning of the word "incur" is to become liable to, or subject to, through one's own action or by omission. Olsson J also referred to the judgment of Hodgson J in ***Standard Chartered Bank of Australia Ltd v Antico*** (1995) 38 NSWLR 290 in which the relevant concept was elucidated in a way described thus by Olsson J: "*... a company incurs a debt when,* ***by its choice****, it does or omits something which, as a matter of substance and commercial reality, renders it liable to a debt for which it otherwise would not have been liable. He considered that such a formulation potentially threw up three factors for consideration, namely:*

- *whether the company has a choice whether to do (or omit) the act or not;*
- *whether it is the act or omission, or something else, which renders the company liable for the debt; and*
- *whether the company would otherwise (in any event) have been liable for the debt.*"

80 In ***Shepherd v Australia and New Zealand Banking Group Ltd*** (1996) 20 ACSR 81, however, Bryson J expressed the opinion that the element of choice referred to by Hodgson J does not form part of the "incur" concept. The South Australian court resolved this matter by preferring the approach taken by other intermediate appeal courts in ***Hawkins*** and ***Pollock***.

81 Case law indicates, in my view, that "incurring" is the act, omission or other circumstance which causes the company to owe the debt. In the present case, where CJC, at the request of MRL, commenced building work in the absence of a contract (but in the context of a mutual expectation that a contract would be made) and the parties, by their conduct, showed an intention of proceeding in accordance with the system of progress claims and certificates envisaged by the form of contract before them, the situation was one in which MRL subjected itself to a liability for quantum meruit payments when, in response to its request, CJC began work. From that point, MRL was party to a regime under which the performance of work CJC progressively generated rights for CJC to be paid for that work.

82 The parties envisaged from the outset that progress claims would be made. That aspect of the regime contemplated by them gives shape to the form of the reasonable remuneration available by way of quantum meruit. The circumstances were not such as to engender any expectation that payment would only be made when the totality of the work had been completed. As J.B. Dorter and J.J.B. Sharkey say at p.5011 of "Building and Construction Contracts in Australia" (looseleaf 2nd ed): "*In contracts like building contracts, the presumption is that if they be of any substantial duration, the price will be paid progressively.*"

83 That presumption is, by statute, extended to any arrangement (not necessarily a contract) under which one person undertakes to carry out construction work for another: see the **Building and Construction Industry Security of**

Payment Act 1999 which creates a statutory scheme for the quantification and recovery of progress claims. Those provisions were not in force at the times relevant to these proceedings.

84 The parties shared intentions and the remuneration basis they contemplate are a clear indicator of what, as between them, is reasonable remuneration. This is so not only in cases where a contract is silent and there is implied a promise that reasonable remuneration will be paid but also in a quantum meruit case where reasonable remuneration is the essence of the restitutionary right. Relevant, therefore, is the observation of Lord Wright in ***Way v Latilla*** [1937] 3 All ER 759 (at p.766), a case of the former kind: *"... the amount to which the appellant is entitled is left at large, and the court must do the best it can to arrive at a figure which seems to it fair and reasonable to both parties, on all the facts of the case. One aspect of the facts to be considered is found in the communings of the parties while the business was going on. Evidence of this nature is admissible to show what the parties had in mind, however indeterminately, with regard to the basis of remuneration. On those facts, the court may be able to infer, or attribute to the parties, an intention that a certain basis of payment should apply."*

85 KCC issued drawdown certificates in accordance with the procedures for progress claims and progress certificates in the form of building contract which existed when, on 4 February 1999, MRL gave the letter of intent to CJC and thereby induced CJC to commence work on Lot 29 in the legitimate expectation that the contract would in due course be made and that, pending its execution, payments would be forthcoming in accordance with its terms for work done. Each amount so certified by KCC represented an instalment of the reasonable remuneration earned by CJC.

86 I am accordingly of the opinion that ASIC has discharged the onus of showing that debts were incurred by MRL in the respective amounts and stated at paragraph [16] above. There is, however, a question as to the time at which each debt was incurred, given my finding that the building contract was never concluded and that remuneration accrued due by way of quantum meruit.

87 Because of the finding as to lack of contract, a right for the builder to be paid was generated solely by the doing of work. And a particular quantum meruit entitlement was quantifiable only as and when recognisable work was completed. Given the contractual position, the builder could have stopped work at any time and MRL could have put a stop to the builder's activities at any time. Completion of each work segment was therefore the event that gave rise to a debt, since there was no certainty in advance that the segment would be completed and the reward earned. On principles analogous with those discussed in ***Hussein v Good*** (1990) 1 ACSR 710, ***Rema Industries and Services Pty Ltd v Coad*** (1992) 7 ACSR 251 and ***Credit Corporation Australia Pty Ltd v Atkins*** (1999) 30 ACSR 727, the time of certification by KCC, following receipt of the relevant progress claim from CJC, should be regarded as the time of the incurring of the quantum meruit debt for the work done, as reflected in the KCC certification.

88 It follows that, by subjecting itself to the regime under which the performance of work by CJC progressively generated rights for CJC to be paid as work was done, with the KCC certifications as quantification, MRL incurred debts in the amounts and at the times for which ASIC contends, as set out at paragraph [16] above.

The position qua solvency as shown by balance sheets

89 It is next necessary to consider the state of MRL's solvency on each of those dates. I begin by considering the financial position as shown by the available balance sheets.

90 The joint venture agreement of 22 December 1998 has annexed to it a balance sheet of MRL as at 21 December 1998 and a profit and loss account also described as *"as at 21 December 1998"*, although given that incorporation occurred only on 16 June 1998 and that MRL had not undertaken any other activity, the profit and loss account may safely be taken to reflect the result of operations from the date of incorporation to 21 December 1998. The balance sheet and profit and loss account do not appear to be mentioned in the operative provisions of the joint venture agreement. For present purposes, that is beside the point. The significant matter is that each carries a certificate signed by both the defendant and Mr Jones stating that it *"is a true and fair view of statement of affairs in the company as at 21 December 1998"*.

91 This balance sheet shows total liabilities of $88,014, being current liabilities in the form of "Creditors and Borrowings" ($18,170) and "Amounts Owing to Other Coys" ($69,844). Net assets and total shareholders' equity are both shown as negative $88,014. The profit and loss account shows accumulated losses of $88,015.

92 On 19 May 1999, Mr Jones sent to Mr Fernandez "Murray River Accounts", consisting of a balance sheet as at 19 May and a profit and loss account for the period 1 July 1998 to 19 May 1999. Both are marked "draft". The balance sheet shows current assets of $9,797 cash and non-current assets of $440,000 ("Mulwala Resort"), making up total assets of $449,797. The sole item on the liabilities side is a current liability of $1,543,641 designated *"Creditors & borrowings"*. Net assets and shareholders' equity are negative $1,093,844. An expanded version of the balance sheet contains a break-down of the "Creditors & borrowings" item showing amounts of $440,000 in respect of Leigh, $86,385.13 in respect of Essington, $29,561.85 in respect of the Club and $987,693.70 in respect of *"Creditors Control"*. This last item is supported by a detailed listing of sundry creditors.

93 A balance sheet as at 30 June 1999 was sent by the defendant to Mr Mullarvey on 23 August 1999 as already noted (see paragraph [57] above). Mr Chamberlain, who became the liquidator of MRL on 14 November 2000 (*having been appointed administrator under Part 5.3A of the* ***Corporations Act*** *on 18 October 2000*) reviewed the 30 June 1999 balance sheet against an accompanying trial balance. In his opinion, the balance sheet requires adjustment in three ways: first, by addition of a note in respect of the non current asset explaining that the capital works had been undertaken on land not owned by MRL; second, by reducing current liabilities by $1,391,602 to $3,304,370; third, by reducing the current liability owed to CJC to $2,834,370; and, fourth, by recognising non-

current liabilities of $1,652,554 (being the re-classified current liabilities of $1,391,602 and subordinated loans from shareholders of $260,952). Mr Chamberlain's affidavit contains, in tabular form, a depiction of the position shown by the balance sheets:

	As at 21/12/98($)	**As at 5/99 ($)**	**As at 30/6/99($)**	**As at 30/6/99 with adjustments ($)**
Current assets	0	9,797	1,358	1,358
Current liabilities	88,014	1,534,641	4,695,972	3,304,370
NET CURRENT ASSETS	**(88,014)**	**(1,524.844)**	**(4,694,614)**	**(3,303,012)**
Non-current assets	0	440,000	4,848,601	4,848,601
Non-current liabilities	0	0	0	1,652,554
NET NON-CURRENT ASSETS	**0**	**440,000**	**4,848,601**	**3,196,047**
NET ASSETS	**(88,014)**	**(1,084,844)**	**153,987**	**(106,965)**

94 Mr Chamberlain also provides a table showing, by reference to the three balance sheets, current assets, current liabilities and the quick asset ratio (that is, the ratio determined by dividing current assets that can be converted into cash, excluding inventories, by current liabilities):

	21/12/1998	5/1999	30/06/1999
Current Assets	0	9,797	1,358
Current Liabilities	88,014	1,534,641	3,304,370
Quick Asset Ratio	0	.006	.0004

95 Mr Chamberlain confirms that MRL operated at a loss in each reported period up to 30 June 1999. A review of bank statements enables Mr Chamberlain to say that the credit balance in MRL's bank account never exceeded $42,404.52, which was the balance on 12 April 1999.

96 The defendant did not contend that any of the balance sheet information was incorrect. Having regard to general notions of insolvency (that is, inability of a person to pay all the person's debts as and when they become due and payable), MRL must be regarded on the basis of the balance sheet information, as having been insolvent at all times from its creation until 30 June 1999 – unless it had resources and funding capability not reflected by the balance sheets. I refer, in that connection, to the following passage in the judgment of Barwick CJ in ***Sandell v Porter*** (1966) 115 CLR 666 (at p.670): *"But the debtor's own moneys are not limited to his cash resources immediately available. They extend to moneys which he can procure by realization by sale or by mortgage or pledge of his assets within a relatively short time--relative to the nature and amount of the debts and to the circumstances, including the nature of the business, of the debtor. The conclusion of insolvency ought to be clear from a consideration of the debtor's financial position in its entirely and generally speaking ought not to be drawn simply from evidence of a temporary lack of liquidity. It is the debtor's inability, utilizing such cash resources as he has or can command through the use of his assets, to meet his debts as they fall due which indicates insolvency."*

97 It is said in the defendant's submissions, however, that this approach requires some modification in the light of s.95A of the **Corporations Act** which, of course, displaces general notions of insolvency in the present context. Section 95A is as follows:

"(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.

(2) A person who is not solvent is insolvent."

98 As Mr Hughes of counsel emphasised on behalf of the defendant, this statutory definition does not refer to the debtor's "own moneys". Those words appear in Sir Garfield Barwick's formulation. As Mr Hughes pointed out, that point of distinction was seen as significant by Palmer J in ***Lewis v Doran*** (2004) 50 ACSR 175. His Honour said (at [111] to [113]): *"In my opinion, the omission of the words "**from its own monies**" from the definition of insolvency in s.95A now leaves the Court free to determine the question of retrospective insolvency free of a qualification which might well be appropriate to determine only prospective insolvency. The omission leaves the Court free to determine insolvency, whether retrospective or prospective, as a question of commercial reality having regard to the particular facts of the case.*

*So, where retrospective insolvency is in issue, the Court can take into account that as at and after the alleged date of insolvency the company actually paid all its debts as they fell due because a third party made funds available to it without security. The Court can look at the arrangements which were actually made rather than artificially excluding them from consideration because the arrangements did not fall within the definition of payments from the debtor's "own monies". To look at what actually happened avoids the possibility that the Court is forced to conclude that, as a matter of law, a company could not pay all its relevant debts when, as a matter of fact, the company clearly **did** pay those debts.*

On the other hand, where prospective insolvency is in issue the Court, as a general rule, would be sceptical of an assertion that a third party is willing to advance funds unsecured on such terms as would not, in any event, bring about insolvency. Such willingness on the part of a third party would have to be cogently demonstrated, if not as a matter of legal obligation, then as a matter of commercial reality."

99 I accept that funds which, on a realistic commercial assessment, are capable of being raised from outside sources are relevant to the question whether a company is solvent. But the availability of such funds in the form of a loan will not enhance solvency (or have the potential to avoid a finding of insolvency) unless the loan terms are such as to exclude

the loan liability from consideration in its own right as part of the debts due or near due. In other words, availability of loan funds for a very short term or payable on demand, as a source from which debts overdue may be paid, does not enhance solvency: it merely substitutes one form of immediate (or near immediate) obligation for another. There is also the point (emphasised by the Court of Appeal in ***Expile Pty Ltd v Jabb's Excavations Pty Ltd*** (2003) 45 ACSR 711) that the capacity to raise funds from external sources must be judged in a practical and businesslike way by reference to the commercial realities of the case, not by way of some theoretical textbook exercise. Possibilities are not enough. Genuine and realistic availability, as a matter of commercial reality, must be seen.

The availability of other financial resources

100 It is therefore relevant to review the attempts actually made by MRL to obtain finance. Such a review will demonstrate the commercial realities.

101 The memorandum of understanding entered into on 4 May 1998 between Essington and the Club allocated to Essington the role of negotiating *"preliminary approval for project finance with financiers"*. The agenda dated 24 June 1998 for the first meeting of the Project Control Group contained an item:

*"**Funding***

(a) Construction Finance

Salomon Smith Barney

- *Metway*
- *St George*
- *Contractors*

(b) End Finance for Buyers."

102 The minutes of the meeting reported, as to (a), that "preliminary discussions" had taken place with Metway and St George through Salomon Smith Barney.

103 The minutes of the second meeting of the Project Control Group (22 July 1998) reported information conveyed by Essington to the effect that the project was outside Metway's area of lending but "several other groups had indicated their interest to fund the project". It was also said that Essington was in discussion with "a major construction companies [sic]" interested in constructing and funding.

104 In a letter to Mr Mullarvey dated 9 November 1998, Mr Jones reported that Essington "has negotiated with three finance companies who are keen to provide the construction funding". He referred to conditions concerning a certain level of pre-sales. At that point, the envisaged mechanism for obtaining sales of units was a registered prospectus offering interests in a managed investment scheme. It was this that caused Mr Jones to add that enquiries potentially convertible into pre-sales could not in fact be converted "as we could be contravening the ASIC requirements".

105 In late 1998, MRL approached two financial intermediaries with a view to obtaining finance for the project. One was Australian Financial Solutions Pty Limited ("AFS"), the other Direct Mortgage Funding Pty Ltd ("DMF"). In late 1999, approaches were made to National Australia Bank Limited ("NAB") and others. The attempts most relevant to the inquiry into solvency at the times material to these proceedings are those involving AFS and DMF. It is appropriate to trace them in some detail.

Attempts to raise funds through AFS

106 AFS was approached in about October 1998 with a view to its arranging finance for the project. Mr Robinson of AFS knew the defendant and Mr Jones. He introduced them to his superior, Mr Gamble who assumed responsibility for the matter in accordance with his practice of attending personally to matters involving more than $10 million. The task set for AFS was to obtain financing for the project as a whole. Mr Gamble was assisted from time to time by Mr Robinson and Mr Smith.

107 A letter of 22 October 1998 from Mr Smith of AFS to Mr Jones headed "Murray River Resort" refers to a recent meeting and requests certain information *"to enable us to progress with inquiries"*. The requested information included "*details of pre-sales including names, amount of deposit and sale price*". On 19 November 1998, Mr Robinson of AFS wrote to Mr Jones (with a copy to the defendant) asking for full further information so that he might "*proceed with this loan application*". On 15 December 1998, AFS and MRL entered into an agreement entitled "Service Agreement and Irrevocable Authority". It was signed on behalf of MRL by the defendant. By that agreement, MRL engaged AFS "to source an offer of finance/loan approval on its behalf" in accordance with certain specifications which included a principal sum of $16.46 million and a term of 15 months. This was a non-exclusive appointment in the sense that MRL remained free to seek finance from other sources.

108 Mr Robinson wrote to the defendant the next day (16 December 1998) saying, in part: *"I am pleased to advise that we understand that this loan application does not come with any guarantees either from the Essington Group or the Mulwala & District Services Club nor will they be provided. The loan will be submitted on that basis."*

The defendant, in a letter to Mr Robinson dated 17 December 1998, confirmed that position.

109 A letter from Mr Robinson to the defendant dated 12 January 1999 made it clear that AFS was awaiting from MRL a valuation of the property and "confirmation of the 99 year lease from the Water Authority". Mr Gamble said in evidence that these were prerequisites to MRL obtaining finance through AFS. As that time, AFS was working to a deadline of 31 January 1999 for the obtaining of finance.

110 Mr Robinson said in the letter of 12 January 1999 that a submission was ready to go to "a couple of possible funders who had expressed interest in the project but that it would be pointless" to forward the submission to them

without the valuation or the confirmation concerning the lease. Mr Robinson also said: "*We are concerned with the January 31st 1999 deadline as the valuation is critical to the final proposal.*"

111 On 8 February 1999, Mr Jones sent to Mr Robinson of AFS a "preliminary valuation report" received from A.W. Male & Associates Pty Limited. Mr Jones commented that the valuation of $2.8 million "is less than anticipated and may be higher in the final document". He expressed the hope that the preliminary valuation report "may enable you to commence the process to arrange the financing necessary to proceed with this project". The preliminary report of A.W. Male & Associates Pty Limited referred to the leasehold estate and to the term of the lease being 36 years from 1990. The report then said: "*The Valuation is based on a proposed negotiated extension of the lease for a period of 99 years, backdated to 1990.*

Should this negotiated lease term vary from the above, then this Report should be returned for the amendment of valuation as necessary."

The report then expressed an opinion that "subject to the following over-riding conditions", the interest of the lessee was valued "at or about" $2.8 million. The conditions included: "*That the relevant NSW Government Department enters into a Lease with Murray River P/L for a period of 99 years.*"

112 On or about 11 February 1999, Mr Reid of CJC telephoned Mr Gamble of AFS to ask about the status of finance for MRL. Mr Gamble told him that AFS was waiting on some documents from MRL before finance could proceed further. Mr Reid said that the first progress payment was due. This was the first that Mr Gamble knew of progress payments becoming due. Mr Reid made further similar inquiries of Mr Gamble in the next three months or so.

113 By letter dated 22 February 1999 addressed to Mr Jones, Mr Smith of AFS requested further information "*to enable us to progress the application to 'Land Bank' the Mulwala site*". Among the items requested were "*Copy of approval to extend lease on security property to 99 years",* a copy of the ten year management agreement with Hilton and a copy of the registered prospectus.

114 Mr Gamble gave evidence that, without these documents, AFS could not realistically approach lenders seeking the finance MRL required. In particular, development funding could not, in his view, have been obtained without the lease extension. There was, he said, a prospect of obtaining short term bridging finance without the lease extension but on very different terms – essentially, smaller amount, shorter term and significantly higher cost.

115 In early March 1999, the instructions to AFS were changed. It was asked to arrange $1.68 million against the security of the land only. This caused AFS to write on 3 March 1999 to Herbert Geer Rundle ("HGR") seeking finance of $1.68 million "representing 60% of valuation" for a term of six months. The letter made it clear that "no directors guarantees will be made available" and, under a heading "Special Conditions", included: "*Consent from Water Administration Ministerial Corporation.*"

The letter also said: "*The current lease tenure is for a term of 36 years from 1990, however negotiations are currently in hand to extend to 99 years.*"

Then, somewhat hopefully perhaps, the letter continued: "*The Resort will be managed by a leading hotel group (present negotiations with Hilton Hotels International) with access to local and international booking facilities ...*"

116 On 3 March 1999, Mr Robinson of AFS wrote to Mr Jones asking for

"*1. A copy of the 99 leap year lease agreement with the Water Administration Ministerial Corporation.*
2. A copy of the 10 year management agreement with Hilton Garden Inns.
3. A copy of the registered prospectus from ASIC.
4. An indication of the progress with the valuer."

117 Mr Jones wrote to Mr Robinson of AFS on 12 March 1999 saying, first, that the "99 year lease agreement" had been "verbally approved" by WAMC and that the lease would be issued after receipt of a "letter of support" from the owners of Lots 1 to 28 which was "anticipated to be faxed to us on Monday 15 March"; second, that "Hilton Management agreement is being delivered Tuesday 16 March"; third, that the registered prospectus "depends upon ASIC" and is beyond our control and may take 3 months; and, fourth that Mr Male had said that the valuation would be completed "by this weekend" and the version showing "on completion value" would follow in one or two weeks.

118 HGR wrote to MRL on 16 March 1999 referring to the application made through AFS. The letter indicated conditional willingness of HGR to provide a one year term facility in an amount of $1.4 million "or 50% of valuation commissioned by us whichever is lower". Mr Jones, on 7 April 1999, signed an acceptance of this offer on behalf of MRL.

119 In the meantime, AFS had written to Mr Jones on 17 March 1999 indicating receipt of a letter of offer from "a private funder" for "$1,680,000 against the land only". It was noted that this was a change from the original instruction or request made by MRL. The defendant wrote to AFS on the same day referring to the letter addressed to Mr Jones indicating the acceptability of the $1.68 million proposal against a third party security given over the land owned by the Club.

120 On 22 March 1999, AFS wrote to HGR referring to that firm's letter of offer dated 16 March 1999. AFS said that it was "*still negotiating with a client*" and that there were currently two issues: first, the inability of the Club to provide a guarantee and the consequent unwillingness of Essington to do so; and, second, the view of MRL that Mr Male's valuation should be acceptable and that no other valuation should be required. HGR were, however, unmoved by these requests or implied requests. On 23 March 1999, Mr Smith of AFS wrote to the defendant saying that HGR

was concerned about the unavailability of guarantees and if they were not provided would be reducing the amount of the loan to between 50% and 55% of security value; also that the valuation by Mr Male was not acceptable and HGR required a valuation by a valuer of their choice. Mr Smith wrote to HGR on 25 March 1999 saying that MRL was "*adamant that the Club will not be providing a guarantee*" and arguing that the A.W. Male valuation should be regarded as acceptable, at the same time mentioning other valuers who would be acceptable if HGR insisted on a valuation of its own.

121 HGR replied on 26 March 1999 identifying its panel valuer for the relevant area and stating that that was the only acceptable valuer for HGR's purposes. After expressing continuing surprise that the Club considered itself unable to give a guarantee, HGR said that they would be prepared to lend 50% of valuation without the guarantee. This result was reported by Mr Smith to the defendant by letter dated 29 March 1999.

122 On 6 April 1999, Mr Smith wrote to Mr Jones enclosing a letter of offer for $1.4 million from HGR. A board meeting of MRL was held on 13 April 1999 to approve the execution of new agreement with AFS for the obtaining of a loan offer in that amount.

123 Some time in the first half of April 1999, Mr Gamble, according to his evidence, received a telephone call from the defendant who said that immediate funds were needed to meet building costs already incurred. Mr Gamble deposes that the defendant said words to the effect, "*The payment to the builder is outstanding*". Mr Gamble said that such money would be costly and the defendant said funds were needed immediately to pay CJC's first progress claim. Soon afterwards, MRL terminated AFS's instructions to seek construction finance and its efforts were concentrated on sourcing $1.4 million from HGR.

124 Following the request from the defendant that AFS seek immediate funds to pay the builder, Mr Gamble spoke to a director of Leigh who indicated a willingness to provide finance if his lawyer, Mr Haralambis, was satisfied that all was in order.

125 On 14 April 1999 AFS forwarded to the defendant a letter confirming availability of a loan of $440,000 for a term of thirty days from Leigh.

126 Mr Haralambis wrote to AFS on 15 April 1999 confirming that mortgage and security documents would be forwarded to the mortgagor's solicitor subject to his client's confirmation. Mr Haralambis described the financing as "second Mortgage" although the AFS letter of 14 April had referred to a first mortgage. Mr Haralambis wrote to MRL's solicitors, Eakin McCaffery Cox, on 20 April 1999 setting out certain requirements, including that he be furnished with certified copies of the building contract between the Club and CJC, the joint venture agreement between MRL and the Club and the constitution of the Club. On the same day, Mr Haralambis sent a separate letter to Eakin McCaffery Cox setting out conveyancing requirements. On 28 April 1999, Mr Haralambis forwarded mortgage documents to the Club's solicitor, Mr Curtis-Smith. On 29 April 1999, Mr Haralambis wrote to his client explaining that, whereas he had first thought that the Club was to be the borrower and mortgagor, it had emerged that the borrower was to be MRL, with a non-recourse mortgage over Lot 29 from the Club. He also advised on security that should be taken over the building contract and commented on title matters, as well as the absence of any formal valuation. Mr Curtis-Smith wrote to Mr Haralambis on 29 April 1999 commenting in detail on the mortgage document. His letter reads in part as follows: "*The terms of the advance of monies are the concern of the borrower, but which have been made known to my client and who has agreed to provide the security now offered. You will be aware that that obligation arises out of clause 3.3 of the Joint Venture agreement made by them.*"

127 Correspondence with Mr Haralambis continued to a point where, after several false starts and mistakes in documentation, the loan transaction was settled on 5 May 1999, with $390,000, out of the total advance, being paid direct by the lender to CJC at MRL's request. The balance was absorbed in interest and fees.

128 While the arrangements with Leigh were being implemented, HGR continued to consider a quite separate loan proposal. On or about 6 May 1999, Mr Gamble received an indication of HGR's willingness to lend $650,000 against a valuation of $1 million received by them – or, if the lease extension was approved, the smaller of $1 million and 50% of valuation. Mr Gamble conveyed this to the defendant who said there was no point in proceeding with HGR as the loan would do little more than refinance the Leigh loan.

129 HGR wrote to AFS on 19 May 1999 saying that it could not advance more than $600,000 on the security of Lot 29. There was reference to a Laing & Simmons valuation which, it was said, was "conditional on various matters including the extension of the Lease to a 99 year term". HGR then said that its concern about the lease was not so much the extension of the term but the uncertainty of future rent in light of the lessor's attitude to increased value generated by enhanced use.

130 The comprehensively documented loan from Leigh which had been the subject of extensive correspondence was for a fixed term of one month. It therefore became due for repayment on 5 June 1999. On 1 June 1999, with four days to go until the loan was repayable, Mr Jones wrote to Mr Toohey of AFS saying: "*We write to you with some concern that the above advance amounting to $440,000 is due for repayment by 5th June 1999 and from this date incurs a further fee of $15,000 per week in advance.*

Our acceptance of this interim funding was based upon the numerous assurances given to us by AFS that the second loan of a minimum of $1.4m to $2.2m would be readily available prior to the date of repayment of the interim loan.

Correspondence and advice from AFS has suggested various target dates for settlement of this second loan from mid-January 1999 onwards, which heightens our concern.

Your urgent advice is sought on this matter.

Would you please advise the lawyers for the lenders of Leigh Superplan Pty Limited that an extension beyond 5th June 1999 may be required."

(Mr Jones said that he was not the author of this letter and that the defendant wrote it.)

131 Mr Toohey of AFS wrote to the defendant on 1 June 1999 referring to Mr Jones' letter of that date. He said that AFS had not been informed that acceptance of the loan from Leigh was based on MRL's obtaining further funding through AFS – rather, as he understood it, MRL accepted the Leigh facility "*due to the fact that there was no other facility available at the time to meet the obligation to the builder*". He went on to say that Mr Gamble of AFS had attended meetings on behalf of MRL with both HGR and Nexus Mortgages and that the defendant was aware that those efforts "were undertaken on a best endeavours basis". He added that he had asked Mr Gamble to ask for an extension from Leigh. Mr Toohey concluded by referring to three options being considered "*for the bridging facility*" (Nexus Mortgages, HGR and several others which had produced no result) and that as regards "*primary funding*", applications had been made to various institutions, as at 25 May 1999, and responses were awaited.

132 An extension of the Leigh loan was eventually negotiated and, on 23 June 1999, a deed effecting the extension was executed. The extension was until 21 June 1999 and a further advance of $30,000 was made. By deed dated 23 June 1999, the term was extended to 5 July 1999. The question of financing was discussed at the meeting which took place at the CJC office in Albury on 16 June 1999 after CJC had ceased work on the project. Mr Reid of CJC is reported as having asked: "*Who will be financing the project? Are your hopes pinned on AFS, who require the lease to be increased from 37 years to 99 years.*"

The defendant is reported to have replied: "*AFS are going down that path. Murray River Pty Ltd are making alternative arrangements however have not discounted using AFS.*"

133 In the end, the Club obtained an advance of $500,000 from Statewide Secured Investments Ltd on the security of Lot 29 and lent the whole of the proceeds to MRL to enable it to repay the Leigh loan. The Club's decision in this regard was communicated in a letter of 29 June 1999 from Mr Mullarvey to the defendant.

134 Subsequently, in November/December 1999, the Club made further borrowings from Statewide and applied these towards reduction of MRL's indebtedness to CJC.

Attempts to raise funds through DMF

135 DMF's first contact with MRL occurred in early December 1998 when Mr Branagan of DMF met the defendant and Mr Jones. On 8 December 1998, Mr Jones wrote to Mr Branagan giving information about the Murray River Resort "to assist your assessment" of what was obviously a request that DMF make attempts to locate financing for MRL. The letter identified MRL as the borrower and explained that it was owned, as to one half of the issued capital, by Essington and, as to one half, by the Club. It was stated expressly, "*No guarantors are available*". Under a heading "*Take Out*" appears the following: "*Murray River Pty Limited will become an unlisted public company and raise $4 million capital through the Club members.*

This equity coupled with the land is more than sufficient security to raise construction funding from traditional sources as necessary.

This source of funding will provide the take-out on or before July 1999."

136 This last comment explains a reference to the term of the desired loan being only seven months. The letter indicated that the Club would transfer the land to MRL "*for use as security to the lender*". It also said "*The Club's security will be by way of subordinated debt.*"

The letter concluded as follows: "*The facility is required to meet payment of consultants fees initially to enable the builder to commence work on 3rd February 1999.*

Monthly draw-downs for the construction in accordance with attached schedule to a maximum with a take-out on or before July 1999."

137 In a letter of 10 December 1998 to Mr Branagan, Mr Jones confirmed that funding was required to July 1999, adding that, at that time, "alternative funding from traditional sources will provide the take out". The maximum level of funding required was identified as $8 million.

138 On 15 December 1998, DMF wrote to MRL conveying a "conditional offer" of a facility "subject to approval by its Funder in accordance with and subject to the general terms and conditions set out below". The following particulars identified MRL as borrower and referred to a loan principal of $8 million consisting of an initial advance of $2.55 million and a "facility drawdown" of $5.45 million. The loan term was identified as 12 months and there was a reference to registered first mortgage security over Lot 29 and to guarantees from Essington, the Club and "all adult beneficial directors of the borrower and guarantor company". There was reference to a requirement of the "Funder" to "complete the necessary due diligence of this development and obtain an independent valuation report". It was stated that if the valuation and due diligence inquiries disclosed "any adverse features (the sole judge of which shall be DMF)", the security property could be declined for security purposes or "further pre-settlement conditions" could be imposed. There was also a list of special conditions including the following:

"*1. Prospectus to be completed and lodged with ASIC prior to construction draw commencing.*
2. Sales & Marketing Plan to be submitted and accepted by lender.
3. Detailed list of expressions of interest to purchase to be submitted to the lender.

4. Take out proposal to be submitted to the lender."

139 Mr Branagan explained in evidence that the purpose of the 15 December 1998 letter was to specify the terms on which DMF was appointed to seek finance and to outline indicative terms of the finance. MRL was, he said, seeking $8 million. Guarantees of Essington, the Club and the MRL directors were envisaged. An acceptable take-out mechanism was essential.

140 The defendant acknowledged the DMF letter of 15 December 1998 by way of short reply dated 17 December 1998. He said that the terms proposed were being reviewed but that some of them were "outside our original brief". On 21 December 1998, the defendant wrote again to DMF confirming concern apparently expressed on the telephone about the requirement for guarantees and saying that the proposal could not be accepted. By letter of the same date, Mr Branagan of DMF said that the prospective lender would not entertain "a non-recourse loan of this size on the structure and security position". Mr McKay of DMF wrote to the defendant on 4 January 1999 noting that "your clients" (no doubt MRL) would not be proceeding and saying that if any "particular negotiable item" would reverse the decision, he should contact Mr McKay.

141 On 12 February 1999, Mr Branagan and the defendant lunched together. The possibility of DMF's again seeking finance for MRL was raised. According to Mr Branagan, the defendant said that approval for extension of the lease term to 99 years had been received and that he would send Mr Branagan a preliminary valuation report. Mr Jones sent this to Mr Branagan. It was the report of Male expressing an opinion of value of $2.8 million for the land on the basis of extension of the lease term.

142 On 22 February 1999, DMF wrote to MRL conveying a new "*conditional offer*" of funding. The loan amount and term were the same as previously, but the fee structure was different. The requirement for guarantors was repeated, as was the requirement for due diligence and an independent valuation report. On 1 March 1999, yet another "*conditional offer*" was forwarded by DMF, again with the same features. These included registered first mortgage security over Lot 29. There were again, however, differences regarding the fee structure.

143 On 4 March 1999, Mr Branagan confirmed that an independent valuation would be needed; also that the lender *"is not comfortable waiving the guarantee until he has completed his valuation/evaluation process"*. Mr Branagan said that when that had been completed, the question of guarantees would be reconsidered. Mr Branagan wrote to the defendant on 17 March 1999 saying that Laing & Simmons would be the valuer. This was confirmed by a further letter on 31 March 1999. A revised summary of the transaction was issued by DMF to the defendant on 12 April 1999. The loan principal of $8 million was confirmed, as was the 12 month term and the security property. The summary referred to the need for a valuation report by Laing & Simmons and to the need for the "*exit strategy*" to be *"put in place prior to drawdown of construction funds",* this being *"either by way of pre-sales, fully subscribed prospectus or verified take-out from a Bank"*. The summary had earlier said: *"The clients intend to raise capital by prospectus to repay $4 million from this facility and the balance of $4 million will be repaid from apartment sales. The end value is anticipated to be $16,000,000.*"

144 On 21 March 1999, Mr Branagan of DMF wrote to the defendant saying that the lender was no longer interested in the application. This was a reference to the lender whose interest had been indicated by the conditional offer of 1 March 1999.

145 Mr Branagan wrote to the defendant on 12 April 1999 setting out "*a summary of the proposed transaction*". A loan amount of $8 million was specified. The term was stated to be 12 months. There were references to management by "*a major hotel group",* an intention to raise $4 million capital by prospectus and a further $4 million from apartment sales, with these two sums clearing the facility. The *"end value"* was *"anticipated to be $16,000,000"*. Mr Branagan said that a valuation by Laing & Simmons would be obtained as part of due diligence. He also said: *"The exit strategy to be put in place prior to draw down of construction funds will be either by way of pre-sales, fully subscribed or verified take-out from a Bank.*"

Mr Branagan asked the defendant to confirm the acceptability of the terms outlined. There is no evidence of any such confirmation.

146 Yet another conditional offer by DMF was submitted to MRL by way of letter dated 25 May 1999. The borrower, principal sum and loan term were only changed, as was the security. The requirement for guarantors had been reinstated in the original form. The lender's right to complete due diligence was retained but, in relation to independent valuation, the requirement was that there be an independent assessment of an apparently existing Laing & Simmons report. A Mr Hepworth was to carry out the assessment. The special conditions were:

"*1. Prospectus to be completed and lodged with ASIC prior to construction draw commencing.*

2. Prospectus to be subscribed to a level to take out the total facility prior to the drawdown of construction funding."

147 On 26 May 1999, Mr Jones wrote to Mr Branagan of DMF saying that the draft prospectus had been prepared and was being assessed by the due diligence committee; also that "all financials" were being "verified" by BDO. It was also said that the prospectus was to be lodged with ASIC by 25 June 1999 and that "ASIC approval" was expected in two to three weeks after lodgment. Because the prospectus was a "simple format", it was said, a "quick approval" was expected. The letter also said: *"The subscriptions are expected to be received from Club members due to their familiarity with the project and the obvious interest shown with 264 inquiries.*"

148 Mr Branagan replied on 27 May 1999 saying that he wished to "point out the hurdles that must be overcome to facilitate this project". He then listed as "pre-settlement conditions":

"· *The prospectus is lodged, approved and subscribed to a level to cover your development requirements.*
· *That a take out facility from a Bank or other party in a format acceptable to our lender is in place prior to drawdown funds being available.*
· *Peter Hepworth to confirm the value of the project in the Laing & Simmons Report.*"

149 Mr Branagan says in his affidavit that, at that point, DMF was aware that the lease extension to 99 years was still being negotiated. He says that, without the extension, "there was no realistic prospect of obtaining the development funding that MR was seeking".

150 Mr Branagan wrote again to MRL on 21 June 1999 asking for a "complete status report" on the two prospectuses being put in place for the project. He asked how the prospectuses worked "i.e. their purpose, legal status, subscription level etc" and referred to the letter of 26 May 1999 in which it was said that the prospectus was expected to be lodged by 25 June with ASIC approval following in two to three weeks. He asked about the current status of these matters. Mr Jones replied on 22 June 1999. He said that the first prospectus was to raise "public funds" of a minimum of $4 million and a maximum of $5 million which would "in the main be raised through Club members". He said that the funds would be utilised "as equity in the project". The second prospectus was said to have the following purpose: "*The ASIC requires that a public company structure be employed as the manager of investment funds, distribution of dividends etc on behalf of the investor.*"

He added: "*The prospectus being developed for No 1 will also be the basic format for No 2.*"

151 Mr Jones said that it was expected that the first prospectus could be lodged for "ASIC approval" on 9 July 1999, with the second prospectus following three weeks later. Mr Branagan made another inquiry as to progress by letter dated 2 July 1999. Mr Jones replied on 5 July 1999 saying that he had requested Mr Urwin, chairman of the due diligence committee for the prospectus, to respond. He added that, as Mr Branagan was aware from conversations with the defendant, progress of the prospectus to finality was dependent upon an offer of funding which could be included in the prospectus. He also expressed an understanding that "the initial drawdown of $2.5 million is not influenced by the timing of the Prospectus".

152 Laing & Simmons wrote to DMF on 26 July 1999 referring to the cost of building work on which their original assessment of value had been assessed and noting that information received from MRL was that this had increased. Laing & Simmons said that they were waiting on certain confirmations from MRL without which they could not issue a revised valuation. DMF wrote to the defendant on 27 July 1999 enclosing a copy of this letter and saying that, if MRL wished to proceed with DMF, it would have to satisfy the Laing & Simmons needs and supply details relating to the first and second conditions in Mr Branagan's letter of 27 May 1999 which were still outstanding.

153 On 29 July 1999, Mr McKay of DMF wrote to the defendant saying that DMF was "anxious to proceed with this transaction" (the letter was headed "Murray River Pty Ltd"). He confirmed that the loan was in two parts, one being "land settlement" and the other being "construction finance". He said that, to facilitate the first part, the valuer had to provide the lender with an accurate "as is" valuation. As to the second part, Mr McKay said that it would be "activated" when "Special Conditions 1 & 2 are complied with" (obviously a reference to the first and second conditions in the letter of 27 May 1999). He then referred to unanswered letters from DMF. Mr Jones wrote to Mr Branagan of DMF on 2 August 1999 setting out concerns and causes of dissatisfaction on the part of MRL in relation to the financing proposals from DMF and DMF's performance generally. There was discontent that Mr Hepworth had, in MRL's view, embarked upon a much more detailed assessment of value than MRL thought necessary for a check report. Mr Jones said: "*Had we understood from the outset that the assessment was going to take some 6 weeks and in fact instructions were still being issued 4 weeks after the initial inspection, we would not have proceeded with the application as we explained very clearly to DMF that the loan had some urgency which was reflected in the interest rate and establishment charges nominated.*"

The letter concluded: "*If as you suggest there is a definite lender now available, please inform us of your proposal to progress the matter and we will seek the decision of the Murray River Pty Limited Board.*"

154 Mr Branagan replied on 3 August 1999 saying that he generally agreed with the timetable of events and confirming that he had a lender willing to fund the transaction in two parts being an "initial advance" and "construction finance" with the amount of the initial advance being contingent upon the viability of the project. He said that the valuer had been instructed to establish the value "as is" and on completion the letter continued: "*Until all the issues pertinent to the valuation have been addressed we cannot proceed. We understand that the valuer has several issues unresolved.*

We have also repeatedly requested a status report on the prospecti [sic]. Although promised has not been received.

To progress the matter please supply to the valuer the information he is requesting and the status report direct to Direct Mortgage Funding Pty Ltd."

155 Mr Branagan received a letter from Laing & Simmons dated 13 August 1999 in which that firm referred to original assessments of value made by it and conveyed revisions of those assessments. The "as is" value initially assessed by Laing & Simmons was $5,700,000. The revised "as is" value as at 30 June 1999 was stated to be $3,500,000. The "gross realisation" value was $28,840,000 and the revision thereof was $24,556,000. The revision was said to be a consequence of increased building costs. The "as is" value had regard to land value and the value of building works to 30 June 1999.

156 On 10 September 1999, DMF wrote to Essington asking for a copy of the current lease of Lot 29. Also sought was "clarification as to whether this lease will be in place when the initial land settlement takes place or if the proposed 99 year lease currently being negotiated will be in place". The matter of lease term was taken up by Laing & Simmons in a letter of 21 September 1999 to Mr Branagan. That letter concluded with an expression of opinion that the "as is" value "with extended lease" was $2,450,000, while the "as is" value "without extended lease" was $500,000. The respective gross realisation values were stated to be $23,456,000 "with extended lease" and $20,595,470 "without extended lease".

157 On 15 October 1999, DMF wrote to the defendant conveying "verbal advice" of the availability of a facility of $8 million, consisting of an initial advance of $500,000 and with the balance being "withheld and drawn down on a cost to complete basis". The loan was described as subject to the borrower providing "satisfactory take out via" prospectus capital raising, pre-sales or bank finance. It was later explained that the initial advance was 100% of the current "as is" value as determined by the valuer. This offer was declined by MRL by letter sent on the same day.

158 Mr Branagan says in his affidavit that the obtaining of construction finance for MRL was "always dependent" on an acceptable valuation, the existence of an executed fixed price building contract, a lodged and approved prospectus, a take-out facility by way of fully subscribed prospectus or bank or similar funding and an extension of the lease of Lot 29 to 99 years.

Attempt to raise funds from NAB

159 By late August 1999, MRL had retained Mercator Funds Management Limited ("Mercator") to seek finance for it. Mr Hickie of Mercator wrote to the defendant on 23 August 1999 forwarding what is described as "the letter from the National Australia Bank with respect to a loan facility for $13 million", said to have been obtained for MRL by Home Link Mortgage Corporation Limited. The letter referred to "main preconditions" including pre-sale of all apartments and guarantees from the two joint venture partners (described as "non negotiable").

160 It appears that the NAB possibility was pursued since, on or about 19 October 1999, a letter of offer was received by MRL from NAB. NAB indicated its willingness to make available a facility of $13 million to assist with the construction of the resort. The expiry date was 30 September 2000. NAB required first mortgage security over Lot 29 and a first charge over MRL's assets generally. Conditions precedent to drawdown included the following:

(a) a sworn valuation of the property showing a value of at least $26 million after completion of improvements;
(b) contribution by Essington and the Club of a minimum of 40% of the required $7.8 million of project costs funded by equity;
(c) evidence of second mortgage funding of at least $4.5 million towards the project;
(d) extension of the lease term to 2088;
(e) satisfactory review by NAB of the proposed prospectus;
(e) pre-sales of units in the development of not less than 142 in number and $26 million in value; and
(g) an executed management agreement with an acceptable resort operator.

Moves towards the raising of capital

161 By December 1998, moves towards the preparation of a prospectus for a raising of capital by MRL were underway. There exists a draft prospectus (labelled "3rd Draft 2/12/98") which had been prepared by a consultant ("Peter") retained for the purpose at the defendant's suggestion. That draft contained statements as follows: *"Construction is programmed to commence in February 1999 and to be completed by December 1999."*

"The construction program allows for the completion of the 142 units by December 1999."

"The existing resort, which has been operated by the Club for [????] years, will close at the end of January 1999 to be demolished to make way for the new resort."

162 In early 1999, there was contact between the defendant and Mr Jones, on the one hand, and Mr Gary Urwin of Urwin Fernandez Pty Ltd, a firm specialising in the sourcing of venture capital. On 10 March 1999, Mr Urwin wrote to the defendant referring to their recent conversations and the defendant's requirement *"to appoint an appropriately qualified person to chair the Due Diligence Committee to be established in relation to the proposed issue of Capital by Murray River Limited"*. He went on to confirm having been informed of the proposal that MRL issue a prospectus to raise $4 million to facilitate the construction of a resort on land presently owned by the Club. He also recorded having been informed that the proposed resort would be managed by Hilton International and that *"an agreement in this regard is presently being documented"*. He commented that the prospectus *"appears to be in an advanced stage of drafting"* and that it was appropriate to "*commence verification*". This, he said, would appropriately be undertaken by a due diligence committee, the workings of which he went on to explain.

163 Mr Urwin arranged for the matter to be progressed by his colleague, Mr Fernandez, who deposes that his dealings thereafter were mainly with Mr Jones. Mr Fernandez also deposes that his client was MRL. He described his firm's task as follows: *"We were appointed to chair and coordinate the DDC that was to be established in relation to the proposed issue of capital by MR. The DDC was to finalise a prospectus for the development of the Mulwala Lakeside Resort. The role of the DDC was to verify the statements made in the prospectus. MR proposed to issue a prospectus to raise money to facilitate the construction of the Resort. The members of the DDC were myself, Jones, Greg Beattie of Eakin McCaffery Cox solicitors and Mr Menzalis from BDO Nelson Parkhill Chartered Accountants & Consultants ('BDO')."*

164 The first meeting of the due diligence committee took place on 16 March 1999. The next day, BDO Nelson Parkhill (Mr Mentzalis) wrote to Mr Jones referring to the previous day's meeting and saying that it appeared that BDO

would need to prepare both an independent accountant's report and an independent review of the directors' profit forecasts. He went on to explain what would be involved and concluded: *"We stress that the overall structure of the deal needs to be resolved first, as this will necessarily underpin your forecasts. Furthermore, additional items are likely to be requested from you as we gain a greater understanding of the overall transaction and your requirements."*

165 On 22 March 1999, Mr Beattie of Eakin McCaffery & Cox wrote a letter to Mr Fernandez referring to the first meeting of the due diligence committee held on 16 March 1999. The purpose of the letter was to outline "*some of the legal concerns and problems to be dealt with in relation to proceeding to the preparation of a prospectus for Murray River Pty Limited to raise the construction costs of the development from the public*". Mr Beattie went on to refer first to matters concerning land title. He explained that Lot 29 was one of 30 lots in a strata plan and that each lease covered a separate part of the overall site. He drew attention in particular to two provisions of the lease for Lot 29. First, he referred to provisions which, "*whilst ambiguous, seemed to contemplate a review of the rent payable in respect of Lot 29 in the event of a redevelopment or development of Lot 29*". Second, he referred to provisions requiring the written approval of WAMC to any new development. He noted, in connection with both these aspects, that plans and specifications for the proposed development had been provided to WAMC and that it was conducting a review of the rent.

166 Mr Beattie next referred to the term of each lease and noted the expiry date of 31 October 2036. He referred also to the application already made to WAMC to extend the term, adding: *"As it is a requirement of the Strata Titles (Leasehold) Act 1986 that all leasehold estates in the same Strata Plan have the same term, we note that Mr Jones of EAP is arranging for letters from the Owners' Corporation and the other owners of the leasehold estates in the Strata Plan to formally request the WAMC for similar extensions of their leasehold estates."*

167 Mr Beattie then said: *"WAMC has informally agreed in conference to an extension of the lease term to 2088 and is currently reviewing the rent to be charged in respect of this extended term."*

168 Mr Beattie's letter then referred to the existing joint venture agreement between Essington and the Club and said that, for the purpose of preparing a prospectus, he would prefer to see MRL with an option to purchase Lot 29 and was currently preparing such a document with a view to submitting it to the Club's solicitors for their consent.

169 It is Mr Fernandez's evidence that he had, to that point, been unaware that the extension of the lease of Lot 29 was still being negotiated. He says in his affidavit: *"Until the extension of the Crown lease on Lot 29 from 36 years to 99 years was granted, there was no realistic prospect of finalising the prospectus."*

170 Mr Fernandez submitted to Mr Jones on 1 April 1999 a due diligence planning memorandum and due diligence workplan with a view to their being discussed at a meeting on 7 April 1999.

171 A letter of 12 April 1999 from Mr Jones to Mr Fernandez confirms that the drafts were discussed at that meeting and minor changes were made. He then gave dates by which various items sought from Essington would be provided, the latest being 20 April 1999. It was reported to a meeting of the directors of MRL held on 13 April 1999 that the due diligence committee was "proceeding with a target date to lodge the documents with ASIC – 28 May 1999".

172 An agenda and other documents (due diligence planning memorandum and due diligence workplan) were distributed on 13 April 1999 for the purposes of the first meeting of the due diligence committee scheduled to be held on 22 April 1999. These were sent by Mr Fernandez to Mr Beattie, Mr Mentzalis and Mr Jones.

173 The minutes of the meeting held on 22 April 1999 were distributed by Mr Fernandez to the same persons on 23 April 1999. The minutes refer to a number of matters communicated by Mr Jones to the meeting including a need for $16.8 million construction finance, with an "*indicative offer*" having been received, "*conditional upon suitable exit strategy*". He then referred to the "*various exit strategies identified*", being 30% pre-sales, capital raising via the prospectus, take out by a bank or other financial institution and underwriting of the proposed capital raising. That part of the minutes continues: *"LJ explained that of the various proposed exit strategies set out above, the most likely scenario (currently at a relevantly advanced stage) is the underwriting. The indication is that Mr Rodney Adler is in favour of underwriting the proposed share issue under the prospectus."*

174 The minutes then record information given by Mr Jones about immediate finance: *"LJ explained to the meeting that at present, finance amounting to a total of $1.4 million had been raised through a private lender (a construction funding superannuation fund) in order to finance stage 1 of the construction. The first drawdown of $440,000 was to be made today and the balance in 7 days' time."*

175 After referring to Mr Jones' reference to a total cost of $22.5 million (made up of construction costs of $16.8 million, land cost of $3 million and costs of 'prospectus etc' of the balance) Mr Jones is reported to have said: *"LJ also noted that an offer has been received from Bankwest to take out the first stage funding of $1.4 million, plus the balance of $16.8 million required to fund the construction. This offer is currently under consideration."*

176 Mr Fernandez gave evidence that, at the meeting of 22 April 1999, it was agreed that the estimate for completion of the draft prospectus was the first week of May 1999. He also said in his affidavit: *"Once this had been completed, members of the DDC would undertake the review, particularly in relation to the correctness and internal consistency of the contents in the prospectus."*

177 On 19 May 1999, Mr Fernandez received from Mr Jones the accounts of MRL as at 31 May 1999 and a document headed "*Murray River Resort Project Feasibility*". The latter reflected a total cost for the project of $22,227,447.

178 A meeting of the due diligence committee took place on the same day, 19 May 1999. Mr Beattie of Eakin McCaffery Cox informed the meeting that he had on that day received from the Club's solicitors documents for the transfer of Lot 29 to MRL (on 24 May 1999, Mr Beattie sent Mr Jones a copy of the special conditions from the contract as he thought they would be relevant to the financing arrangements Mr Jones was negotiating). Mr Fernandez's handwritten notes of the meeting refer to a number of matters communicated by Mr Jones – including that Hilton Hotels were not proceeding and might be replaced by Marriott or Sheraton; that the body corporate would meet the following Wednesday to approve extension of the term of the lease from WAMC and the new subdivision; and that it appeared that an underwriter ("a private individual") had been "signed up" although "a contract has not been drafted. Mr Beattie is recorded in the notes as having indicated that the plan of subdivision was needed as soon as possible for presentation to the body corporate.

179 On or about 5 July 1999, Mr Fernandez received a copy of the letter of that date from Mr Jones to Mr Branagan of DMF saying that Mr Urwin, chairman of the due diligence committee, had been asked to respond to Mr Branagan's letter of 2 July 1999 (see paragraph [151]). Mr Fernandez did nothing in response but did on 5 August 1999 write to Mr Jones as follows: *"Could you please advise me of the status with regards to the above company [MRL], in particular the progress on the Prospectus? I look forward to your written reply shortly."*

180 Mr Fernandez received no reply to this letter.

181 Another meeting of the due diligence committee took place on 4 November 1999. Present were the members of the committee (Mr Fernandez, Mr Beattie, Mr Mentzalis and Mr Jones) plus Mr Edwards and a Mr David Hickey of Mercator Funds Management Limited. Mr Hickie informed the meeting of a proposal for the provision of finance by NAB. The proposal came to fruition at a later stage, although in a highly conditional form (see paragraphs [159] and [160]).

182 On 5 November 1999, Mr Jones sent to Mr Fernandez a draft prospectus, a draft hotel management agreement, a draft sales list and unit entitlement and a draft strata management agreement.

183 On 15 November 1999, Mr Fernandez wrote to Mr Jones about the possibility of using Pannell Kerr Forster *"for the special independent report to be included as part of the prospectus"*. He gave Mr Jones some information on that firm and suggested he contact them direct.

184 Thereafter, nothing further was done by or in relation to the due diligence committee. Mr Fernandez's evidence is that this was because of MRL's failure to provide and confirm important information needed for the prospectus. Mr Fernandez also says that, "long after" regular meetings of the committee ceased, he was told by Mr Jones that the obtaining of approval for the prospectus had been taken over by Mr Hickie of Mercator.

Attempts to obtain extension of the lease term

185 On 8 September 1998, Mr Jones, using Essington letterhead, wrote to WAMC informing it of the Club's proposal to develop Lot 29 by replacing the existing tourist complex with a new 142 suite resort complex. He said that Shire Council required WAMC's approval as part of the development application process.

186 A meeting took place on 22 September 1998 between Mr Radcliffe of WAMC, Mr Jones, Mr Beattie of MRL's solicitors, Eakin McCaffery Cox, and a representative of the Department of Land and Water Conservation. According to Mr Radcliffe's note of the meeting, Mr Jones, after outlining the development proposal said that expiry of current leases in 2036 did not give sufficient economic base to raise finance and market the project. Mr Jones said that an extension to 99 years was sought. Mr Radcliffe, according to his note, replied that a full 99 year extension from 2036 was not likely to be approved but that it might be possible to treat the last extension of 50 years as a 99 year extension so that the term would continue to 2088. In response to an inquiry from Mr Jones whether it would be possible to acquire the freehold, Mr Radcliffe, according to his note, said that this would not be possible because it was contrary to Departmental policy.

187 By letter dated 6 October 1998, the Department of Land and Water Conservation wrote to Mr Jones conveying consent on behalf of WAMC as lessor to the lodgment of a development application with the Shire Council in respect of the proposed development. Nothing was said about any extension of the lease.

188 The initial meeting with WAMC does not appear to have been followed up until early 1999. On 15 January 1999, Mr Beattie wrote to Mr Jones referring to the meeting and mentioning WAMC's agreement to provide the Shire Council with a consent in relation to the lodgment of the development application (which Mr Beattie said he understood had been provided) and WAMC's agreement in principle to extend the lease term, subject to agreement on rental. Mr Beattie said that, following execution of the joint venture agreement between Essington and the Club, he had confirmed with the Club's solicitors that he might approach WAMC "to negotiate any extension to the leasehold estate".

189 According to a letter sent by Mr Jones to A.W. Male on 1 February 1999, a meeting between Mr Beattie and Mr Radcliffe of WAMC took place and WAMC "have agreed to vary the lease for a term of 99 years backdated to the original lease, that is 1989". He referred to the recommended new rent figure and said that approval of the proposal would take two to three weeks.

190 Mr Beattie of Eakin McCaffery & Cox, acting for MRL, attended meetings with WAMC on 18 and 22 January 1999. On 28 January 1999, he wrote to WAMC (attention Mr Radcliffe) formally seeking variation of the lease by extension of the term from 31 October 2036 to 31 October 2088. Recognising that the request was made by a person with no interest in the lease, he added that he was obtaining a formal letter from the owners' corporation of

strata plan 37724 requesting the extension in relation to the leasehold estates for all lots and the common property. He noted (presumably having been informed by Mr Radcliffe) that WAMC could begin the process of dealing with the application before receiving the formal application from the owners' corporation.

191 On 28 May 1999, Mr Radcliffe wrote to Mr Jones saying that WAMC had given approval under the lease to the erection of buildings and structures described in the plans and specifications submitted to the Department and approved by the Shire Council. Nothing was said at this point about extension of the term of the lease.

192 On 8 November 1999, Mr Radcliffe wrote to Eakin McCaffery & Cox saying that he was still awaiting advice from the Regional Director, Murray Region regarding extension of the lease term. He enclosed a variation document used in another matter, suggesting that it might be used as a precedent – although obviously without pre-empting the extension decision itself.

193 On 24 February 2000, Mr Radcliffe wrote to Eakin McCaffery & Cox forwarding a copy of a letter he had sent to Mercator Funds Management Limited which read in part as follows: "*I am pleased to advise that approval in principle has been given on behalf of the Water Administration Ministerial Corporation to extension of the lease terms for the strata leasehold scheme SP 377424 from the current expiry date in 2036 to expiry in 2088.*

Final approval is subject to execution of satisfactory legal documents to effect the extension of the leases and any associated changes to the leases that may be required."

194 Mr Radcliffe said in evidence that this letter to Mercator was the "first external communication of a decision to approve in principle an extension of the lease to 31 October 2088". He said that the decision was made in December 1999 by the Regional Director, Murray Region.

195 On 18 May 2000, Mr Radcliffe wrote to the Chief Executive Officer of the Club referring to a request by Mr Curtis-Smith for confirmation of the approval of the lease extension so that it might be included in the prospectus. He then said: "*I am able to confirm that the leases will be varied to extend all the existing leases to terminate on the 31st October 2088. It is not anticipated that the terms and conditions of the existing leases will alter other than the termination date and any minor consequential amendments arising from the extension of the lease terms. Upon the completion of the development on Lot 29 and the registration of the Strata Plan, new leases will issue in respect of the new lots formed, and the additional common property thereby formed merged with the existing common property lease. A rental review will be made upon the registration of the strata plan in accordance with the provisions of the existing leases.*"

Conclusions on solvency

196 The negotiations with all potential financiers made it clear from the very outset (that is, from the point in late 1998 at which attempts to raise finance began) that, at a commercial level, funding of the construction would not be feasible without some, at least, of a number of elements: guarantees from the Club and Essington, security over the leasehold interest in Lot 29, extension of the lease term to 2088, availability of a satisfactory valuation based on the extended lease term, the execution of a fixed price building contract, the existence of a management agreement with a recognised hotel or resort operator and a coherent "take-out" strategy by way of capital raising, bank funding or other acceptable longer term arrangement. The catalogue of requirements (a) to (g) in the NAB letter of October 1999 (see paragraph [160] above) is representative of lenders' attitudes, although aspects varied in detailed respects among the various potential lenders.

197 The key requirements of AFS and DMF were made known virtually from the outset of discussions with them. The requirement for security over the leasehold was stated in the "Service Agreement and Irrevocable Authority" with AFS dated 15 December 1998 and in the DMF letter of the same date. The requirement for extension of the lease term to 2088 was stated in the AFS letter of 12 January 1999 and confirmed on behalf of MRL to DMF when, on 17 February 1999, MRL sent to DMF the Male valuation which was predicated on the extension of the lease term. The need for pre-sales of units or capital raising or some other exit strategy was flagged by AFS in a letter of 22 October 1998 and by DMF in a letter dated 15 December 1998. These fundamental considerations were repeated throughout the course of correspondence and discussions with the potential finance providers. None of them could have been regarded as negotiable. They represented essential elements of the ability to raise finance and must have been understood accordingly by the defendant.

198 Extension of the lease term was a requirement of all lenders except Leigh in respect of the $440,000 short-term loan it actually made. In fact, the loan from Leigh can be seen as a fairly reliable indication of the full extent of the independent borrowing capacity of MRL at that time, even with the availability of the leasehold as security. The only other indication of borrowing capacity predicated on security over the leasehold without extension of the term was that received on 16 May 1999 from HGR through AFS to the effect that $600,000 might be lent on that basis. Without extension of the lease term, borrowings beyond $650,000 supported only by security over the leasehold must be regarded as having been commercially unavailable.

199 Even with extension of the lease term, no lender was willing to finance the total construction cost in the absence of an exit plan. The only tangible steps MRL took in that direction were the capital-raising steps to which I have referred in outlining the evidence about the draft prospectus and the due diligence committee and its activities. As that review shows, the extension of the lease term was seen by at least the due diligence committee's chairman, Mr Fernandez, as essential to the proposal to raise capital. Mr Beattie may be taken to have been similarly aware. By November 1999, the prospectus plans were no longer being progressed through the due diligence committee, although there

was some talk of a similar proposal being pursued through Mercator. The latter proposal, if it ever existed, never came to anything.

200 The first written confirmation of an in-principle decision by WAMC to extend the lease to 2088 was issued by WAMC in February 2000. Mr Jones told Mr Male a year earlier, in February 1999, that WAMC had agreed to the extension, citing Mr Beattie as the source of this information. But Mr Beattie's correspondence of that period (his letter of 15 January 1999 to Mr Jones and his letter of 28 June 1999 to Mr Radcliffe) does not bear out any suggestion that he had received any such assurance from WAMC. And several months later, on 8 November 1999, Mr Radcliffe made it clear to Mr Beattie that the attitude of the Regional Director, Murray Region, to the matter of extension of the term was still awaited. Before February 2000, there may have been grounds for speculation that WAMC would eventually agree to an extension of the lease term. But there was no basis on which anyone could believe that the extension would be granted.

201 In the light of all this evidence, the position in the period from January 1999 was that MRL, standing alone and with access only to the leasehold by way of non-recourse third party security from the Club, was capable of borrowing in the open market only the $440,000 it in fact borrowed from Leigh (or, perhaps, the $600,000 that HGR indicated may be available). The crucial matters of lease extension and capital raising – together with other aspects of a viable operation including take-out strategy – were in such a state that any objective assessment would have shown that further funds were, as a matter of commercial practicability, simply not available. The onerous terms of the Leigh loan emphasised the unattractiveness of the proposition from a lender's viewpoint.

202 The defendant, in submissions, makes much of the argument that the Club should have provided financial support to MRL and that there was a well-based and reasonable expectation that it would do so. He points, in that respect, to clauses 5.1 to 5.4 of the joint venture agreement. The submission is that the Club was obliged by those provisions, read in the light of a provision compelling co-operation (clause 2.1), to provide funds to MRL as the need arose. (*Logic would say that, if the Club was bound in that way, Essington was likewise bound.*) Mr Mullarvey testified that the Club made it clear from the outset that it would not be involved in funding and, in particular, would not give any guarantee. That, according to the defendant, was irrelevant (even if true) in view of an "*entire agreement clause*" (clause 11.6).

203 The joint venture agreement clearly contemplated the possibility that the Club or Essington or both might make loans to MRL or guarantee repayment of loans obtained by MRL. One need not look beyond clauses 5.2(b) and 5.3 for confirmation of this. But the agreement did not oblige either party to make loans or to give guarantees. There was no more than contemplation of the possibility and a statement of certain agreements that would be operative if and when, as a matter of separate and subsequent decision, the possibility became real. Clause 5.1 justified the Club's attitude that it was for Essington to arrange all funding without resort to the parties. Essington, moreover, recognised that reality at the time. Its early approaches to Mr Robinson of AFS were on the express basis, acknowledged by him in his letter of 16 December 1998 to the defendant, that neither Essington nor the Club would be providing guarantees. The early approaches to DMF were on the same basis. The defendant was fully aware that the Club would not give any guarantee and he cannot have had any well-based expectation that it would change its mind. This case is clearly distinguishable from one in which some past pattern of behaviour may ground an expectation of shareholder support: see for example ***Deputy Commissioner for Corporate Affairs v Caratti*** (1980) 5 ACLR 119, ***Flavel v Day*** (1984) 9 ACLR 502.

204 I should deal, at this point, with another submission advanced on behalf of the defendant. The submission was to the effect that the Club wrongfully or improperly failed to complete the transfer of Lot 29 to MRL in accordance with clauses 3.3 and 3.4 of the joint venture agreement; and that the Club thereby, in effect, denied to MRL borrowing capacity that it could have turned to account.

205 The evidence shows that some steps were taken towards implementation of clauses 3.3 and 3.4 in early 1999 with a view to completion of the transfer of Lot 29 to MRL by 31 May 1999 but that the transfer was never completed. The evidence also shows that the condition in clause 3.3 were never satisfied, which means that those steps were taken despite the agreement rather than in pursuance of it. Mr Hughes of counsel, who appeared for the defendant, pointed to some inconsistent statements in Club documents on the matter. He also referred to aspects of the evidence showing that Mr Mullarvey was party to such inconsistent statements. The reason for discontinuation of the steps to transfer the leasehold to MRL do not appear clearly. But it seems to me that they do not matter.

206 In obtaining the Leigh loan of $440,000, MRL was able to provide third party security given by the Club over the leasehold in the form of a specific mortgage without recourse – in other words, the lender was in a position where it could look to MRL for repayment and, in case of default, exercise mortgagee rights in respect of the Club's leasehold, but without any right of action against the Club for any deficiency. Had the property been owned by MRL, its borrowing capability would have been the same. As with the Leigh loan, a lender would have enjoyed a promise by MRL to pay and the right, in case of default, to resort to the leasehold property by way of exercise of the power of sale.

207 I deal next with another submission made on behalf of the defendant. Mr Hughes emphasised that, at and after a meeting on 16 May 1999 in Canberra between the defendant and Mr Joss (to be dealt with in some detail later), Mr Joss was aware of MRL's financial problems and wished to find a "practical solution". In late 1999, CJC informed NAB that it was not about to sue MRL for moneys due. Mr Joss accepted that this was said in the hope that it would persuade NAB to make facilities available to MRL so that CJC could be paid.

208 These matters are referred to as a basis for a submission, based on ***Re Kerisbeck Pty Ltd*** (1992) 10 ACLC 619, that the debts upon which ASIC relies were not, in reality, due. The thesis is that CJC, by acting as it did, extended the time for payment. The evidence does not support this. CJC's concern throughout was to protect its position. That may, at times, have entailed a willingness not to press for payment in the hope that something hastening payment would eventuate. But CJC at all times continued to assert, and in no way abandoned, its right to immediate payment.

209 It is also argued that the willingness of CJC to be patient if that seemed conducive to some positive outcome had an effect on the solvency position. But again, the evidence does not support a conclusion that the debts to CJC were ever the subject of any revision or new payment arrangement justifying a legal conclusion that they were not due and therefore a negative component of the solvency calculation.

210 Even allowing for the fullest recognition of the principle in ***Sandell v Porter*** (above), as understood in the light of ***Lewis v Doran*** (above), that an assessment of solvency pays attention not only to financial resources already held but also to those reasonably obtainable in a relatively short time, the clear conclusion must be that MRL was insolvent at the time it incurred each of the debts to CJC upon which ASIC relies. It had no reasonably accessible source of capital and no developed means of raising capital by prospectus or from the joint venture parties. Nor did it have saleable assets. The only way in which it could have obtained cash was by borrowing. For reasons I have stated, $600,000 must be regarded as fairly representing the maximum extent of MRL's borrowing capacity. The Leigh loan was for an extremely short term and on onerous terms. Its availability therefore really did nothing to enhance the availability of cash to meet other debts. By obtaining the Leigh loan and applying it towards satisfaction of the indebtedness to CJC, MRL merely substituted debt carrying a one month term for debt that was overdue. That did nothing to enhance solvency. Any remaining borrowing capacity of the order of $160,000 was quite inadequate in the circumstances.

211 My conclusion on the issue of solvency is that MRL was insolvent when, on 3 February 1999, CJC began work on the project and that it continued in a state of insolvency at all times thereafter.

The defendant's knowledge of commencement of work

212 In the light of the findings to this point, the next relevant inquiry is whether one of two conditions arising from s.588G(2) was satisfied: was the defendant aware at the time of the incurring of the relevant debts to CJC that there were grounds for suspecting that MRL was insolvent or would become insolvent by the incurring of the debts; or, alternatively, would a reasonable person in a like position in MRL's circumstances have been so aware? The first step in considering these matters is to look to aspects of the evidence directly involving the defendant.

213 Before the end of 1998, the defendant was aware that KCMS were providing project management services for the proposed construction and that CJC was likely to be the builder. He knew that Mr Jones and Mr McNamara were having discussions with CJC, including discussions about the proposed contract setting out the basis upon which CJC would undertake construction of the resort. These matters are clear from evidence given by the defendant himself.

214 The defendant said in cross-examination that he believed that he would have seen the draft prospectus of 2 December 1998. He considered it likely that he saw that draft in December 1998. He would thus have seen the statements in the draft prospectus to the effect that construction was programmed to commence in February 1999 and to be completed by December 1999, with demolition work beginning after close of the Club's existing resort at the end of January 1999.

215 The defendant accepted in cross-examination that he had seen the conditional offer of finance from DMF dated 15 December 1998. He confirmed his understanding at the time that this was an offer of development finance and that it was conditional. Furthermore, he appreciated that development finance would not be obtained in the absence of extension of the lease to 2088 and receipt of an acceptable valuation based on a lease to 2088.

216 At virtually the same time, the defendant was in contact with AFS and confirmed the understanding of Mr Robinson of that company that guarantees from Essington and the Club were not available to support borrowings by MRL. This is made clear by Mr Robinson's letter to the defendant dated 16 December 1998 which was acknowledged by the defendant's letter of 17 December 1998. The defendant maintained in evidence that he believed the Club was obliged by clause 5.3 of the joint venture agreement to provide guarantees. But he did not obtain any legal advice about that and any such understanding would have been inconsistent with the position he represented to Mr Branagan. The approaches to potential lenders at that time were consistent with an understanding that the Club would not be providing guarantees and could not be compelled to do so.

217 By 31 January 1999, therefore, the defendant was, on the evidence, in a position where he knew that construction finance was not readily and immediately available through either AFS or DMF and that any such finance was going to have to be obtained in a way that did not entail the giving of any guarantee by the Club. Furthermore, his knowledge, at that point, was also such that he appreciated the need for an extension of the lease term to 99 years and the need to be able to show some suitable take-out strategy to a financier. Indeed, his appreciation of the need to raise capital is evidenced by the fact that, under his auspices, steps towards the drafting of a prospectus were, by January 1999, already in train, although in somewhat embryonic form.

218 Against this background, I turn to the evidence about the defendant's knowledge of progress with CJC and the proposal that work should start on 3 February 1999. Plans in that direction became increasingly firm toward the end of 1998. According to Mr Joss' evidence, there had been a decision by early December that 3 February 1999 was to be the commencement date. On 8 December 1998, Mr Jones wrote to Mr Branagan that finance was required "to enable the builder to commence work on 3 February 1999". A CJC construction programme dated 8 December 1998 showed 3 February 1999 as the date on which CJC would take possession of the site. On 10 December 1998,

Mr Jones referred, in a letter to Mr Branagan, to a need for funding "through to July 1999" because "ASIC may take four to five months to approve the prospectus", thus implying that the funding requirement would crystallise four or five months before July 1999.

219 In early 1999, according to Mr Jones' evidence, he told the defendant that the Club had said that construction needed to be completed by December 1999 and "therefore needs to commence by February". He said he told the defendant this in the context of an inquiry regarding progress with funding. Mr Jones also explained to the defendant, according to Mr Jones' evidence, the importance of completion by December 1999 and how that completion date had been fixed. I quote from Mr Jones' cross-examination:

"*A. The position was quite clear. It was explained to Mr Edwards that if the contract did not complete by that December date, it would be delayed for at least 12 months.*

Q. The December date of 1999—

A. Yes.

Q. --was one that was arrived at in all these project control meetings before Murray River Pty Ltd was even operating as a joint venturer in relation to the project."

220 Later, referring to minutes of a project control meeting, cross-examination of Mr Jones continued as follows:

"*Q. And then, over on page 52, Knapman Clark table a report: 'On time. On budget. Construction to commence February 3, 1999.' See that?*

A. Yes.

Q. That was what the people in this committee were working towards assiduously, in the course of these meetings; correct?

A. Of course."

221 And later:

"*A. This committee had to use its best endeavours to achieve the programme that had been set out.*

Q. Set out by Mr McNamara?

A. No, not Mr McNamara alone. That's not correct.

Q. You and Mr McNamara?

A. Everyone who was on this committee. A date was chosen, as I think I mentioned yesterday, working back from December 1999, and this was the most appropriate date to start."

222 An article in the local newspaper, the "Border Mail", on 23 January 1999 headed "Million bricks to build resort" began: "*More than a million bricks will be used by Border contractor Colin Joss to build a $23 million resort in Mulwala.*

Work will start on February 4 on building a resort for the Mulwala Services Club that will include 142 units, a reception area and a pool.

The contents of the existing buildings will be auctioned on February 4 before the site is demolished.

When finished in December, the lakeside centre will be the largest tourist resort on the Murray River.

The resort, to be built on the former Capri Waters site, is a partnership between the club and the Essington Group."

223 The defendant saw this article on or before 27 January 1999. On that day, he appended to a copy of it a handwritten note to Mr Jones: "*LGJ for info. Have we got the valuation yet. MLE 27/1.*"

224 The defendant conceded in cross-examination that he had read this article in its entirety. He said that, at the time, he saw it as a "*marketing article*" and that, having seen it, he asked for a letter to be sent to Mr Joss and Mr Mullarvey "*to make certain that everybody knew there were no contracts*". He also said that he asked Mr Jones to make it clear to both those persons that nothing could commence until the contracts had been completed; and that he believed that Mr Jones had done this. In addition, the defendant said that he had had such a conversation himself with Mr Mullarvey "*at some stage in February*".

225 In an affidavit of 24 October 2004, the defendant deposed that he was told by Mr Jones in late February that CJC was on the site doing "*work for practice*". He also said that this was the first he knew of work having begun. Mr Jones agreed that there had been such a conversation. The defendant said that he first became aware of the matter when he overheard a conversation between Mr Jones and Mr McNamara. He explained the matter in cross-examination: "*They were talking about site clearance or site works and I asked in relation to what and one or other of them was saying that it was Mulwala and I said:* ***'Well you can't be dealing with that'*** *and I believe they just said that the club had allowed some preliminary site works to be carried out and I said:* ***'Well, we haven't got any contract with him''*** *and that was confirmed and I said:* ***''Well, the club's an idiot'.*** *That was the sort of, the context of the discussion. ... I said, you know, there's no contract and there's no obligation and the comment was made by Jones,* ***'Oh, he's building for practice'*** *and I said:* ***'Well, as long as it is not our obligation, because nothing has been transferred, there are no contracts'****, and that was confirmed.*"

226 Mr Jones, as I have said, confirmed having spoken with the defendant about CJC "building for practice". But it is clear that this description was not intended by him to convey the meaning that CJC was not entitled to reward. The defendant merely assumed that, because the land (leasehold) belonged to the Club, it would be to the Club that CJC would have to look for reward under what he assumed must have been an arrangement between the Club and CJC – an assumption which, in cross-examination, he eventually accepted to be "*an incorrect and stupid assumption*".

227 The defendant's initial evidence was thus that he had no advance knowledge that work was to start on 3 February 1999 and that he had found out about it by chance by overhearing the conversation some weeks later between Mr Jones and Mr McNamara that led on the **"building for practice"** understanding. The introduction into evidence of the newspaper article carrying his handwritten note to Mr Jones dated 27 January 1999 caused the defendant to give new and inconsistent evidence which, I am satisfied, makes unreliable his initial version and warrants a finding that he was aware on 27 January 1999 not only that work was to begin but that it was to be for the account of MRL.

228 The most significant matter underpinning this conclusion is the handwritten notation itself. If, as he sought to say, the defendant was alarmed by the prospect of work beginning without a contract and saw a pressing need to impress on Mr Joss and Mr Mullarvey the message that there was no contract (the implication being that the Club and CJC were at risk and should see themselves as being at risk), he would not have been content with merely sending the press article to Mr Jones "for info", with an apparently casual inquiry whether the valuation had been received. The defendant's assertions that, after seeing the article, he told Mr Jones to put Mr Joss and Mr Mullarvey appropriately on notice about the absence of a contract and actually spoke to Mr Mullarvey himself to that effect are quite inconsistent with the handwritten notation. They are also matters not mentioned in the defendant's affidavit evidence or in the evidence of Mr Jones, Mr Joss or Mr Mullarvey.

229 The substantive content of the handwritten note of 27 January 1999 was an inquiry by the defendant of Mr Jones as to progress with the valuation. The defendant knew that the valuation was important to the obtaining of finance. The inquiry was thus an inquiry concerned with the general issue of the availability of finance to MRL. Concern about (or interest in) that matter was consistent with an understanding and expectation on the defendant's part that MRL would have to pay for construction work which, as the article made clear, was about to begin.

230 Also telling against the version of events put forward by the defendant in this respect is a note to him from Mr Jones dated 29 January 1999, that is, two days after the defendant's note appended to the newspaper article asking whether the valuation had been received. Mr Jones said: "*I have this morning spoken to Alistair Male – valuer. He claims he was held up by the Water Administration Board. I am advising the Club and Builder of the delay due to documentation.*"

This does not in any way suggest that the defendant had sought to instil into Mr Jones the need to communicate to the builder and the Club the message he says he asked to be conveyed after reading the newspaper article. Mr Jones merely responded to the inquiry about progress with the valuation. He said nothing about the other matters which, on the defendant's version of events, had been raised with him by the defendant.

231 I am satisfied that the defendant was, at least from 27 January 1999, aware that CJC was to start work on 3 February 1999 for the account of MRL and that he took no steps either to prevent the commencement of work or to put it to the Club and CJC that the risks of embarking upon construction work (or even preparatory work) in the absence of a contract were to be theirs alone. His immediate and, I am satisfied, only reaction was to inquire as to the progress with the valuation that was important to the obtaining of finance. That reaction was consistent with his acceptance of the reality that, with the commencement of work imminent, MRL would need money with which to pay for that work.

232 In summary, therefore, I am satisfied that, as of late January 1999, the defendant was aware that CJC was about to start work and that MRL would be financially responsible for that work, which would be ongoing. His concern was to inquire after an element necessary to the obtaining of the necessary funding. He did not take steps to defer the commencement of work or to argue, on behalf of MRL, that the imminent work would not be for its account or that the contractor and the landowner were in any way at risk by reason of the commencement of work. The subsequent references to "building for practice" were, as the defendant well understood, no more than a shorthand way of referring to the fact that work had commenced before the execution of any contract.

The defendant's on-going knowledge

233 Mr Gamble of AFS gave evidence of having had a telephone conversation with the defendant in April 1999 in which the defendant said: "*We need immediate funds in order to meet the building costs already incurred ... We need to find some finance immediately in order to pay Colin Joss his first progress claim.*"

234 The defendant accepts that he saw the first drawdown certificate in April 1999, shortly before a MRL board meeting held on 13 April 1999 (in fact, minutes of two board meetings on that day are in evidence). Two things must have become clear to the defendant from that certificate: first, that CJC alleged the "Value of contract" to be $14,483,447; and, second, that work certified at $390,000 had been performed in the period to 27 February 1999. The drawdown certificate became the subject of discussion at the 13 April 1999 board meeting and the project control meeting on the same day. The defendant was cross-examined as follows:

"*Q. At the time you saw this drawdown certificate, you should have taken immediate steps, should you not, to have caused the work to come to a halt so that there was no possibility of any further obligation coming into existence - I withdraw that. You should have taken steps to prevent work continuing on the site, should you not, so that Murray River Pty Ltd would not be exposed to a claim made by Colin Joss and Company for any further work performed on the site?*

A. I agree with you had Murray River owned the land or had signed the contract with Colin Joss.

Q. You understood, didn't you, that regardless of whether the land had been transferred, if there was a contract between Murray River Pty Ltd and Colin Joss in respect to work performed on the site, that Murray River Pty Ltd would be liable under the contract to pay for that work, didn't you?

A. Yes.

Q. And that was a contract which was being put before you on 13 April 99, correct?

A. Yes.

Q. And it was pursuant to that contract that this drawdown certificate number 1 had been issued at or about 13 April 99 for work performed to 27 February 99, correct?

A. It - correct, pursuant to an unsigned contract.

Q. Even in the absence of making any inquiry at or about 13 April 1999, you expected at that point in time, didn't you, that in accordance with the building contract, that if work had been performed pursuant to that contract to 27 February 99, that the builder would have continued to perform work pursuant to that contract for the month of March 1999?

A. In hindsight, yes, but that is not what was put to me on the 13th of April 1999.

Q. But if you had thought about it for a moment on 13 April 99, you would have appreciated that fact, would you not?

A. Yes."

235 At and after 13 April 1999, therefore, the defendant knew that continuation of work by CJC entailed an increasing debt obligation.

236 The defendant accepted in cross-examination that he had also seen the second drawdown certificate. That certificate was dated 26 April 1999. The defendant said in cross-examination that he saw it in mid-May. The cross-examination continued: ***"McINERNEY:***

Q. The builder was paid in respect to the first drawdown certificate, correct?

A. Correct.

Q. And as at mid-May, there was no finance available to be drawn down to meet any payment which may have been required to have been made to the builder for work he had performed for the month of March 1999?

A. That is correct.

Q. And as at mid-May 99, there was no finance available to draw down to meet any obligation which Murray River Pty Ltd may have had to pay the builder for work performed for the month of April 1999, correct?

A. Correct.

Q. And you did not, did you, upon seeing the second drawdown certificate, take any legal advice, did you, as to what steps you ought to take to immediately prevent Murray River Pty Ltd permitting the builder carrying any work out on site, did you?

A. Yes.

Q. From whom did you take that advice?

A. Eakin McCaffery Cox.

Q. And was that advice taken before or after you went and saw Mr Joss down in Canberra?

A. Before.

Q. Did you take any steps to resign as a director following receipt of that advice?

A. No.

Q. Did you take any step under the contract to prevent Joss and Company carrying out further work on the site?

OBJECTION. OBJECTION WITHDRAWN.

HIS HONOUR:

Q. Answer the question.

A. Yes.

McINERNEY:

Q. What step do you say you took under the contract?

A. I went to Mr Joss and told him that I was surprised at the amount of work that had been done or that he had been allowed on the site and asked him to either slow or adjust the works until the financing was put in place.

Q. Did you understand my question, Mr Edwards?

A. I thought so, Mr McInerney.

Q. I was asking you whether you took any step under the contract, meaning did you take any advice as to your rights under the contract?

A. Yes.

Q. To bring the contract to an end?

A. Yes.

Q. What was that advice?

A. The advice was that I should try to come to an arrangement with Joss to cease, or whatever word is appropriate, before the contract would open the company up to a substantial claim, I forget the words, which he could claim for the whole contract, save for a mitigation against what he hadn't had to pay out. I can't remember the exact words at the time.

Q. Did you take any advice from Eakin McCaffery Cox or anyone else as to whether an administrator should be appointed as at mid May 1999?

A. Yes, I discussed that with Mr Joss who certainly didn't want any administration and since everyone involved with the company knew its position, it wasn't as though we were trading to the lack of knowledge of others.

HIS HONOUR:

Q. Your answer to the question did you take advice was that you took advice from Mr Joss; is that correct.

A. Yes, your Honour."

237 The defendant sought to say that, while he was aware that continuation of work by CJC entailed an increasing debt obligation, he did not see that obligation as an obligation of MRL, at least before action was taken by Mr Jones on 3 May 1999 to execute a copy of the building contract for MRL. He says that he regarded any obligation in respect of earlier work as an obligation of the Club because the work was being done on the Club's land and MRL had not become party to any contract with CJC. He further said that he was torn between two courses of action: first, stepping in and putting a stop to the work being done by CJC; and, second, arranging for MRL to obtain the funds it eventually borrowed from Leigh and to apply those MRL funds in satisfaction of the first progress payment, thus "keeping faith" with the Club and the joint venture.

238 I do not accept this version. The minutes of two meetings of directors of MRL on 13 April 1999 show that the directors determined that the building contract should be executed (subject to "KCMS approval" of certain matters) and concerned themselves with the obtaining of finance in two tranches, one of $444,000 and the other of $1,400,000. The next day, 14 April 1999, the defendant received a letter of offer from AFS in relation to the advance of $444,000 the purpose of which was stated to be: *"To make progress payment to Colin Joss & Co Pty Ltd in the amount of $390,000.00 and associated fees with the advance."*

239 There is no record of the defendant having said at the board meeting that MRL was not obliged to make the first progress payment. He was, at the time, party to efforts to raise funds to enable MRL to make the payment. Had he been of the opinion that MRL was under no obligation but that it might (or would) be in MRL's interests to meet the payment in any event, he would, as a responsible director, have raised those matters with his co-directors and sought approval of the strategy to outlay MRL funds in the absence of any liability and for the purpose of "keeping faith" with the Club and the joint venture. He raised no such matter with the board. I am satisfied that his failure to do so supports a finding that he did not, at the time, hold the views he described in his evidence. As at 13 April 1999, he accepted that MRL was obliged to meet the first progress payment and was engaged in efforts to raise the necessary funds. And that remained his state of mind into the future.

The Canberra meeting and surrounding events

240 As already mentioned, Mr Joss and the defendant met on 16 May 1999. Mr Joss was in Canberra for a conference. The defendant went there by arrangement for a discussion with him. The meeting was instigated by the defendant.

241 The defendant says that he asked Mr Joss to slow the project down. Mr Joss accepts that such a request or suggestion was made. Mr Joss said in cross-examination:

"Q. So does all of the evidence you have just given in that last answer or two constrain you to agree with what I am putting to you which is that as at 16 May 1999, you were of the view that this project was moving forward and had such a head of steam up, it had to keep going?

A. Yes. Unless we were told otherwise.

Q. Do you say Mr Edwards said something about slowing the job down?

A. Correct.

Q. What did you understand when he said something to you about slowing the job down, if that is what he said?

A. Well, if he wanted us to stop the job, he could have stopped the job, but you can't slow it down. I mean, we had - there was no way you could slow it down. I guess you could stop it but that's - I mean what do you slow down? How do you slow a job down? You either stop it or you keep it going.

Q. Well, I suppose, Mr Joss, that you could do things at a rather more leisurely pace?

A. Yes, and then be late on delivery.

Q. Was that the performance bond issue?

A. No, the liquidated damage issue.

Q. Well, did you say anything to him about that in that conversation, 'No, Mr Edwards we can't possibly slow the job down because that would put us in the gun for a late issue'?

A. Well, Malcolm Edwards has been around. He would know that.

Q. He has been around. You had only met him for the very first time this day?

A. By this time we had a fair clue on what they were - on who we were dealing with.

Q. You never said to him, 'Look, we can't slow this job down, Mr Edwards', because of any reasons that you wanted to advance, did you, because you were fully committed to this moving forward to meet what you understood to be everyone's required deadline, December 1999?

A. Contracted deadline.

Q. Mmm?

A. Our contracted deadline.

Q. No contract - you were fully committed to move this project forward, there was nothing to stop you saying to Mr Edwards, 'Look, Mr Edwards, there is a problem slowing this down for me and the problem is this'; you didn't say that, did you? You assumed he had been around a long time?

A. No, it was discussed to slow the job down and I explained to him we didn't - we weren't able to slow it down. We could stop it, but we can't slow it down.

Q. And it was apparent—

A. So am I going to send half the concreters away and half the bricklayers away and half the electricians away? I mean, you are either - you either stop it or you keep it going.

Q. It is a very compelling argument as you make it now but you didn't seek to make it in front of Mr Edwards at the time, did you?

A. We would - we did discuss for a short period of time slowing the project down.

Q. And the reason - and it was he who raised it, so you say in your affidavit?

A. Correct.

Q. Wasn't it? And the reason, and you well understood it—

A. Well, if he was so concerned—

Q. Would you let me finish, please, my question? The reason that he was raising it, and you well understood it at the time, was that he was concerned about debts of the company being further racked up? A. Well, why didn't he say, 'Stop the job. I can't pay you'? Why didn't he say that and give it to us in writing so that then we have got something to stop the job.

Q. You understood when he was asking you to slow it down that there must have been a reason for that, didn't you?

A. You bet.

Q. And it was pretty obvious what the reason was, wasn't it?

A. I - I would have to say it was financial.

Q. Yeah.

A. But then he promised to pay us on the 25th of May and everything was going to be cosy and rosy after that. So if he was prepared to state that he wants to pay us on 25 May, why on the 16th is he telling us to slow it down."

242 It is clear from this that the defendant canvassed with Mr Joss the possibility of slowing the pace of work but never asked that work cease. Mr Joss made it clear in his evidence that, if he had been asked to stop work, he would have done so. The defendant had obviously come to realise, some time before 16 May 1999 that his hopes of raising finance were misplaced.

243 From Mr Joss's viewpoint, the most important topic discussed at the meeting was when overdue payments would be made. The defendant said that he expected a payment could be made on or about 24 or 25 May 1999. That was confirmed in the defendant's letter of 23 May 1999 to Mr Joss. That letter identified as the defendant's "concern", from the perspective of the Canberra meeting, "*the order of works that had been carried out prior to the execution of the building contract*". The same line was taken by the defendant in a memorandum of 26 May 1999 to Mr Jones which reads in part as follows: "*You will readily understand how I have stewed since the revaluation [sic] in the meeting with you and Ken on 15th May (in preparation for my meeting with Joss where I believed there was no contract until the lender enforced execution) that with or on your authority KCMS had accepted the builders quote before Joss entered the site, prior to title passing from the club to Murray River. I accepted for weeks the comment that, as you informed Mullarvey, he is working for practice. I could not understand the stupidity of Joss or the Club allow work to commence without a contract. Len, I can't believe my own stupidity to have relied on non-specific comment.*"

244 Mr Jones gave evidence that, in sending this memorandum, the defendant was actuated by a decision that "it was time he moved to protect himself". I am satisfied that that was the defendant's purpose in writing the memorandum. I have already found that the defendant was aware from late January 1999 that work was to start on 3 February 1999. I have also found that, at least from 13 April 1999, he was aware that work had in fact begun as planned without any contract having been executed. That being so, there is no objective reason why he should have chosen to write a memorandum to Mr Jones on the matter more than a month later. Taken as a whole, the memorandum does not show itself to have any substantial purpose apart from communication of the quoted extract. Given the close proximity in which the defendant and Mr Jones worked and the fact that they saw one another several times a day, the memorandum must be accepted as having been brought into existence for a purpose other than communication of its content by the defendant to Mr Jones. I accept that the defendant created it in an attempt to protect himself in case of later scrutiny of his actions.

245 It is relevant to mention, in this context, two events that had happened earlier in May 1999. On 3 May, Mr Joss telephoned the defendant and asked, "Where is my money?" The defendant replied that the money would be in CJC's bank account "tomorrow" and that AFS was being "very pedantic with the documentation". On 13 May, Mr Reid of CJC sent to KCMS a letter which has already been noticed (see paragraph [46] above). That letter set out a full catalogue of events from 19 November 1998 to 13 May 1999 concerning the proposed contract and payment obligations in respect of work done, as CJC saw them. A handwritten note placed by Mr Reid on the original put through the fax machine shows that he confirmed with "Pat from Essingtons" at 12.40pm that "ME, LJ and KMc" (obviously the defendant, Mr Jones and Mr McNamara) had received copies of the letter.

246 Neither in the 3 May telephone conversation with Mr Joss nor in response to the copy of the 13 May version of events as seen by CJC did the defendant seek to say that CJC should not have started work on 3 February 1999 or that CJC could not or should not look to MRL for payment for work done. This is added confirmation that his complaint to Mr Jones in the memorandum of 26 May 1999 was written for the self-protecting purpose to which Mr Jones referred in his evidence.

The s.588G(1) elements

247 I pause at this point to consider the position that has been reached in relation to the elements referred to in s.588G(1).

248 I have found that debts were incurred by MRL in the amounts and at the times for which ASIC contends: see paragraph [16] above. It is not disputed that the defendant was a director of MRL at each of those times: see paragraph [9]. I have also found that MRL was insolvent at each of those times: see paragraph [211] above. The apparently constructive attitude of CJC from 16 May 1999 to seeking a solution to MRL's financial problems did not affect matters relevant to the second and third of these findings. The requirement that the time of incurring of the debt be after the commencement of the **Corporations Act** is met by the effect of transitional provisions: see paragraph [4] above. These findings combine to supply all the elements contemplated by paragraphs (a), (b) and (d) of s.588G(1). It remains to consider the question posed by paragraph (c), that is, whether, at the time of the incurring of the debt (or, as here, each debt), there were *"reasonable grounds for suspecting"* that the company was insolvent or would become insolvent by incurring the debt.

249 The inquiry relevant to s.588G(1)(c) is not an inquiry concerning the particular director whose conduct is under scrutiny. It is an inquiry into the objectively formed state of mind of a person of ordinary competence. These propositions are supported by cases such as ***3M Australia Pty Ltd v Kemish*** (1986) 10 ACLR 371 and ***Metropolitan Fire Systems Pty Ltd v Miller*** (1997) 23 ACSR 699. As Einfeld J observed in the latter case (at p.703) questions of the particular director's knowledge of and participation in the incurring of the debt play no part in this aspect of the s.588G inquiry.

250 The central word in s.588G(1)(c) is "suspecting". The criterion is one of suspicion, which is something less developed and less well formulated than expectation. The matter was explained by Kitto J in ***Queensland Bacon Pty Ltd v Rees*** (1966) 115 CLR 266 (at p.303) in this way: *"In the first place, the precise force of the word **"suspect"** needs to be noticed. A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to **'a slight opinion, but without sufficient evidence'**, as Chambers's Dictionary expresses it. Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence. The notion which **'reason to suspect'** expresses in sub-s. (4) is, I think, of something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear that the situation of the payer is in actual fact that which the sub-section describes--a mistrust of the payer's ability to pay his debts as they become due and of the effect which acceptance of the payment would have as between the payee and the other creditors."*

251 I am of the opinion that the "reasonable grounds for suspecting" element, with respect to the insolvency of MRL, existed in the circumstances of this case. A director of ordinary competence, viewing objectively the whole of the circumstances of MRL at the time of the incurring of each of the quantum meruit debts, would have had no real idea at all where the necessary money would be found. There would have been, at the least, a suspicion that MRL was unable to pay its debts. The suspicion would have been so strong as to represent near certainty. Section 588G(1)(c) is therefore satisfied.

252 I accordingly record my finding that all of the elements that s.588G(1) makes necessary in order to cause s.588G to apply exist in this case.

The s.588G(2) elements

253 The thing which, in terms of s.588G(2), constitutes contravention is a default rather than an act. A person contravenes by "failing to prevent the company from incurring the debt". This form of words does not imply that contravention can occur only if the particular director possesses a capacity, acting alone, to deflect the company from the particular course of action. I quote from the judgment of Ormiston J in ***Morley v Statewide Tobacco Services Ltd*** [1993] 1 VR 423 (at p.439): *"If a director were entitled to rest supinely and protest that he could not act without the concurrence of one or more of his colleagues when he knew that the company was in fact insolvent, then the section would have little practical purpose. It would be wrong if the word 'authority' were so narrowly construed and the director was not in those circumstances obliged to take all steps practicable to prevent the company from trading while insolvent. The fact that often a single director may be unable to prevent the authorised person contracting a debt is irrelevant. If he is unable to persuade his fellow directors to withdraw that authority when the company is insolvent, he should seek to have the company wound up or resign. If each director took account of his obligations the company would soon cease trading."*

254 The same approach was taken by Mandie J in ***Australian Securities and Investments Commission v Plymin*** (2003) 46 ACSR 126 (at p.221): *"What of an individual director? I do not think that the requirement that a director must have failed to prevent the company from incurring the debt means that it must be shown that the individual director had the power by himself to prevent either the incurring of each debt or, more realistically in the present context, to prevent Water Wheel's continuing to trade. By analogy with the previous law and the reasoning referred to above, inactivity or the failure to attempt to prevent the company from trading or incurring the debt will be sufficient to constitute a failure to prevent the company from incurring the debt within the meaning of s 588G(2)."*

255 Mandie J went on to support that conclusion by reference to other parts of s.588G (at p.221): *"This analysis is in my view supported by the existence of the particular defences expressly provided for by s 588H(4) and (5). Section 588H(4) provides that it is a defence if it is proved that 'because of illness or for some other good reason', the director did not take part at the relevant time in the management of the company. Section 588H(5) provides that it is a defence, if it is proved that the director 'took all reasonable steps to prevent the company from incurring the debt'. In that regard*

I note that s 588H(6) provides that the matters to which regard is to be had in determining whether the director took all reasonable steps are to include any action a director took with a view to appointing an administrator of the company, when that action was taken and the results of that action. This latter provision suggests what the legislature had in mind in relation to the kind of steps which an individual director might take in any attempt to prevent a company from incurring a debt or debts. The constructional effect of providing for these defences is, it seems to me, that the legislation, read as a whole, treats a director, or at least an inactive or acquiescent director, as having failed to prevent the incurring of a debt unless the director satisfies the onus of proving one or more of the matters referred to in those sections. Put another way, the language in which these defences is couched depicts the obverse of a failure to prevent the company from incurring a debt."

256 In the present case, the defendant did not, as a practical matter, work as part of a board of directors in the matter of raising finance. Not only the Club and those of its directors who were members of the MRL board (plus Mr Mullarvey), but also Mr Jones, deferred to the defendant in that area. In fact, all of them deferred to the defendant more generally. The Club personnel did not profess any particular commercial skills. They were certainly not skilled or experienced in matters of property development. In their minds, Essington brought those skills to the joint venture. And within Essington, it is clear that the defendant was, in a practical sense, superior to Mr Jones who in many ways did the bidding of the defendant or carried through plans he had developed. Mr Jones gave evidence that the defendant preferred to appear to be in the background even though he was active. While allowing Mr Jones to appear to be the active party, the defendant was busy behind the scenes, even to the extent of correcting and re-writing Mr Jones' letters.

257 In the particular factual circumstances, the defendant could, at any time, have stepped in and required that building work cease. He could also have stepped in to ensure that it did not commence in the first place. Had he taken such a step (citing lack of financial capacity as the reason), it is virtually certain that the other directors of MRL would have accepted his intervention and even welcomed it. He, as they saw him, was the commercial and financial expert and his view on matters of financial prudence would have been accepted virtually as a matter of course. Had he said that the desired timetable dependent upon work starting on 3 February 1998 was not commercially feasible and would have to be revised because funding was not yet in place, his view would have prevailed. If, after work had started, he had said that it should stop because MRL could not afford it, again his view would have prevailed.

258 The defendant never warned his co-directors of the reality that MRL did not have the funds with which to undertake the project. The message he communicated, both directly and through Mr Jones, was always that the various elements necessary to secure the necessary funding were within grasp. It was always just a matter of a short time until all would be well.

259 The defendant had, at all material times, ample ability to cause MRL to avoid incurring the relevant debts by ensuring that building work was not undertaken. He did not exercise that ability. He therefore failed to prevent MRL from incurring the quantum meruit debts generated by the performance of the building work.

260 The remaining issue under s.588G(2) is whether paragraph (a) or paragraph (b) is satisfied – in other words, was the defendant aware, at the time of the incurring of each debt, that there were reasonable grounds for suspecting that MRL was insolvent; or would a reasonable person in a like position in a company have been so aware?

261 Each of these questions must be answered in the affirmative. As to the defendant's own awareness, the findings already made leave no doubt that he knew all the facts contributing inexorably to an objectively based mistrust, at each material time, as to the ability of MRL to pay all its debts as they fell due. As to the view of a reasonable person in a like position, there is no reason to think that such a person would not have shared the objectively based mistrust that was in fact in the mind of the defendant.

Conclusion on s.588G

262 All the elements which, in combination, must exist in order to justify, by reference to ss.588G(1) and 588G(2), a conclusion of contravention of s.588G have been shown to exist in relation to the incurring of each of the debts upon which ASIC relies. I therefore conclude that the defendant contravened s.588G by failing to prevent MRL incurring each of those debts, subject to any defence that may be made available by s.588H.

Matters by way of defence

263 In referring as I have to the availability of any defence under s.588H, I intend to refer to only some of the matters raised by the defendant as set out in paragraph [18] above. I have already said that the defendant's case did not seek to make good several of those matters, with the result that the only items in the list relied upon were (a), (d), (e), (f) and (g), as explained and supplemented by items (i) to (x) set out in paragraph [20] above.

264 In relation to insolvency of the company at the time of the incurring of the relevant debt, the necessary ingredients of contravention are, first, a finding that the company was insolvent when the debt was incurred (or would become insolvent by incurring it); second, that there were, at that time, reasonable grounds for suspecting that the company was insolvent (or would become so); and, third, that the person alleged to have contravened was, at that time, aware that there were reasonable grounds for suspecting insolvency. I have made positive findings adverse to the defendant on all those matters.

265 The only aspect of s.588H that the defendant makes any real attempt to advance by way of defence is s.588H(2). There is reference in the materials to reliance upon s.588H(3) but the evidence provides no basis for this. The only person upon whom the defendant could conceivably seek to say that he relied, in the s.588H(3) sense, is Mr Jones. But any such argument would fail at the threshold. It was the defendant, not Mr Jones, who was principally involved

in developing plans to raise finance for MRL. The defendant could not possibly have believed, or had any grounds to believe, that Mr Jones was in any way "responsible" for providing to him adequate information about MRL's financial position. Under the joint venture, it was Essington that had the task of arranging finance for the project being pursued through MRL. And within Essington, it was the defendant, not Mr Jones, who played the leading role in relation to financing and MRL's financial needs.

266 In relation to s.588H(2), it is the task of the defendant to prove that, at the time of the incurring of each relevant debt, he had reasonable grounds to expect, and did expect, that MRL was solvent at that time and would remain so even if it incurred the debt. The defendant has attempted to discharge that onus by pointing to the observations in **Lewis v Doran** (above) that the company "own moneys" do not mark the limits of the resources to which regard may be had in determining solvency, coupled with what he chose to regard as the right of MRL to obtain financial support from the Club under clauses 5.2 and 5.3 and clauses 3.3 and 3.4 of the joint venture agreement. For reasons I have already expressed (see paragraphs [202] to [206] above), those clauses could not have been the source of any well-based objective view as to the existence of any financing obligation of the Club. To the extent that the defendant may in fact have held any such view (and I am not satisfied that he did), it was not of such a quality as to represent any reasonable ground of expectation of the kind with which s.588H(2) is concerned.

267 Before leaving matters of defence, I must refer to submissions advanced on behalf of the defendant which put much store by the proposition that the Club was, at all material times, a "shadow director" of MRL – that the Club "called a tune" that was "danced to" by Messrs Hargreaves, Tait and Nieuwenhout who were directors of both the Club and MRL and made up of a majority on the MRL board. It follows, on this thesis, that it was the unseen hand of the Club in the affairs of MRL that was the real force in everything that MRL did. The thesis is supported by various references in the documentary evidence to decisions of the Club's board as to how the three persons should act as directors of MRL.

268 The first thing to be said about this is that, on the evidence, Messrs Hargreaves, Tait and Nieuwenhout were rarely active as directors of MRL except in purely formal ways. To the extent that they were parties to substantive decisions, the relevant resolutions were apparently unanimous. There is accordingly no evidence that they, as a group, imposed the will of some external party in the person of the Club.

269 Second, the "shadow director" submission is made in support of the proposition that the Club wrongfully denied to MRL financial resources (in the form of a guarantee by the Club and transfer of Lot 29) that it was bound by the joint venture agreement to provide. For reasons I have already stated, the Club was not under any such contractual duty. The "shadow director" argument therefore leads nowhere at that level.

270 Third and fundamentally, however, how would the defendant's position have been different if the Club had been a "shadow director" and (to take up another item in the defendant's submissions) had acted in a way that was contrary to the interests of MRL? Those circumstances, if they had existed, would not have relaxed or modified the defendant's duties in the matter of insolvent trading. If the reality had been that the Club was deliberately and wrongfully starving MRL of funds that it should have been providing, that would have been something that the defendant was bound to take into account in determining his own conduct. It would have sharpened his duty to take such action as he properly could to prevent the incurring of the debts in question. At a substantive level, therefore, the "shadow director" allegation, even if made out, would not avail the defendant.

271 The defendant has not made good any defence available under s.588H. Nor has he made good the sweeping assertion quoted at subparagraph (x) of paragraph [20] above.

Conclusion

272 In the result, therefore, I am satisfied that the defendant contravened s.588G(2) in that he did not prevent the incurring by MRL of each of the several debts referred to at paragraph [16] above. The court is therefore required by s.1317E(1) to make a declaration of contravention in respect of each contravention. I direct that, within 21 days, appropriate forms of declaration complying with s.1317E(2) be drawn up by ASIC, submitted to the defendant for comment and delivered to my Associate together with such comments as the defendant may have made. I shall then make the declarations in chambers, unless either party wishes to be heard on any matter going to their form.

273 For reasons given by the Court of Appeal in ***Forge v Australian Securities and Investments Commission*** (2004) 52 ACSR 1, there must be a separate hearing on penalty. That hearing will be appointed in due course. ASIC has already indicated that it will seek a disqualification order under s.206C(1) but will not seek the imposition of any pecuniary penalty under s.1317G(1). The separate hearing will be the appropriate occasion for any submissions there may be as to the exercise of the dispensing powers of the court under ss.1317S and 1318, assuming that the defendant wishes to press those matters.

Mr A.J. McInerney – Plaintiff Instructed by Australian Securities and Investments Commission Solicitor
Mr T.D.F. Hughes – Defendant Instructed by Phillip R. Loiterton