

## **CHAPTER 2**

### **TERM OF REFERENCE 1.10**

#### **NATURAL GAS SALES AGREEMENTS**

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#### **HALLS HEAD DEVELOPMENT**

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## **5.1 The term of reference**

5.1.1 The Commissioners are required by their Commission, as affected by the *Royal Commission into Commercial Activities of Government Act 1992*, to inquire and report whether there has been —

- (a) corruption;
- (b) illegal conduct; or
- (c) improper conduct,

by any person or corporation in the affairs, investment decisions and business dealings of the Government of Western Australia or its agencies, instrumentalities and corporations in respect of the involvement of the Government Employees Superannuation Board (formerly the Superannuation Board) in the Halls Head development and further to report whether —

- (d) any matter should be referred to an appropriate authority with a view to the institution of criminal proceedings; or
- (e) changes in the law of the State, or in administrative or decision making procedures, are necessary or desirable in the public interest.

## **5.2 Statutory background**

5.2.1 The Superannuation Board ("the Board") was constituted under the *Superannuation and Family Benefits Act 1938*. The Board consisted of three members appointed by the Governor: section 9(1). Section 9(2) required that one of the members be a "contributor" elected by contributors. In general, contributors were, persons employed in a permanent capacity by the State in any department who were, by the terms of their employment, required to give their whole time to the duties of their employment. Section 9(3) required the Governor to appoint one of the members of the Board to be the Chairman. No person was eligible to be a member of the Board or to continue as a member after attaining the age of 65 years: section 9(4). Subject to that age restriction, the members of the Board could be appointed for any period not

exceeding seven years, and every member was eligible for re-appointment: section 10(1). Where a member of the Board died or otherwise vacated office, the Governor could, subject to certain restrictions, appoint a person eligible to be a member of the Board to fill the vacancy: section 11.

5.2.2 Section 15 required the Chairman of the Board to preside at its meetings, and conferred on the Chairman a deliberative vote. The Chairman and the other members of the Board were paid such remuneration as the Governor from time to time determined: section 16. By section 17, two members of the Board constituted a quorum for the purpose of transacting the business of any meeting of which notice had been given to all the members. Where the voting on any question was equal, the question had to be postponed until the next meeting of the Board, and notice of the question and of the fact that the voting was equal had to be given in the notice calling the next meeting: section 18(1). If the voting at the next meeting was again equal, the question had to be postponed to a full meeting of the Board: section 18(2).

5.2.3 By section 19(1), the Board was constituted as a body corporate called "The Superannuation Board" with perpetual succession and a common seal. Section 19(2) prohibited the seal of the Board from being attached or affixed to any document except on resolution of the Board, and required that the seal be authenticated by the signatures of two members of the Board. Section 20 permitted the Board, by resolution under seal, to authorise the Chairman to determine such matters as were specified in the resolution. Section 20 also authorised the Board at any time in like manner to revoke such authority. The staff of the Board were appointed under, and were subject to the provisions of, the *Public Service Act 1904*, and included a secretary: section 21.

5.2.4 Prior to 1 July 1984, the cost of the administration of the Act had to be paid out of moneys appropriated from time to time by the Parliament for the purpose. Those moneys, and the accounts in connection therewith, had to be kept as part of the public accounts separately from the moneys and accounts of the Superannuation Fund. After 1 July 1984, the cost of the administration of the Act had to be paid out of the Fund: section 22 and amending Act *No 30 of 1984*.

5.2.5 Prior to 1 July 1986, it was necessary for the Board in each year to submit to the Minister to be laid before both Houses of the Parliament, a report dealing with the general administration and working of the Act. After that date, the provisions of the *Financial Administration and Audit Act 1985* regulating the financial

administration, audit and reporting of statutory authorities applied to and in respect of the Board and its operations: section 23 and the *Acts Amendment (Financial Administration and Audit) Act 1985*.

5.2.6 Section 24(1) required that, for the purposes of the Act, there be a fund, to be called "The Superannuation Fund", which had to be kept at the Treasury and administered by the Board. Section 24(1) further provided that the contributions of employees who became contributors or qualified contributors, and payments by the State under the Act, and any "employer" payments made on behalf of the State for the purposes of the Act, had to be paid into the Fund. Section 24(1) also provided that the benefits provided for in the Act were to be paid out of the Fund. By section 24(2), income derived from the investment of the Fund formed part of the Fund. The income of the Fund was not subject to taxation by the State: section 24(3).

5.2.7 Section 25(1) enumerated the investment powers of the Board. Section 25(1) provided:

"(1) The Fund may and shall, as far as practicable, but subject to subsection (2) of this section, be invested in investments of the following kinds, that is to say —

- (a) any investments which are from time to time authorised by any Act of the State for the investment of trust funds; and
- (aa) loans secured by mortgages of estates in fee simple; and
- (b) any debentures or other securities issued or given by any corporate body constituted or established by any law of the Commonwealth of Australia or of any State in the said Commonwealth which authorises the issue of such debentures or the giving of such other securities, and provides that the said debentures or other securities are guaranteed by the Government of the Commonwealth or of the State, as the case may be, under the laws whereof the said debentures are issued or the

said other securities are given as aforesaid; and

- (c) the acquisition or taking on lease of any land and the construction of buildings and effects or other improvements thereon; and
- (d) the acquisition from the Government Employees' Housing Authority established under the *Government Employees' Housing Act, 1964* of land upon which are erected houses as defined in that Act, upon such terms and conditions as the Board and that Authority, as they are hereby authorised to do, in writing agree upon."

5.2.8 Section 25(2) of the Act provided:

"(2) The Board shall not invest the Fund or any portion thereof in any investment of any kind whatever without the consent of the Treasurer being first obtained."

5.2.9 Section 25(4) empowered the Board to sell, alienate, mortgage, charge and lease any land acquired or leased by it under section 25(1)(c).

5.2.10 Moneys in the Fund held uninvested could be lodged at call with any bank approved by the Minister, and while in any bank were to be held to be moneys of the Crown: section 26.

5.2.11 Section 29 empowered the Board to borrow for, and the Treasurer to lend to, the Fund moneys not exceeding two-thirds of the amount of, and on the security of, moneys of the Fund invested in securities of the Commonwealth and in securities of the State.

5.2.12 Section 16(1) of the *Trustees Act 1962* prescribed the manner in which a trustee could invest trust funds. Section 16(1)(n) provided:

"(1) A trustee may invest any trust funds in his hands, whether at the time in a state of investment or not, in

any investments authorised by the instrument (if any) creating the trust for the investment of money subject to the trust, or in the manner following, that is to say —

...

- (n) subject to the provisions of sub-sections (5), (6), (7) and (8) of this section, in the units, or other shares of the investments subject to the trust, of a unit trust scheme in respect of which there is in existence at the time of investment an approved deed under any law of the State relating to Companies;"

5.2.13 Sub-sections (5), (6), (7) and (8) of section 16 provided:

"(5) A trustee who proposes to make any investment under the power conferred by paragraph ... (n) of sub-section (1) of this section shall first obtain and consider proper advice in writing on the question whether the investment is satisfactory having regard —

- (a) to the need for ensuring that investments of the trust are, so far as circumstances allow, sufficiently diversified in respect of the descriptions of investment and, where diversification within a particular description would be prudent, in respect of the investments within that description;
- (b) to the suitability to the trust of investments of the description of investments proposed and of the investment proposed as an investment of that description.

(6) A trustee who retains any investment made under the power conferred by paragraph ... (n) of sub-section (1) of this section shall determine at what intervals the circumstances and in particular the nature of the investment make it desirable to obtain the advice mentioned in sub-section (5) of this section, and shall obtain and consider that advice accordingly.

- (7) For the purposes of sub-sections (5) and (6) of this section, proper advice is the advice of a person who is reasonably believed by the trustee to be qualified by his ability in and practical experience of financial matters; and that advice may be given notwithstanding that the person gives it in the course of his employment as an officer or servant.
- (8) Sub-sections (5) and (6) of this section do not apply to one of two or more trustees where he is the person giving the advice required by this section to his co-trustee or co-trustees, and do not apply where powers of a trustee are lawfully exercised by an officer or servant competent under sub-section (7) of this section to give proper advice."

### **5.3 The composition of the Board at material times**

5.3.1 At material times prior to 30 June 1987, when the *Government Employees Superannuation Act 1987* came into force, membership of the Board was as follows:

Mr Dennis Barton	13 April 1977 to 30 June 1983 (part-time Deputy Chairman from 24 March 1981 to 13 March 1982 and part-time Chairman from 13 March 1982 to 30 June 1983)
Mr Richard Yorg	29 March 1982 to 28 March 1985 (Director of Board from 29 March 1982 to 24 July 1984)
Mr Harry Jarman	20 July 1983 to 24 July 1984 (part-time Chairman)
Mr Leonard Brush	24 July 1984 to 13 March 1987 (full-time Chairman until 24 November 1986, and part-time Chairman from 25 November 1986 to 13 March 1987)
Mr Tony Lloyd	19 March 1987 to 30 June 1987 (Chairman from 19 March 1987)

Mr Barry Markey 29 October 1981 to 30 June 1987

Mrs Winifred Scott 21 May 1985 to 12 July 1986

Although section 9(1) of the *Superannuation and Family Benefits Act 1938* required a Board of three members, no appointment was made to fill the vacancy created by Mrs Scott's resignation on 12 July 1986. The Board proceeded with only two members in office until it was replaced by the Government Employees Superannuation Board ("GESB") on 1 July 1987.

Between 1 July 1987 and 30 June 1989, membership of GESB was follows:

Mr Lloyd 1 July 1987 to 31 December 1987 (part-time Chairman)

Mr William Rolston 1 July 1987 onwards (Chairman from 1 January 1988)

Mr Markey 1 July 1987 to 31 December 1987

Mr Marwood Kingsmill 1 July 1987 onwards

Mr Michael Helm 14 October 1987 onwards

Mr Kevin Edwards 1 January 1988 to October 1988

Mr Ossie Mansfield 10 June 1988 onwards

Mr James McGinty 10 June 1988 onwards

Mr Owen Middleton 10 June 1988 onwards

Mr William Heron 4 October 1988 onwards

5.3.2 When the Board agreed to purchase a 50% interest in the Halls Head development, the Board comprised Mr Barton, Mr Yorg and Mr Markey. When the Board agreed to sell that interest, the Board comprised Mr Brush and Mr Markey.

5.3.3 Mr Brian Neville commenced employment with the Board in November 1964. He remained with the Board for more than 20 years. Mr Neville was originally employed as a clerk. He was subsequently promoted from time to time. Between 11 November 1981 and 24 November 1986, he was the Board's Investment Manager. He was seconded to Fundscorp Australia, a division of the West Australian Development Corporation, as its Senior Investment Officer, on 24 November 1986. Mr Neville occupied that position until 16 September 1988. He was involved with the Halls Head development not only while he was the Investment Manager of the Board, but also while employed by Fundscorp Australia. At all material times, Mr Neville was an associate of the Australian Society of Accountants.

5.3.4 Mr Neville's duties as Investment Manager of the Board were to review and report to the Chairman on all aspects of the Board's investments, including management, research and performance. He also supervised the activities of the Investment Section of the Board, and represented the Board in relation to development projects. Further, Mr Neville was a member of the Board's Share Committee, and he liaised with professional advisers and consultants in connection with all investment matters.

5.3.5 In April 1988, Mr Brush and Mr Robert Martin were presented for trial in the District Court of Western Australia on charges of corruption, forgery and uttering. Mr Neville gave evidence at the trial as to his working relationship with Mr Brush, as follows:

Q: Would you agree with me that when Mr Brush became the Chairman your relationship with him was a very good working relationship?

A: It didn't start off that way ...

Q: ... but very shortly afterwards you and he had an excellent working relationship?

A: Correct.

Q: Was it true that Mr Brush implemented a policy, with you as the investment adviser, that any proposal made to the Board had to be checked in detail by both of you before it went on to the Board?

A: That was generally the case, yes.

Q: Indeed, many proposals which came to the Board you and he looked at and rejected?

A: Correct.

...

Q: I am instructed - and would you agree - that never once did a proposal for investment by the Board go forward to the Board, that is, from Mr Brush unless you were in agreement with it?

A: That would be correct.

Q: And in due course, as we have seen from a number of the minutes and attachments, you generally supplied the documentation which substantiated or backed up any proposal or recommendation to the Board?

A: Correct.

...

Q: So when you gave evidence yesterday on the number of occasions that Mr Brush decided to do this or decided to do that those decisions of course he as the Chairman would take, but invariably after consultation with you?

A: That is correct."

#### **5.4 The Halls Head development prior to the involvement of the Board**

5.4.1 Esplanade (Mandurah) Pty Ltd ("Esplanade Mandurah") was a subsidiary of Parry Corporation Limited ("Parry Corporation"). Parry Corporation was listed on the Stock Exchange, and was the holding company of numerous other companies which carried on a variety of business and investment activities. Mr Kevin Parry, through Paracel Pty Ltd ("Paracel"), controlled Parry Corporation. In 1977, Esplanade Mandurah acquired approximately 1,000 hectares of land at Halls Head in Mandurah. The land was purchased for the purpose of subdivision, development and eventual sale, the development including the construction of fully developed villa units and a waterways complex.

5.4.2 Between 1977 and mid-1982, a number of lots within the Halls Head development were subdivided, developed and sold. During that time, the project was managed and gradually implemented by Esplanade Mandurah. Mandurah comprises two main areas; the established township, and the Halls Head and Falcon-Avalon areas. During the 1970s, the majority of residential growth occurred in the Falcon-Avalon area. The Halls Head area was, in consequence, surrounded by residential areas. As at September 1982, recent residential growth had been concentrated in the Halls Head area.

## **5.5 The reasons why Esplanade Mandurah decided to sell 50% of the Halls Head development**

5.5.1 During the first half of 1982, Parry Corporation sought advice from Tricontinental Corporation Limited ("Tricontinental Corporation"), a subsidiary of the State Bank of Victoria, concerning the Parry group's corporate planning and, in particular, cashflow aspects of the group's operations. Tricontinental Corporation recommended, amongst other things, that the Board of Parry Corporation give serious consideration to the sale of a 50% interest in the Halls Head development. It was an integral part of the recommendation that the sale be made to an entity which was not obliged to pay income tax, for example, a Superannuation Fund of the Commonwealth or one of the States. The Board of Parry Corporation accepted Tricontinental Corporation's recommendation.

5.5.2 The apparent rationale underlying the decision to sell 50% of Halls Head, and the importance of a sale to a non-income tax paying entity, is illustrated in the minutes of a meeting held on 21 April 1982 and attended by representatives of Tricontinental Corporation (including Mr Shane Doherty), representatives of the Parry group (including Mr Parry and Mr Kenneth Court) and Mr Brian Coppin. The minutes provide, so far as is material:

"Brian Coppin was introduced to explain the proposed joint venture with a Superannuation Fund. He opened by explaining that the proposal was aimed at maximising the project's value to Parrys by sale of (say) 50% of the project to a Superannuation Fund. Essentially, the scheme comprises:

- Sale of 50% (say) interest in the project to a Superannuation Fund for \$50m (say).

- The Fund would earn 50% of the annual sales revenue as its return. Parrys would earn 50% of the sales revenue for its participation.
- All development and other costs (tax deductible items) would be the responsibility of Parrys Esplanade.

Brian [Coppin] argued that considering the Super-Funds are not tax paying bodies, they are not concerned with after-tax cash flows nor interested in the tax deductible items relating to projects in which they become involved. Therefore, to maximise the value of the project to Parrys, the cash-flow which should be sold to such a body is the before tax and costs cash flows (ie. sales revenue). Parrys should incur all tax-deductible items and earn 50% of the sale revenue for its involvement. (It would be necessary to structure the deal as a joint-venture.)

Brian [Coppin] likened his concept to project financing because there existed known reserves (the land) which would become a depleting asset. (Ken Court likened it to a leveraged lease because of the taxation gearing aspects.)

SD [Mr Doherty] pointed out that the inherent risk was substantially greater than under a project financing concept which normally included firm sales contracts. Other points highlighted were:

1. Basically, Super-funds are opposed to land subdivisions, especially Broadacres outside metropolitan areas. A full market study by Jones Lang Wootton would probably be required.
2. Considering the lack of sales contracts ('guaranteed income'), the depleting nature of the asset and the length of the project, any Super-fund which became involved would probably look to Parrys for a guarantee of a minimum annual return. This would substantially alter the risk to Parrys, because:
  - (i) if sales did slump, Parrys would need to service the project costs and the Super-fund's required return from other sources. Evidence of this capacity would be necessary in any presentation.

- (ii) any such contingent liability would need to be disclosed in the annual accounts. This could provide difficulties in setting other financing arrangements.

Alternatively, a Super-fund may require a bank guarantee or performance bond. However, this would have similar effects as those outlined above. (Ken Court commented, 'We would have to put our money where our mouth is'.)

It was emphasized that the price/value would relate to the return required by the Super-funds. Assuming a guarantee was in place a compounded return of 25% pa would appear reasonable. Otherwise, a return of approximately 30% pa would probably be required.

Further, considering the depleting asset nature of the project, the annual returns would effectively represent a return of "principal and interest". That is, the future cash-flows would need to return the price paid plus provide the required return over the life of the project. Therefore, a discounted cash flow technique would be appropriate in determining the price/value.

The required return would be the discount rate applied in determining the present value of the assigned cashflow (ie. sales revenue).

The estimated project value limited the number of Super-funds which could be approached. Further, the amount suggested may even exclude many of these large funds, especially when consideration is given to their portfolio policies and exposure limits particularly in relation to Western Australia and property. The most logical fund to approach would be the Commonwealth Fund.

Brian Coppin concurred with this view. Further, he indicated he had a close association with the Commonwealth Fund and was aware that their total assets exceeded \$3.5 billion of which only \$35 million (approx. 1%) was committed to WA. He emphasized that the fund was looking for WA investments and believed that if presented correctly the Halls Head project would appeal (Kevin [Parry] agreed).

Brian [Coppin] also indicated that the fund was under-staffed (approx. 30 on staff) and because of this only projects in excess of \$25 million were given consideration. He insisted that their investment criteria were simplistic and provided a project returned several percentage points above the equivalent bond rate it would be given consideration."

## **5.6 Mr Barton's initial role in the Halls Head development**

5.6.1 At all material times, Mr Barton was an actuary in private practice in Perth.

5.6.2 In April 1982, Mr Barton attended a luncheon which was also attended by Mr Peter Unsworth, who at all material times was a financial consultant to the Parry group. Mr Unsworth prepared and sent to Mr Parry a memorandum dated 20 April 1982. The memorandum referred to, amongst other things, the luncheon. It provides, so far as is material:

"I had lunch today with Dennis Barton, Chairman of the State Superannuation Fund. The concept of a portion of Halls Head being sold has already been discussed by him with Vince [Pental] and Barbara Dene Jones at a recent Parrys Esplanade presentation. Dennis advised:

- (a) Halls Head is still a property development with inherent risks.
- (b) Halls Head is a dwindling asset — hence does not meet State Super Fund requirements to the extent that its investment funds are being returned rather than held long term.
- (c) Minimum rate of return on virtually zero risk property situations (revenue and capital gain combined) currently required is 23%.
- (d) For higher risk property deals such as Halls Head, a substantially higher return would be required.
- (e) Halls Head is essentially a broadacres development — although a development with a track record and with

less risk than a totally new development just commencing.

- (f) Dennis Barton is an independent professional actuary who specialises in rates of return for super-funds etc, and has his own computerised property development package which can do various return calculations etc."

5.6.3 Mr Barton said in evidence that he thought the memorandum accurately summarised in relation to the Halls Head development what he told Mr Unsworth at the luncheon. Mr Barton gave further evidence as follows:

Q: ... At the time this lunch was held, in your view the Halls Head project was not an attractive proposition for the purpose of investment by the State Superannuation Board?

A: No. For the State Superannuation Board to buy Halls Heads, it wouldn't be the sort of thing that it would want to do.

Q: So that was your view at the time the lunch was held?

A: That was my view at the time ...

...

Q: Now, did you subsequently change your mind in relation to Halls Head being a property development with inherent risks?

A: No. It remained a property development, but the State Superannuation Board didn't buy the whole of Halls Head. It went into a joint venture on certain terms.

Q: So you thought that was material in limiting the extent of the Superannuation Board's exposure to these inherent risks?

A: Yes, I did, but it needs to be said that this document was a discussion with Peter Unsworth where the State Super Board wasn't — in my mind at the time at all in contemplation, but he was seeking from me general — views on the acceptability or otherwise of this to a whole range of institutional investors.

...

Q: So, when the Board ultimately came to purchase a 50% interest in Halls Head you remained of the view that it was still a property development with inherent risks; is that correct?

A: Oh, yes, clearly you don't get a return of 22.5% without there being an element of risk in it. But acceptable risks."

5.6.4 After the luncheon and prior to the involvement of the Board in the Halls Head development, Mr Barton was appointed by the Parry group as consulting actuary to the Halls Head development with instructions to review a feasibility study in relation to Halls Head that Tricontinental Corporation had prepared, and to establish a computer model to enable a sensitivity analysis to be performed. Mr Barton's work for the Parry group was disclosed to the Board by Mr Barton and Tricontinental Corporation prior to the Parry group and the Board entering into negotiations with respect to Halls Head.

## **5.7 Negotiations between the Parry group and the Board**

5.7.1 In about late August 1982, Mr Doherty of Tricontinental Corporation, acting on behalf of the Parry group, had discussions with Mr Yorg and Mr Neville concerning the possible involvement of the Board in the Halls Head development. In a letter dated 2 September 1982 from Tricontinental Corporation to the Board, Tricontinental Corporation set out a broad outline of the proposal that was discussed at the meeting. The relevant proposal was described as follows:

"It is proposed that the project be sold to the State Superannuation Board for a consideration which would provide an acceptable internal rate of return. The transaction could be structured so that Parrys maintain a joint venture interest or act as a project manager. It is envisaged that settlement would comprise an up-front component and deferred payments, subject to satisfactory progress and based on a staged development. This method would reduce the initial commitment by your Fund and the later payments should be supported by returns which emanate from the project, and should also enhance the returns to the Fund.

The transaction could take several forms, alternatives which we have examined include the sale of shares and sale of land. Mr AP Webb, QC, has reviewed these alternatives and the nature in which the transaction could be consummated (a copy of his advice is enclosed). An alternative which is currently being examined involves the State Superannuation Board acquiring an option over the project with payments taking place as each stage is

undertaken. We believe this concept has merit and would suggest further investigation. However, prior to completing any transaction, it would be necessary to seek clearance from the Taxation Commissioner.

These areas would be subject to negotiation and we would appreciate the opportunity to discuss any alternatives you may consider or any difficulties you may envisage with the proposed transaction."

The letter dated 2 September 1982 also enclosed a copy of the feasibility study prepared by Tricontinental Corporation.

5.7.2 On 3 September 1982, the Board agreed to carry out a preliminary feasibility study into a joint venture with Esplanade Mandurah, subject to a number of conditions. The conditions were recorded in minutes of a meeting of the Board held on 3 September 1982. The relevant conditions were these:

- "(1) Acceptable guaranteed minimum profit.
- (2) Restricted financial exposure through deferment of payments.
- (3) An option to withdraw.
- (4) A full disclosure by Parry of taxation aspects relating to the proposition.
- (5) Examination of sales evidence.
- (6) A guaranteed internal rate of return of 20% over the time of the investment. The target internal rate of return to be in excess of 30%."

5.7.3 After correspondence between the Parry group and Tricontinental Corporation on the one hand and the Board on the other, the Board and Esplanade Mandurah entered into Heads of Agreement dated 17 November 1982. The Heads of Agreement did not legally bind either party. They simply recorded, as a basis for further negotiations, certain agreements in principle which had been reached by the parties.

5.7.4 On 24 December 1982, and pursuant to the Heads of Agreement, Mr Yorg sent a letter to Esplanade Mandurah confirming the Board's intention to purchase 50% of the Halls Head development. The purchase price was \$30 million payable over 15 years, free of interest. The obligation of the Board to pay \$30 million was not conditioned by the success or otherwise of the joint venture. However, the Board was to be entitled to a priority profit allocation which was designed to ensure that it achieved an internal rate of return on all funds invested of 20% over the life of the joint venture. As the name suggests, the priority profit allocation was payable only out of the profits (if any) derived by the joint venture. The proposed purchase was subject to a number of other conditions, including agreement between the parties on the final documentation.

## **5.8 The Geraldton land**

5.8.1 When the Board's intention to purchase was confirmed on 24 December 1982, it understood that it was acquiring an interest in the assets of the Halls Head development, but that it was not assuming any of the existing liabilities. During the course of negotiating the formal documentation in the first half of 1983, the Board became aware that the assets of the Halls Head development were encumbered by a mortgage liability of approximately \$4.2 million. The Board agreed not to require the discharge of this mortgage liability in consideration of its priority profit allocation being increased from 20% to 22.5%, and in consideration of the Board receiving a 50% interest in certain land at Drummond's Cove, Geraldton. It was agreed that this Geraldton land would be subdivided and sold pursuant to another joint venture between Coolibah Pty Ltd, a subsidiary of Parry Corporation, and the Board.

## **5.9 Expert advice received by the Board prior to the acquisition of 50% of the Halls Head development**

5.9.1 The Board retained Mr Ian Sanderson of PC Kerr & Associates, real estate agents and property consultants, to advise it on its proposed acquisition of 50% of the Halls Head development. On 2 December 1982, Mr Sanderson provided the Board with "an interim abbreviated report" on the probable value of the Halls Head land. On 17 May 1983, he provided the Board with a valuation of the Halls Head land and the Geraldton land. Mr Sanderson assessed the value of the Halls Head land at \$14.188 million, and the Geraldton land at between \$750,000 and \$1 million. On 15 June 1983, Mr Sanderson provided the Board with a report on the likelihood of the

Board achieving its investment criteria in relation to the Halls Head development. For that purpose, he used the services of Mr Barton, who had made calculations indicating that the Board's investment criteria could be achieved on the assumption that there were reasonable market conditions and the development occurred over a period of 22.67 years. Mr Sanderson's report of 15 June 1983 contained the following conclusion:

"Given a return to reasonable market conditions and a continuation of the successful promotion and development of the Halls Head project, we consider that the investment criteria of your Board are likely to be achieved through the subdivision and sale of the land contained in the property register attached to our report of 17 May 1983.

However, we consider that the retirement village is unlikely to meet the criteria. However, its probable value of \$1 million represents its in globo value which could be achieved if the individual units comprising the retirement village were sold for alternative uses such as strata title holiday accommodation. As such the assessment of \$1 million in our opinion is a figure which contains practically no risk of capital loss although, as mentioned previously, it may not achieve the income requirements.

We commend the proposal [that is, the proposed investment by the Board in Halls Head] to your Board as being a satisfactory investment on the terms and conditions outlined in the various agreements and reports prepared."

5.9.2 On 17 June 1983, Collison & Hunt, the solicitors for the Board, sent Mr Sanderson additional information which he reviewed and, in a letter dated 20 June 1983 to Collison & Hunt, he revised the valuation of the Halls Head land contained in his report of 17 May 1983 from \$14.188 million to \$14.092 million.

## **5.10 The formal documentation**

5.10.1 The formal documentation was negotiated over a period of several months. The documents, which were signed on 23 June 1983, comprised a contract of sale, a joint venture agreement relating to the Halls Head land and a joint venture agreement relating to the Geraldton land.

5.10.2 The first instalment of the purchase price of \$30 million was paid on 30 June 1983.

## 5.11 The SB Investment Trust

5.11.1 It was never contemplated that the Board itself would be a direct joint venture participant.

5.11.2 Section 25(1) of the *Superannuation and Family Benefits Act 1938* did not empower the Board to enter into a joint venture for the purpose of developing land or, indeed, for any purpose. Further, neither the *Trustees Act 1962* nor any other Act of the State relating to the investment of trust funds authorised the Board to enter into a joint venture. Section 16(1)(n) of the *Trustees Act* did, however, authorise the Board to invest in the units of a unit trust scheme in respect of which there was in existence at the time of investment an approved deed under the *Companies (Western Australia) Code*.

5.11.3 The Board sought advice from a solicitor, Mr Michael Hunt, who was then a partner of Collison & Hunt, in relation to the proposed joint venture with the Parry group. Mr Hunt gave relevant evidence as follows:

Q: ... Are you aware of the reason why the Superannuation Board had a need for [an approved deed under the Companies Code]?

A: Yes. It had a desire to enter into a joint venture, and the provisions of the Superannuation Board's then Act, which I think was called the Superannuation and Family Benefits Act, the investment provisions were not wide enough in my opinion to allow the Board to invest in a joint venture, to participate in a joint venture. So I was asked ... by the Superannuation Board officers, 'Is there another way the transaction can be done?', and I said, 'Yes. ... The Board has a power to invest in any investments which are authorised under the Trustees Act', and the Trustees Act as it then was permitted the investment of trust funds in, amongst other things, an approved fund ...

Q: ... Who from the Superannuation Board approached you on this matter? Do you remember?

A: I think it was probably Mr Neville, the Investment Manager, but I can't recall.

Q: So having given that advice to the Superannuation Board, what happened next?

A: I said 'This is firstly the way to do it'. ... The person who gave me the instructions said 'We want to do it quickly'. I said, 'It will take some months ... to set up an approved deed. Do you want me to see if I can find a shelf trust?', and I was able to find this one. I checked it out. ... It had not been traded or used and therefore we acquired that trust and then of course changed its name.

5.11.4 The approved trust acquired by the Board was the Richards Property Trust. Its name was changed to the SB Investment Trust. Perpetual Trustees WA Ltd ("Perpetual Trustees") became the trustee and manager. Perpetual Trustees, in its capacity as trustee, entered into the joint venture with Esplanade Mandurah.

5.11.5 At the time of its acquisition by the Board, the Richards Property Trust was merely an approved empty shell. The Board made an investment by acquiring units in the Trust. The Board was the source of all moneys for the time being forming part of the trust fund of the Trust. The Board transferred money to the trust fund by subscribing for units in the Trust. When Perpetual Trustees required money to pay an instalment of the purchase price owing to Esplanade Mandurah, or to discharge its obligations as a joint venturer, the Board simply subscribed for more units. At all material times, the Board was the sole unit holder.

5.11.6 Mr Hunt gave further evidence as follows:

Q: Did you by any chance get Counsel's opinion as to whether this procedure was lawful?

A: The procedure of subscribing for units?

Q: The initial procedure of using the device of buying a shell and then giving it life, and then going into a joint venture?

A: No, sir. I didn't get Counsel's advice.

Mr Hunt said subsequently in evidence that he saw no reason to seek Counsel's advice.

5.11.7 Mr Barton gave evidence as follows:

Q: So in a nutshell, the SB Investment Trust, as it ultimately came to be known, was used as a means whereby the board could get around restrictions on its investment capacity. Is that a fair statement?

A: That's a fair statement. It could be put slightly differently: it could be put as a means to ensure that the Superannuation Board could make investments which are similar to all other superannuation funds. But, yes, there was no attempt to hide the fact that under the Trustees Act, you could only do certain things and one of those things wasn't form a joint venture but under the Superannuation and Family Benefits Act, you could have bought the whole thing but we didn't want to buy the whole thing for the reasons that I have said. So we came up with this, if you like to call it, device of the SB [Investment] Trust, which did the same thing except in respect of half of it, and we put it up through the filter of the Under Treasurer and then to the Treasurer at the time, probably Mr O'Connor, and it came back down that that was okay from the Government.

Q: Was it because the approval of the Under Treasurer and the Treasurer were obtained to the use of the unit trust to acquire this interest, that you did not regard the acquisition by that means as improper?

A: Not at all. In no way did I regard it as improper, particularly -- there wasn't any murmur of dissent from Les McCarrey, the Under Treasurer because, as I said, we could have acquired the whole thing and we only got half of it through doing it this way. There's no question at all, in my view, that it was totally proper.

5.11.8 Mr Hunt gave further evidence as follows:

Q: Yes. And it would be a mistake therefore, would it be, to assume that had you not recommended the method of using the SB Investment Trust that the Board would not have found some other way to go ahead with that investment?

A: Oh, yes. It would certainly be a mistake. I mean, as I said before, there were other ways in which it could be done. First of all you could take a more aggressive attitude to the investment powers of the board than I was prepared to do, and just say, well the investment powers at the time under the Superannuation and Family Benefits Act were wide enough to allow it to do this. And I think that's an argument which is perfectly feasible. The only reason I was being pedantic and over-cautious was simply because the Board was acting with trust funds.

Q: And indeed the Board had power not only to invest in land but also to develop that land?

A: That's quite correct, yes.

Q: But as it happened, it was decided to develop it as a joint venture and by doing that through the SB Investment Trust, there was no provision in your view to prevent it from proceeding in a joint venture method as distinct from some other way of doing it?

A: They always wanted to do it in joint venture. The question was were they empowered to — or how could one make sure they had power to do it in a joint venture.

5.11.9 The Board was a statutory corporation: see section 19(1) of the *Superannuation and Family Benefits Act 1938*. Statutory corporations have such rights and can do such acts only as are authorised directly or indirectly by statute.

5.11.10 The Commission is of the opinion that section 16(1)(n) of the *Trustees Act 1962* contemplates that where trust funds are used for the purpose of investment in the units of a unit trust scheme, the relevant units will have some value other than the value created by the money used to subscribe for them. The Commission is of the view that neither section 25(1) of the *Superannuation and Family Benefits Act 1938* nor section 16(1)(n) of the *Trustees Act 1962* contemplates that the Board may invest The Superannuation Fund by acquiring units in a unit trust scheme, not for the purpose of the inherent investment value of the units or the assets represented by the units, but as a device for the purpose of circumventing the investment restrictions imposed upon the Board.

5.11.11 The Board's use of the SB Investment Trust for the purpose of circumventing the investment restrictions imposed upon it was unfortunate. It may have been desirable for Mr Hunt to have sought Counsel's advice. In the circumstances, however, the Board did not act improperly in using the SB Investment Trust. The Board sought advice from its solicitors, and had no reason to doubt the advice given.

5.11.12 At all material times, section 16(5) of the *Trustees Act 1962* relevantly required a trustee who proposed to make an investment in the units of a unit trust scheme, to first obtain and consider proper advice in writing on the question whether the investment was satisfactory, having regard to the need to ensure that investments are sufficiently diversified and to the suitability of the proposed investment. For the purposes of section 16(5), proper advice meant the advice of a person who was reasonably believed by the trustee to be qualified by his ability in, and practical experience of, financial matters; and that advice could be given notwithstanding that the person gave it in the course of his employment as an officer or servant: section 16(7).

The Commission notes that, on advice from Mr Hunt, the Board purported to comply with section 16(5) prior to the acquisition of 50% of the Halls Head land. The Board apparently relied upon advice from Mr Sanderson as to the value of the Halls Head land, and advice from Mr Neville as to the diversification and suitability of the proposed investment. The advice of Mr Sanderson was contained in his memorandum of 17 May 1983 and his letter of 15 June 1983. The advice of Mr Neville was contained in a paper to the Board dated 10 August 1983. The Commission observes that Mr Sanderson's advice was directed to the suitability of the Halls Head land as an investment, and not to the critical question of the suitability of units in the SB Investment Trust as an investment. The Commission also observes that Mr Neville's advice appears not to have been reduced to writing until after the Board invested in units in the SB Investment Trust. These failures to comply with section 16(5) were consistent with the use of the SB Investment Trust as a device to circumvent the investment restrictions imposed upon the Board.

5.11.13 At all material times, section 16(6) of the *Trustees Act 1962* provided, in effect, that a trustee who retained any investment made under the power conferred by section 16(1)(n) must determine at what intervals the circumstances, and in particular the nature of the investment, made it desirable to obtain the advice mentioned in section 16(5), and must obtain and consider that advice accordingly. It does not appear that the Board ever made any determination of the kind referred to in section 16(6). No such determination is recorded in the minutes of the Board.

5.11.14 A handwritten note from Mr Yorg to Mr Neville, which was written on 1 December 1983, records the substance of a telephone conversation between Mr Hunt and Mr Yorg. It appears that Mr Hunt telephoned Mr Yorg to tell him that he had discovered that the Board had been making payments direct to the Parry group, that it was wrong for the Board to have done so, that the payments should have been made by the SB Investment Trust to the Parry group, and that accounting entries would have to be reversed. These failures are consistent also with the use of the SB Investment Trust as a device to circumvent the investment restrictions imposed upon the Board.

5.11.15 Perpetual Trustees remained as manager of the SB Investment Trust until 19 May 1986, but it had always had a token management role. At all material times prior to that date, the Board was the real manager. Mr Oliver Price was employed by Perpetual Trustees between February 1984 and October 1989. He gave evidence as follows:

"As I understood it, the only reason Perpetuals was appointed manager was to accommodate an urgent situation. That situation was to enter into the joint venture relating to the Halls Head project. I was assured when I read the file and realised what the position was that it was a temporary position and that Perpetuals was never intended to be the real manager. In order to obtain the Commissioner for Corporate Affairs' approval to the deed, it was necessary to have a public company as a manager. There was not one available at the time when approval was given and Perpetuals evidently consented to occupy the dual role."

5.11.16 On 19 May 1986, SB Investment Limited, a subsidiary of the Board, became the Manager of the SB Investment Trust.

5.11.17 By section 173(1) of the *Companies (Western Australia) Code*, the manager of the SB Investment Trust was required to lodge with the National Companies and Securities Commission, within two months after the end of each financial year applicable to the Trust Deed, a return in the prescribed form. However, no return on behalf of the Trust was lodged in respect of the years ended 30 June 1983, 1984 or 1985. Further, the return for the financial year ended 30 June 1986 was not lodged until 30 March 1987. The failure to comply with section 173(1) was explained by the secretary of the Board, Mr Stuart Tindale, in a letter dated 1 April 1987 to the Treasurer, Mr Brian Burke:

"... because of a misunderstanding between Perpetual Trustees and the Board, neither party submitted the returns for the years ended 30 June 1983, 1984 and 1985. Furthermore, the 1986 return was not lodged until 30 March 1987 owing to the Board inadvertently sending the return to Perpetual Trustees.

I am arranging for the necessary returns to be completed and lodged with the Corporate Affairs Office today."

5.11.18 At a meeting held on 16 December 1986, representatives of the Board told representatives of Perpetual Trustees that the Board wanted Perpetual Trustees to be merely a nominal trustee. The representatives of the Board said that it had never been intended that Perpetual Trustees would have any other kind of role.

5.11.19 In summary, the Commission finds that the use by the Board of the SB Investment Trust was contrary to the spirit of the applicable legislation. Several facts clearly indicate that the Trust was a mere device: the evidence of Mr Hunt and

Mr Barton as to the reasons why the Board subscribed for units in the Trust; the Board making payments direct to the Parry group; Perpetual Trustees' token role as manager; the performance by officers of the Board of the manager's functions; the absence of attention to the requirements of section 173(1) of the *Companies (Western Australia) Code*; and the intention of the Board that Perpetual Trustees should be merely a custodian trustee. The failure to comply with section 16(5) of the Trustees Act accentuated the breach by the Board of the spirit of the legislation. Such a breach by a Crown instrumentality is undesirable and to be avoided.

## **5.12 The agreement to make the section 36A(2) election**

5.12.1 Prior to commencing negotiations with the Board, Parry Corporation and its adviser, Tricontinental Corporation, sought advice from a Queen's Counsel and two firms of accountants in connection with the taxation implications of a sale of a 50% interest in Halls Head.

5.12.2 Taxation advice was necessary for two reasons. First, the land at Halls Head had acquired the characteristics of "trading stock" as defined in section 6 of the *Income Tax Assessment Act 1936*. Secondly, the market value of the relevant land was approximately \$30 million, whereas the value in Esplanade Mandurah's books of account was approximately \$12 million.

5.12.3 Section 36 of the *Income Tax Assessment Act* provides, in effect, that where a vendor disposes of trading stock other than in the ordinary course of business, the market value of that trading stock is included in the assessable income of the vendor.

5.12.4 Section 36A of the Act deals with the situation where a vendor disposes of an undivided share in trading stock (for example, a 50% interest).

5.12.5 Section 36A(1) deems there to have been a sale of the whole of the trading stock by the persons who owned the stock before the disposal to the persons who own the stock after the disposal, and provides that section 36 applies to the deemed sale. For example, where A sells a 50% interest in trading stock to B, and A and B agree to carry out a joint venture with respect to the trading stock, the market value of the trading stock will be included in the assessable income of A, and a deduction of the same amount will ultimately be allowed to the joint venture of A and B.

5.12.6            However, section 36A(2) permits the parties in certain circumstances to a sale of an undivided share in trading stock to elect that the value of the stock for taxation purposes will be the value that would have been taken into account if no disposal had taken place, and the year of income had ended on the date of the disposal. Thus, if the trading stock has been valued in the books of account of the vendor at cost, it will be deemed to have been disposed of at the cost stipulated in the vendor's books, and the new owners will be deemed to have purchased the trading stock for the same amount. The result is that any profit arising from the ultimate sale of the trading stock to third parties will be taxable only after it has actually been realised.

5.12.7            In general, on a sale by one taxpaying entity to another taxpaying entity of an undivided share in trading stock, there are competing interests between the vendor and the purchaser as to the sale price to be attributed to the stock for taxation purposes. In simple terms, the vendor's interests are usually best served by a low sale price for taxation purposes, and the purchaser's interests are usually best served by a high sale price. This conflict does not exist where the purchaser is a non-taxpaying entity. Obviously, this point was appreciated by Parry Corporation's taxation advisers.

5.12.8            Price Waterhouse was one of the firms of accountants which gave advice to Parry Corporation in connection with the taxation implications of a sale of a 50% interest in Halls Head. The advice from Price Waterhouse was contained in a letter dated 16 April 1982, and provided, so far as material, as follows:

"On the basis that the land is trading stock a sale by [Esplanade Mandurah] of a one-half interest in the land for say \$15 million (ie one half of present market value) would have the following effect for income tax purposes.

Deemed sales (Sections 36 and 36A(1))	30,000,000
Cost of land sold	12,000,000
	_____
Net assessable income arising from sale of one-half interest for \$15 million	\$18,000,000
	_____

The cost of the land to the joint owners following the sale would, as expected, be \$30 million.

In brief, section 36 provides that where a taxpayer disposes of trading stock other than in the ordinary course of business the value (market value) of that trading stock is included in the assessable income of the taxpayer. Section 36A covers the situation where an interest in trading stock is disposed of by the taxpayer. The section deems a sale of the whole of the property by the persons who owned the property before the change to the persons who own the property after the change and provides that section 36 shall apply to the deemed sale. The significance of these provisions is illustrated if one contemplates the example of say a sale of a 5% interest for \$1,500,000 (ie 5% of 30 million). The tax effect is:

Deemed sale of whole of land	30,000,000
Cost of sales	12,000,000
	-----
Net assessable income arising from sale of 5% interest for \$1.5 million	\$18,000,000
	-----

You will note the net assessable income arising is the same as in the previous example.

To overcome the effects of the above, section 36A(2) provides in certain appropriate circumstances that if all parties to the transaction (ie all vendors and purchasers) agree in writing and give a notice to the Commissioner the value of the property for the purpose of section 36 shall be instead of the market value the value (if any) that would have been taken into account at the end of the year of income if:

- a) no disposal had taken place and
- b) the year of income had ended on the date of the change in ownership.

In other words, where a section 36A(2) notice is given the deemed selling price is cost and the new joint owners are deemed to have purchased the stock for that cost. In our example there would be a deemed selling price of \$12,000,000 notwithstanding the actual consideration for the interest.

...

This brings us to the proposal. If a one half interest in the [Halls Head] land were to be sold to an institution the income of which is exempt from tax the purchaser may be prepared to agree to participate in a section 36A(2) notice. This is because such a purchaser would not have any great interest in the 'cost for tax purposes' as allowable deductions are meaningless in exempt circumstances.

Expressed in figures the effect on [Esplanade Mandurah] of the above proposal would be:

Actual sales of 50%	15,000,000
Cost of sales	6,000,000
	_____
Profit before income tax	9,000,000
Income Tax	Nil
	_____
Profit after income tax	\$9,000,000
	_____

In the [Esplanade Mandurah/Superannuation Fund joint venture] the cost of the land for income tax purposes would be \$12 million.

In our discussion of the above we canvassed the possible application of the new Part IVA of the Income Tax Assessment Act which deals with schemes to avoid income tax. I am confident there is no tax benefit as defined in Part IVA based on the provisions of section 177C(2) which provide that a tax benefit does not include a reference to the non inclusion in income of an amount which is attributable to the making by taxpayers of a declaration election or selection, the giving of a notice or the exercise of an option etc expressly provided for in the Act. Section 36A(2) notices are expressly provided in the Act and hence Part IVA has no application."

In summary, Price Waterhouse advised that section 36A(2) might be used without offending the terms of Part IVA of the *Income Tax Assessment Act*.

5.12.9           The other firm of accountants who gave advice to Parry Corporation was Duesburys. In a letter dated 23 June 1982, Duesburys advised that what was in contemplation by Parry Corporation was a "tax avoidance scheme" within Division 9C of the *Income Tax Assessment Act*.

5.12.10           In early August 1982, Mr AP Webb QC advised Tricontinental Corporation that, the sale by Esplanade Mandurah to the Board and the election under section 36A(2) was not a "tax avoidance scheme" within Division 9C of the *Income Tax Assessment Act*, and was not designed to create a "tax benefit" which would fall within Part IVA of the *Income Tax Assessment Act*. In a letter dated 2 September 1982, Tricontinental Corporation told the Board that prior to the completion of any sale from Esplanade Mandurah to the Board, "it would be necessary to seek clearance from the Taxation Commissioner". The letter enclosed a copy of Mr Webb's advice. The decision of the Board, made on 3 September 1982, to carry out a preliminary feasibility of a joint venture with Esplanade Mandurah was conditional on a full disclosure by the Parry group of the taxation aspects of the proposed sale.

5.12.11           In early September 1982, Mr Yorg and Mr Neville approached Mr Les McCarrey, the Under Treasurer, to obtain his advice. Mr McCarrey's advice was to see the Deputy Commissioner of Taxation, to make a full disclosure and to ascertain whether the Deputy Commissioner thought the proposed election would "create problems for the taxation office".

5.12.12           Mr Barton, Mr Yorg and Mr Neville saw the Deputy Commissioner on 28 September 1982. According to Mr Yorg, the Deputy Commissioner informed them that the proposed election could lawfully be made under the provisions of the Act, that the Taxation Office had adequate powers under the Act properly to assess and tax Esplanade Mandurah in respect of any tax liability resulting from the proposed joint venture, and that Esplanade Mandurah would not be able to derive any undue tax advantage from the Board's tax exempt status and its participation in the development. Mr Yorg recorded his recollection of the meeting in a memorandum prepared in early April 1984. According to Mr Barton, the Deputy Commissioner said that the "Section 36A election wouldn't get up, or words to that effect". It was Mr Barton's belief, based on what the Deputy Commissioner said, that the election would not be allowed by the Commissioner. In a note made in April 1984, Mr Barton recorded his recollection of the meeting as follows:

"... we discussed Parrys and another investment. In both cases, we got the idea that the deals would not get Tax approval. Therefore Parrys would not be able to use the Board for tax avoidance ... My summary [of what the Deputy Commissioner said] would be 'they've got no chance' — or words to that effect."

In a written statement made in April 1984, Mr Neville said that the Deputy Commissioner did not express any "concern about the Halls Head project and my impression was that [the Deputy Commissioner] was confident that the Department had adequate powers to ensure that the Parry group would not be able to evade any tax liability that might arise out of this development". The Deputy Commissioner at the material time, Mr Ronald Gill, could not be called to give evidence, he having died in 1989. The Commission finds that when Mr Barton, Mr Yorg and Mr Neville saw the Deputy Commissioner they made a full disclosure of the proposed transaction with the Parry group, and were assured by him that the proposed election could lawfully be made and that the Taxation Office had adequate powers properly to assess and tax Esplanade Mandurah.

5.12.13 The Board formed the view, based on the advice obtained from the Deputy Commissioner, that the Parry group would not succeed in reducing its tax liability in consequence of the making of the proposed election. The Board informed the Parry group of the advice obtained from the Deputy Commissioner. The Parry group then obtained further taxation advice to the effect that the proposed election would be valid and effective. The Parry group, believing the proposed election would be effective, wanted to proceed with the transaction. The Board, believing the election was proper and would not result in the Parry group reducing its proper tax liability, also wanted to proceed with the transaction.

5.12.14 Mr Yorg reported back to Mr McCarrey on the visit to the Deputy Commissioner. Mr McCarrey said in evidence:

"In due course Yorg rang me ... and said they'd had the discussion with [the Deputy Commissioner]. [The Deputy Commissioner] had indicated that [the election] could be legally made ... that he saw ... no particular embarrassment about it to him. He was confident that the arrangement would be taxable under other sections of the Act."

5.12.15 In early May 1983, while considering the proposed section 36A(2) election, the solicitors for the Board, Collison & Hunt, decided that it was not appropriate to seek a formal tax clearance from the Deputy Commissioner in relation to the proposed election, because such a clearance would take a considerable period of time, possibly more than a year. The solicitors advised the Board that in their view the best course was to notify the Deputy Commissioner in terms of a draft letter prepared by the solicitors.

5.12.16 On 16 May 1983, the Board, with the agreement of the Parry group, wrote to the Deputy Commissioner in terms of the draft prepared by the Board's solicitors. The letter enclosed a copy of the joint venture agreement, gave further details of the proposed transaction, referred to the intention of the parties to make an election under section 36A(2) and stated:

"We wish to place on record with you the above because our concern is that as an exempt body for income tax purposes, we do not wish to be seen in any way to be utilising our exempt status for any tax avoidance purpose. Our advisers inform us that the transaction is perfectly proper and in accordance with the Act."

The Commission finds that the letter disclosed all material facts to the Deputy Commissioner, and that the Board acted appropriately in sending the letter.

5.12.17 The Commission finds that the agreement by the Board to make the section 36A(2) election was not corrupt, illegal or improper.

### **5.13 The section 36A(2) election — the consent of the Treasurer**

5.13.1 At the material time, section 25(2) of the *Superannuation and Family Benefits Act 1938* provided:

"The Board shall not invest the Fund or any portion thereof in any investment of any kind whatever without the consent of the Treasurer being first obtained."

The interpretation of section 25(2) is not without difficulty. For example, it would be quite impractical for the Board to obtain the prior consent of the Treasurer to each and every investment that the Board might make in shares or debentures. No doubt, such investments would change frequently, and some changes of investment would require

rapid implementation. The Commission has concluded, however, that it would be improper for the Board to enter into a complicated investment transaction involving substantial financial liabilities, without the prior written consent of the Treasurer.

5.13.2 Prior to the Halls Head transaction, the practice of the Board was to obtain the consent of the Treasurer at the commencement of each financial year to the Board's investment budget for that financial year. The budget allocated the Board's anticipated expenditure on investments for the relevant year between several major categories. The Board submitted each proposed investment budget to the Under Treasurer or another senior officer within the Treasury, who in turn submitted the proposed budget to the Treasurer for approval.

5.13.3 By a letter dated 23 December 1982, Mr Yorg wrote to Mr Ray O'Connor, the then Treasurer, in connection with the Board's proposed participation in the Halls Head development. The letter, which sets out the salient terms of the Heads of Agreement, was obviously intended to be informative. It did not purport to seek any consent from Mr O'Connor. When the letter was written, no binding agreement existed between the Board and Esplanade Mandurah.

5.13.4 Although the Board did not usually refer individual investments to the Treasurer, it did, on some occasions, seek the Treasurer's specific consent where there was something unusual about a particular investment, or where the Board thought that a particular investment should be drawn to the Treasurer's attention. This occurred in the case of Halls Head.

5.13.5 By a memorandum dated 2 June 1983 signed by Mr McCarrey as Under Treasurer, the specific consent of Mr Burke, the then Treasurer, was sought to the Board's acquisition of 50% of Halls Head. The memorandum was prepared by the Board and sent to Mr McCarrey. Mr McCarrey signed the memorandum and sent it to Mr Burke. Mr Burke indicated his consent to the investment on 5 June 1983.

5.13.6 By a memorandum dated 17 June 1983, the Board sought confirmation from Mr Burke that his earlier consent to the Board's investment in Halls Head extended to the acquisition of an interest in the Geraldton land, and to the acquisition of the interest in the Halls Head and Geraldton land by means of the SB Investment Trust. This confirmation was sought by the Board at the instigation of solicitors acting for the Parry group. The memorandum was prepared by the Board and signed by Mr Yorg.

The signed memorandum was then sent to the Treasury Department. An officer of the Department appears to have referred the memorandum to Mr Burke for approval and signature. This occurred on or about 17 June 1983.

5.13.7 Neither of the memoranda just mentioned contained any reference to the proposed section 36A(2) election. The memoranda set out in some detail particular features of the transaction including the amount and terms of payment of the purchase price, the 22.5% priority rate of return, the SB Investment Trust, and a brief description of the likely internal rate of return to be achieved by the Board.

5.13.8 Mr Yorg said in evidence that he had not seen any point in mentioning the section 36A(2) election in either memorandum. He said that by June 1983 that election, from the point of view of the Board, had ceased to be an issue.

5.13.9 Mr McCarrey said that he did not mention the section 36A(2) election to Mr Burke prior to Mr Burke giving consent to the investment because, in Mr McCarrey's view, the proposed election had been handled administratively by him. He had given certain advice, that advice had been followed, and the matter "put to bed". Mr McCarrey saw no need to "worry the Treasurer" with the proposed election, as the matter had been satisfactorily concluded and had occurred in the life of a previous Government. It did not occur to him to raise it for that reason.

5.13.10 The election under section 36A(2) was considered by Price Waterhouse in the context of a review by it of the Board. In April 1984, Price Waterhouse presented a report on its review. The report referred to the section 36A(2) election and stated that whether the Board should be involved in such elections was a matter beyond the scope of the report.

5.13.11 Mr Burke apparently learnt of the section 36A(2) election in about late March 1984 when he received a draft of the proposed Price Waterhouse report.

5.13.12 On 5 April 1984, Mr Yorg was requested to attend a meeting at Parliament House. The meeting was attended by Mr Burke, Mr Joe Berinson the Attorney-General, Mr Jarman, the then Chairman of the Board, and Mr Yorg. In a statement prepared on or about 11 April 1984, Mr Yorg described what occurred at the meeting as follows:

"The meeting lasted for about 30 to 45 minutes.

In the course of the meeting the Premier advised me that questions in Parliament had been asked about the possibility of an interim report from Price Waterhouse and he had also been questioned by a reporter in that regard.

He further indicated that he had become aware of the 36A election and that this had placed the Government in a very embarrassing position because it was the Government's view that by the means of this election Parrys had saved themselves an enormous amount of tax liability.

A figure of either \$20,000,000 or \$24,000,000 was mentioned.

I was questioned about the election and about my meeting with McCarrey and the Deputy Commissioner of Taxation.

Burke told me that McCarrey had no recollection of the meeting (I have subsequently discussed this with McCarrey who says that that is not the case at all and that he can in fact recall myself and Brian Neville coming to see him).

I could not at that stage remember who I had seen McCarrey with although I did tell the Premier and Berinson that I had been in the presence of another person from the Board at the time that we had visited McCarrey.

I further advised them that the Chairman of the Board and Neville and myself had all gone to see the Deputy Commissioner of Taxation.

Burke stated that he had been advised that the only knowledge that the Department of Taxation had of the matter was my letter of May 1983 which he characterised as being 'after the event'.

He also indicated that the letter did not call for a reply.

Burke indicated that the Government viewed the whole matter with a great degree of seriousness and also that had he known about the Section 36A aspect he would never have approved of the project."

5.13.13 Mr Yorg also recorded in the statement that after the meeting on 5 April 1984, Mr Jarman indicated to Mr Yorg that there had been further discussion of Mr Yorg's position after his departure from the meeting. Mr Jarman told Mr Yorg that the Premier would accept his resignation or alternatively a transfer to another position, and that he had to give an answer by 9 April 1984. Mr Yorg refused to resign and, at that time, to accept a transfer.

5.13.14 Mr Burke said in evidence that, in his view, the proposed election under section 36A should have been drawn to his attention prior to him giving his consent to the Halls Head transaction. According to Mr Burke, where a State Government instrumentality enters into a transaction which is likely to have an impact on revenue collections by the Commonwealth, the relevant instrumentality should refer the proposed transaction to its responsible Minister. In Mr Burke's view, the issue of revenue collection and tax minimisation is, and was as at June 1983, of such political sensitivity, that the responsible Minister should be informed of the relevant details, and should decide whether or not the transaction should proceed. In Mr Burke's view, both Mr Yorg and Mr McCarrey should have told him of the proposed election.

5.13.15 The Commission finds that there was no corruption or illegality in connection with the non-disclosure of the proposed election. Further, there was no impropriety on the part of the Board (and, in particular, Mr Yorg) or Mr McCarrey.

5.13.16 The Commission also finds that, although it may have been desirable for the Board to inform Mr Burke prior to him consenting to the investment in Halls Head, by June 1983 the approach to the Deputy Commissioner was a matter of history and had ceased to be of importance. In any event, the approach to the Deputy Commissioner was a matter of public administration handled by senior public servants of the Commonwealth and the State.

5.13.17 The evidence does not justify a finding that Mr Burke deliberately exaggerated his response upon learning of the non-disclosure with a view to justifying the removal or transfer of Mr Yorg. The Commission observes, however, that Mr Burke's response upon learning of the non-disclosure was disproportionate and quite remarkable in the circumstances. It was also inconsistent with the manner in which the payment of compensation by the joint venturers in the Ashton diamond joint venture was facilitated by Mr Burke: see chapter 7.

5.13.18 Mr Burke's response may be attributable to the activities and attitude of Mr Brush during and immediately after the preparation of the Price Waterhouse report.

5.13.19 Mr D M O'Hara, who at material times was an employee of Price Waterhouse, was centrally involved in its review of the Board and the preparation of its report. Price Waterhouse's client, for the purposes of the review and the report, was the Department of the Premier and Cabinet. Mr Brush was the representative of the Department with whom Mr O'Hara and other representatives of Price Waterhouse dealt.

5.13.20 In a file note prepared on or about 14 February 1984, Mr O'Hara described the experience of the Price Waterhouse team with Mr Brush as follows:

- "(a) On 13 February 1984, we raised the question of the section 36A election signed by the Board and Parrys with Len Brush. Prior to this date, we had not referred Len to the section 36A election because we wanted to check the situation out more thoroughly before briefing him. Our prior experience with Len is that when briefed he tends to jump to conclusions and head off in tangents with the result that the orderly collection of data and formulation of conclusions is disrupted unnecessarily.
- (b) On 13 February, Len was questioning [Stephen Wall, another employee of Price Waterhouse] regarding the overview model he had prepared on the Halls Head project and it became clear from Len's line of questioning/interrogation that he was hunting in the dark for certain magic answers which do not exist or at least cannot be arrived at without the preparation of a detailed model and a major investigation. To redirect Len from this rather fruitless line of attack, we briefed him on the nature of the section 36A election and the impact on both Parrys and the Board of such an election.
- (c) In response [to the briefing on the nature of the Section 36A election], Brush behaved as we would anticipate and jumped to all sorts of conclusions, some of which were logical and others were not. We provided Brush with copies of the information memoranda forwarded to Ray O'Connor [in his day] and Brian Burke at the time the purchase was being contemplated. These documents make no reference to section 36A. Len's response was to take the matter to the Premier within a matter of hours after we had had our initial discussions.

- (d) We must be aware that Brush has direct access to the Premier and is prone to jump to conclusions with only half facts. The potential problem is that Brush may misrepresent the situation in his dealings with the Premier, by only having half the facts and a warped view of those facts."

The Commission accepts Mr Brush's tendency to "head off in tangents" and "jump to conclusions with only half facts", and finds that this tendency, no doubt, contributed to Mr Burke's disproportionate and quite remarkable response.

5.13.21 After the Price Waterhouse team told him of the section 36A election, Mr Brush approached the Australian Taxation Office. He was told initially that the Taxation Office had no record of any attendance on the Deputy Commissioner at the relevant time by representatives of the Board. Mr Brush's evidence was as follows:

"... I had been told by Dennis Barton that he had referred the matter to the Deputy Commissioner of Taxation. So I then took the matter up with the Deputy Commissioner of Taxation. And as I recall there was at that time, or recently before then, there was a change of Deputy Commissioners of Taxation which clouded the issue a little bit. ... But the Acting Deputy Commissioner of Taxation indicated to me that he had been through [the Deputy Commissioner's] diaries and there was no record of any such meeting. And Mr Barton had given me an indication of the time that he went down there. So I asked the Taxation Department could they clarify that matter for me because it was of vital importance. If what they were telling me was correct, then Mr Barton wasn't telling me the truth. So they did come back to me and said definitely that no one from the Superannuation Board had been down there to see them."

Subsequently, the Taxation Department did confirm that Mr Yorg, Mr Barton and Mr Neville had attended upon the Deputy Commissioner as stated by them. However, it is clear that Mr Brush's erroneous belief that he was not being told the truth about the attendance on the Deputy Commissioner was conveyed by him to Mr Burke and that was, no doubt, also partly responsible for Mr Burke's response.

5.13.22 The manner in which Mr Yorg was treated by the Premier was inappropriate and unwarranted. There was nothing in the circumstances relating to the

section 36A(2) election, properly understood, which would justify the Premier's response.

5.13.23 By an agreement dated 10 March 1987, the SB Investment Trust sold its interest in the Halls Head development to Esplanade Mandurah. The circumstances of that sale are examined in detail in section 5.17 of this chapter. However, it should be mentioned now that clause 2(4) of the agreement provided for the SB Investment Trust and Esplanade Mandurah to make an election under section 36A(2) to treat the book value of the Halls Head land in the accounts of the SB Investment Trust as at the date of sale as the value of the land for the purposes of section 36. On 24 June 1988, a notice of election under section 36A(2) was signed by Perpetual Trustees as trustee of the SB Investment Trust and Esplanade Mandurah. When the agreement was signed on 10 March 1987, Mr Brush was the Chairman of the Board and Mr Burke was the Treasurer. Mr Brush and Mr Markey signed the agreement. Each of Mr Brush, Mr Burke, Mr Markey and Mr Neville said that he had no involvement in, or could not recall any involvement in, the decision whereby the Board agreed to make the election. None of them could assist the Commission in any way in ascertaining how clause 2(4) came to be included in the agreement. The Commission observes, however, that it would be surprising if Mr Brush had no involvement in the decision to include clause 2(4), because at the material time he was clearly the chief decision-maker within the Board. If Mr Brush did approve of or acquiesce in the decision, it would have been totally inconsistent with the severe criticism he made of the earlier section 36A election which the Board agreed to make, and evidence he gave to the Commission to the effect that, in his view, the Board should not be involved in such elections.

## **5.14 The appointment of Mr Brush**

5.14.1 It is now appropriate to examine the circumstances of Mr Brush's appointment as the full-time Chairman of the Board. Prior to his appointment, the office of Chairman was a part-time position. Price Waterhouse recommended in its report that the office become a full-time position.

5.14.2 On 16 May 1984, Mr Yorg had a meeting with Mr Burke. At the meeting, there was discussion concerning the possibility of Mr Yorg moving to another senior position within the public service. Shortly after that meeting, Mr Yorg was approached by Mr Brush who said that he had been asked by Mr Burke to "follow up

a transfer for [Mr Yorg] to another senior position in the public service". Mr Yorg gave evidence as follows:

"Mr Brush said that he had been asked by Mr Burke to follow this through. I think that he said it was a very good opportunity for me; that I could name my own position, what I wanted to do, name my own salary. His words were that I could make the job as cushy as I wanted to and that this would be a wonderful opportunity for me."

5.14.3 On 21 May 1984, Mr Berinson, in his capacity as Minister for Budget Management, sent a memorandum to Mr Burke which read in part:

"Following your discussion with him, Mr Len Brush has provided me with a copy of the [Price Waterhouse] report, and with draft press releases as follows:

- (1) Receipt from Price Waterhouse on their review of [the Board].
- (2) Announcement of Mr Jarman's resignation as part-time Chairman.
- (3) Announcement of Mr Brush's appointment as full-time Chairman.

These drafts, with my suggested amendments, are enclosed. I agree that the replacement of the Chairman on the above basis should take place. The first step in this process is Cabinet approval for the new appointment and I assume that you have this in hand."

Mr Burke made a handwritten note on the memorandum instructing his private secretary, Mr Michael Balfe, to arrange the preparation of a Cabinet minute reflecting Mr Berinson's advice concerning "Mr Brush's appt".

5.14.4 On the morning of 28 May 1984, Mr Bruce Beggs, the Director General of the Department of the Premier and Cabinet, requested Mr Les Smith, the Executive Officer of that department, to prepare urgently the Cabinet minute sought by Mr Burke and deliver it to Mr Burke at a Cabinet meeting that morning. Mr Smith did so. The Cabinet minute recommended, amongst other things, approval by Cabinet of the

appointment of Mr Brush as full-time Chairman of the Board. On 31 May 1984, Mr Smith had discussions with Mr Brush about the Cabinet minute. Mr Smith then sent a memorandum dated 31 May 1984 to Mr Burke which read in part:

"In the light of Len's discussion with you yesterday, I have modified the Cabinet [minute] to include reference to:

- (a) The establishment of the Superannuation Board as a separate Department of the Public Service so that the Chairman would have direct access to the responsible Minister.
- (b) Len's appointment to be for a term of five years as the permanent head of the Superannuation Board.
- (c) Some clarification of the likely salary as a result of talks I had with Digby Blight and the Public Service Board."

The modified Cabinet minute was considered by Cabinet on 11 June 1984. Cabinet approved the minute subject to the position of full-time Chairman being advertised and the Board "remaining a branch of the Department of Treasury".

5.14.5 In a memorandum dated 13 June 1984 to Mr Brush, Mr Yorg referred to their discussions "over the last month", and to Mr Yorg's discussion with Mr Burke on 16 May 1984, and set out his thoughts on his "proposed promotion". The memorandum contained Mr Yorg's suggestion as to the title of the new position, its objectives, and other details concerning duties, staff, accommodation and salary.

5.14.6 The position of full-time Chairman was advertised on 16 June 1984. Mr Smith said that Mr Brush had some involvement in the preparation of the advertisement.

5.14.7 Several applications were received and the Chairman of the Public Service Board, Mr Ken McKenna, appointed a selection panel to consider the applications. The panel comprised Mr Beggs, Mr Ross Bowe, the Deputy Under Treasurer and Mr Francis Campbell, a member of the Public Service Board. The panel decided to interview three applicants for the position, namely, Mr Brush, Mr Yorg and Mr Markey. The interviews took place on 11 July 1984. At all material times, the panel knew that Mr Brush was the candidate favoured by Mr Burke. It prepared a report and

decided, by a majority, to recommend the appointment of Mr Brush. The Commission was not able to examine the panel's report, it having been destroyed.

5.14.8 On 16 July 1984, Mr Brush sent a memorandum to Mr Beggs which attached a document setting out details of a new position to be created by the Public Service Board, and to be known as "Director of Special Projects/Principal Government Actuary". In the memorandum, Mr Brush said:

"The position is not to be advertised and Mr Yorg, the Director of the State Superannuation Board is to be appointed.

Mr Yorg is aware of the promotion and is in full agreement with this action.

The appointment is to be made simultaneously with the announcement of the appointment of the full-time Chairman of the State Superannuation Board."

The new position was not, in reality, a promotion. It was more analogous to a sinecure. Its creation did not serve or advance any legitimate aspect of public administration.

5.14.9 On 18 July 1984, Mr Yorg telephoned Mr Beggs to say that the proposed new position in the Public Service was acceptable to him, but he stressed that his preference was for the office of full-time Chairman of the Board. On the same day, Mr Beggs sent a memorandum to the Chairman of the Public Service Board informing him of Mr Yorg's position. In the event the Public Service Board accepted the recommendation of the selection panel. Mr Brush was appointed full-time Chairman of the Board for five years with effect from 24 July 1984. Mr Yorg was appointed to the newly created position of Director of Special Projects and Principal Government Actuary with effect from 30 July 1984. Both were entitled to the same salary and benefits.

5.14.10 There is no doubt that Mr Yorg's application for the office of full-time Chairman of the Board was prejudiced by the manner in which he had been treated by the Premier in connection with the section 36A(2) election. The whole circumstances attending Mr Brush's appointment as full-time Chairman, and the creation of the new Public Service position for Mr Yorg, give rise to considerable disquiet, and have a tendency to undermine public confidence in the method of making appointments to senior Public Service positions.

## **5.15 The management of the Halls Head joint venture**

5.15.1 The Halls Head joint venture agreement established a Board of Management. Clause 3.1 of the joint venture agreement required that the Board of Management consist of not more than four representatives of each joint venturer. At all material times, the Board of Management, in fact, consisted of two representatives of each joint venturer. The representatives nominated by Perpetual Trustees were members or employees of the Superannuation Board. The powers and duties of the Board of Management included the determination from time to time of a detailed programme for the development of the Halls Head land and a budget setting out particulars of the revenue anticipated to be received, and the costs anticipated to be incurred, by the joint venture. By clause 4.2A of the joint venture agreement, Esplanade Mandurah was appointed the Joint Venture Manager.

5.15.2 Esplanade Mandurah, in its capacity as the Joint Venture Manager, was obliged, subject to any directions from time to time from the Board of Management and in accordance with the applicable programme and approved budget, to attend to the day to day management and control of the project and to open and operate a separate banking account to be styled "Halls Head Estates" (or in such other manner as the Board of Management might from time to time decide) in the names of the joint venturers with the Commissioners of the Rural & Industries Bank of Western Australia ("the R & I Bank"), Metropolitan Markets branch: clause 4.3(a) and (b).

5.15.3 By clause 4.7 of the joint venture agreement, Esplanade Mandurah, as Joint Venture Manager, had authority, without prior reference to the Board of Management, to undertake aggregate expenditures not exceeding \$100,000 (indexed as provided in clause 4.7) from time to time on any matter or thing coming within the general scope of the Joint Venture Manager's authority as set out in clause 4. The authority conferred on Esplanade Mandurah as Joint Venture Manager by clause 4.7 was subject to two relevant provisos, as follows:

- (a) where possible and practicable, before undertaking any such expenditure, Esplanade Mandurah was obliged to consult with as many individual representatives of the Board of Management as might then be available for such consultation for the purpose of determining whether there was likely to be any objection to such expenditure; and

- (b) any such expenditure undertaken had to be referred to the next meeting of the Board of Management for approval.

## **5.16 The donation**

5.16.1 At all material times, as contemplated by Clause 4.3(b) of the joint venture agreement, the Halls Head joint venture maintained an account at the Metropolitan Markets branch of the R & I Bank. The account was in the joint names of Esplanade Mandurah and Perpetual Trustees as trustee for the SB Investment Trust. At all material times, the account was under the practical control of the Parry group.

5.16.2 At all material times, Mr Parry was the dominant person within Esplanade Mandurah and the Parry group as a whole. Mr Parry was Chairman and Chief Executive of Parry Corporation, which was the holding company of the group. Mr Parry, through Paracel Pty Ltd ("Paracel"), controlled Parry Corporation. Mr Court and Mr Peter Firkins were part-time employees of the Parry group during the relevant period. Mr Lawrence Humphry was a full-time employee, but he was undoubtedly subordinate to Mr Parry, and subject to instructions and directions from him.

5.16.3 Mr Parry was the chief decision-maker within the Parry group. At times Mr Parry was autocratic in relation to Parry Corporation. His will generally prevailed. If Mr Parry gave an instruction to anyone in the Parry group which was capable of being carried out, the instruction was carried out. There is evidence before the Commission of Mr Parry having told his subordinates within the Parry group that decisions affecting finance were not to be made without reference to him. Mr Parry could not tell the directors of Parry Corporation what to do, but he could get rid of them.

5.16.4 In late July 1985, a cheque for \$150,000 was drawn on the Halls Head joint venture account. The payee of the cheque was the No 1 Advertising Account. The cheque was presented to the Premier, Mr Burke, as a donation to the Australian Labor Party, and was deposited by Mrs Brenda Brush (Ministerial Officer, Office of the Premier) in the No 1 Advertising Account at the Town & Country Building Society.

5.16.5 The practical effect of paying the \$150,000 from the Halls Head joint venture account was that the donation was financed as to \$75,000 by Esplanade Mandurah, and as to \$75,000 by the Board. The \$75,000 that was effectively financed

by the Board was, of course, trust money that had been paid by contributories to The Superannuation Fund.

5.16.6 At all material times, Esplanade Mandurah had four directors, namely, Mr Parry, Mr Humphry, Mr Court and Mr Firkins. Mr Court and Mr Firkins denied any knowledge of the donation until they were informed of it in about April 1992 by Commission staff. Their evidence is accepted by the Commission. There is no evidence that either of them knew about the donation at any earlier time.

5.16.7 The substance of relevant evidence given by Mr Parry was as follows:

- (a) He believed he was approached by Mr Terry Burke for a donation, that the request was made by telephone and that a donation of \$150,000 was sought.
- (b) He believed that he went to a meeting of the Halls Head joint venture Board of Management and said that he had been asked for a donation. The meeting was attended by all of the then members of the Board of Management, namely himself, Mr Brush, Mr Neville and Mr Humphry. Mr Parry said that he raised specifically with Mr Brush at that meeting the issue of the joint venture making the donation, and he was quite sure that everyone present at the meeting had heard what he said. Mr Parry said that there was no dissent by either Mr Brush or Mr Neville, and "we then proceeded to make the donation".
- (c) He said that he had no recollection of having presented the cheque to the Premier.

5.16.8 However, the Commission had difficulty with Mr Parry's evidence. In successive interviews with Commission investigators, he made inconsistent statements and was generally unhelpful.

5.16.9 Mr Parry displayed a poor memory of relatively recent, significant events. For example, Mr Parry thought, erroneously, that he had been shown a cheque at the interview with Commission investigators in April 1991, and again at the interview with Commission representatives in April 1992. Mr Parry could not recall, in the witness box, some documents which he had been shown at the April 1992 interview.

5.16.10 The Commission finds that Mr Parry had no memory of material events relating to the donation, and he simply adopted and embroidered parts of Mr Humphry's evidence. Mr Parry admitted that he had read Mr Humphry's evidence, and reports in the press of the Commission's proceedings, prior to giving evidence. In summary, the Commission finds that Mr Parry was an unsatisfactory witness, and that his evidence in relation to any material matter, unless corroborated, should not be accepted.

5.16.11 The substance of relevant evidence given by Mr Humphry was as follows:

- (a) In 1985, Mr Parry told him that he had been asked to make a donation of \$150,000 to the Australian Labor Party. Mr Humphry was uncertain as to whether or not Mr Parry mentioned who had asked him for the donation. He thought that Mr Parry might have used the word "Burkie".
- (b) He gained the impression that Mr Parry felt under pressure to make the donation. He said Mr Parry told him that \$150,000 was "too much money".
- (c) He said Mr Parry came to him one morning and said: "I think I've solved that problem. I'm going to have the joint venture make the payment and that way at least they'll be paying half." Mr Humphry's reaction was that it sounded like "a pretty good solution to the problem".
- (d) He believed that he went and asked for a Halls Head joint venture cheque for \$150,000 from Mr Fraser Petrie. At the material time, Mr Petrie was an accountant employed within the Parry group to carry out accounting functions in connection with the joint venture.
- (e) He initially gave evidence that Mr Parry told him that the payee of the cheque should be the No 1 Advertising Account. When recalled several days later to give further evidence, Mr Humphry said that, on reflection, this evidence was not correct. He said that what had happened was as follows:
  - (i) He asked Mr Parry for the identity of the payee of the cheque.

- (ii) Mr Parry said that he should see Mr Brian Conway about that matter. (Mr Conway was employed within the Parry group at that time, and he had a close association with the Australian Labor Party)
- (iii) He spoke to Mr Conway about the matter, and Mr Conway subsequently told him that the payee should be the No 1 Advertising Account.
- (f) He said the cheque was presented by Mr Parry to the Premier at a meeting at the Premier's office in the Capita Centre attended by the Premier, Mr Parry, Mr Humphry and some other people. There is no suggestion that any representative of the Board attended the meeting.
- (g) He said the making of the donation from the Halls Head joint venture account was mentioned by Mr Parry to Mr Brush at a meeting of the Board of Management of the joint venture. Mr Humphry was not sure whether the relevant meeting occurred before or after the making of the donation. He thought the amount of the donation was not mentioned. Mr Humphry said he overheard Mr Parry say to Mr Brush at the meeting something to the effect: "I'm sure you'll have no objection to the joint venture making a donation to your Leader's Party." Mr Humphry said that Mr Brush simply shrugged his shoulders and made no objection. He added that he took Mr Brush's reaction to be consent. He also said that he thought Mr Parry made mention of the donation to Mr Brush, but not to Mr Neville.
- (h) Shortly after the cheque was presented by Mr Parry to the Premier, Mr Humphry was engaged in drafting and sending a letter to the R & I Bank. The \$150,000 donation had not been provided for in the joint venture budget previously given to and approved by the Bank. It was necessary to give the Bank an explanation for the unbudgeted expenditure. The letter sent to the Bank was a fabrication. It did not disclose the real reason for the unbudgeted expenditure. It said, falsely, that the \$150,000 was required in connection with the development of part of the Halls Head land known as "the Sticks". The letter was signed by Mr John Gardner, who, at the material time, was the financial

manager of the Parry group. Mr Humphry said that a first draft of the letter was prepared by Mr Gardner. The initial draft was then discussed and amended at a meeting in Mr Gardner's office attended by Mr Gardner, Mr Humphry and Mr Stephen Parry, a son of Mr Kevin Parry. Mr Humphry said he thought Mr Gardner and Mr Stephen Parry knew about the donation at the time the letter was drafted and sent. However, Mr Gardner said he had no knowledge of the donation until he was interviewed by Commission investigators in about April 1991. Mr Stephen Parry said he acquired knowledge of the donation only shortly before the commencement of the hearing of this term of reference.

- (i) In about late 1986, Mr Humphry signed financial statements relating to the joint venture including a balance sheet as at 30 June 1986. The financial statements failed properly to disclose the donation of \$150,000. Documents tendered in evidence before the Commission clearly establish that the donation was included as a current asset under the item "Freehold Land and Improvements for Resale". The relevant financial statements were also incorporated in the taxation return of the joint venture for the 1985/1986 year of income. The donation was, no doubt, claimed as a deduction from the taxable income of the joint venture. Prior to signing the financial statements, Mr Humphry did not take any steps to ensure that those statements properly disclosed and accounted for the donation. Neither did Mr Parry. The implications of these findings are further discussed in a confidential appendix to this report.

5.16.12 The risk of the donation being detected by anyone (including employees of the Board and the auditors of the joint venture) was minimised in consequence of the donation having been disguised or hidden in the joint venture's financial statements and taxation returns at the instigation of someone within the Parry group. At all material times, the Parry group was responsible for maintaining the accounts of the joint venture. An employee of Arthur Young & Company, the auditors of the joint venture, made notes to the effect that an amount of \$150,400 (which amount in fact included the donation) had not been vouched, and the amount of \$150,400 had to be "cleared with Fraser, the accountant". The reference to "Fraser" was to Mr Petrie, the accountant employed within the Parry group to carry out accounting functions in connection with

the joint venture. Unfortunately, the point was never followed up by the auditors of the joint venture. Mr Sing Chin, a chartered accountant, was employed as an audit manager by Arthur Young & Company at the material time. Mr Chin was involved in auditing the relevant financial statements of the joint venture. Mr Chin said in evidence that there were two possible reasons why the \$150,400 point of query was not resolved. One explanation was that Mr Chin had a discussion within the audit group at Arthur Young & Company responsible for auditing the joint venture, and it was decided that the \$150,400 was not sufficiently significant within the scheme of the audit to be of concern. The other explanation was that the point of query was not resolved in consequence of an oversight by Mr Chin.

5.16.13 Mr Humphry presented as an honest witness who readily admitted his role in relation to the donation, and did his best to recall relevant events. In general, his evidence is accepted by the Commission. There are, however, two areas where evidence given by Mr Humphry conflicts with evidence given by other witnesses.

5.16.14 The first area of conflict relates to whether or not Mr Brush was informed of the donation or proposed donation by Mr Parry. Mr Humphry's evidence concerning that matter was emphatically denied by Mr Brush. The issue as to whether Mr Brush was told is obviously important. Neither Mr Humphry nor Mr Brush would concede that he might be mistaken in this aspect of his evidence.

5.16.15 The Commission prefers the evidence of Mr Humphry for these reasons. First, Mr Humphry frankly acknowledged his part in the making of the donation and the fabrication of the letter to the R & I Bank. Secondly, if Mr Humphry had decided to invent his evidence that Mr Brush was informed of the donation, one would have expected Mr Humphry to have told a story which more effectively removed him from any possible criticism. For example, in his evidence Mr Humphry did not commit himself as to whether the matter was raised with Mr Brush before or after the donation was made. And Mr Humphry said he did not think that Mr Brush was told the amount of the donation. Thirdly, any credit that might attach to Mr Brush's evidence as a truthful witness has been severely and adversely affected by evidence he gave in the Fremantle Anchorage term of reference. That evidence relates, amongst other things:

- (a) to the payment of a \$1 million fee to Anniversary Nominees Pty Ltd ("Anniversary") when (as the Commission finds) he knew that it was the common intention of the relevant parties that Anniversary (and others)

would not be entitled to their fees unless and until the whole of the land in the Anchorage site (including, in particular, the Swan Wool Scourers land, but excluding the land owned by Delta Trading) had been acquired by the Board and when he knew that the fee was not due and payable;

- (b) to a bank cheque he purchased with cash in December 1986 and the use of a false name and fictitious address when purchasing the cheque;
- (c) to the creation of false documents relating to the loans made to Mr Brush's company by Mr Robert Martin's company;
- (d) to the backdating of security documents prepared by Mr Terence McDonnell with respect to the loans;
- (d) to telling lies in early 1987 to police and journalists investigating the loans;
- (e) to telling lies to his solicitor in early 1987;
- (f) to his failure to disclose to the Board the making of the loans;
- (g) to the giving of inaccurate statements as to his financial circumstances to the National Australia Bank in October 1988 and the Bank of Melbourne in February 1990; and
- (h) to some important and material inconsistencies in his evidence generally which are set out in section 6.13 of chapter 6.

The Commission accepts Mr Humphry's evidence, and finds that Mr Parry sought Mr Brush's acquiescence to the joint venture making a donation to the Australian Labor Party (but without telling Mr Brush the amount to be donated) and that Mr Brush acquiesced in the making of the donation.

5.16.16 The second area where evidence given by Mr Humphry conflicts with evidence given by other witnesses relates to whether or not Mr Gardner and Mr Stephen Parry were aware of the donation as at the date on which the fabricated letter was drafted and sent to the R & I Bank. Mr Humphry said that he thought they would have

been aware. However, Mr Humphry had no recollection of telling either Mr Gardner or Mr Stephen Parry about the donation, and he had no recollection of being present while someone else told either of them about it. As previously mentioned, Mr Gardner denied having any knowledge of the donation at the material time, and Mr Stephen Parry asserted no awareness of the donation at that time. The evidence does not justify a finding that either Mr Gardner or Mr Stephen Parry knew of the donation at the time the fabricated letter was drafted and sent to the Bank, or a finding that either Mr Gardner or Mr Stephen Parry knowingly participated in the fabrication.

5.16.17 The evidence does not establish that Mr Neville knew anything about the donation until shortly before the commencement of the hearing of this term of reference. Mr Humphry confirmed that it was unlikely that Mr Neville had been told about the donation at the Board of Management meeting. His evidence on the point was as follows:

Q: Now, you mention that you overheard this conversation between Mr Parry and Mr Brush. During the course of the meeting, did Mr Parry say anything to Mr Neville in relation to the cheque?

A: I don't believe so.

Q: So your recollection is that Mr Parry made mention of the cheque to Mr Brush but not to Mr Neville?

A: Yes. ...

Mr Parry gave evidence suggesting that Mr Neville was told of the donation in about late July 1985, but the Commission is of the view, for reasons previously given, that Mr Parry's evidence should not be accepted. The Commission finds that Mr Neville knew nothing about the donation until recently.

5.16.18 The Commission finds as follows:

- (a) It was improper of Mr Humphry to have engaged in the fabrication of the letter to the R & I Bank. Fortunately for Mr Humphrey, evidence from Mr Frank Roach, an employee of the Bank, clearly indicates that the letter did not induce the Bank to extend credit to the joint venture. The implications of this finding are further discussed in a confidential appendix to this report.

- (b) It was improper of Mr Parry and Mr Humphry to have failed to take reasonable steps to ensure that the donation was properly disclosed in the financial statements and taxation returns of the joint venture. The implications of this finding are further discussed in a confidential appendix to this report.
- (c) It was improper of Mr Brush to acquiesce in the donation, to fail to make further enquiry about the donation, and to fail to ensure that the donation was not made. On no view can it be said that it was a proper use of funds in which the Board had an interest, that those funds be used to make a donation to a political party.
- (d) Mr Neville knew nothing about the donation until recently.
- (e) The evidence does not justify a finding that either Mr Gardner or Mr Stephen Parry knew of the donation when the fabricated letter was sent to the Bank.

5.16.19 The Commission observes that Mr Parry, as the Chairman and Chief Executive within the Parry group at the relevant time, should carry primary responsibility for the area in which the Commission has found that both Mr Parry and Mr Humphry acted improperly.

5.16.20 With reference to Mr Parry's assertion that he was under pressure, in our view the evidence does not justify a finding that any improper pressure was applied by any person to induce him to make a donation.

## **5.17 The resale by the Board to Esplanade Mandurah**

5.17.1 By early 1986, relations between Esplanade Mandurah and the Board had deteriorated. Mr Brush was dissatisfied with the financial performance of the joint venture, and with the manner in which the joint venture was being managed.

5.17.2 Mr Brush sought advice from the Board's solicitors, Collison & Hunt, on the terms of the joint venture documents and possible commercial tactics to be used against the Parry group. He also obtained advice from Mr Barton, who was formerly

Chairman of the Board and who was, at all material times, in private practice as an actuary.

5.17.3 In a letter dated 14 April 1986 from Mr Brush to Mr Hunt of Collison & Hunt, Mr Brush said:

"I am becoming increasingly concerned regarding the Board's position in relation to this development.

Since the inception of the joint venture the project has been in a loss making situation which in turn has required borrowings to be obtained in order that development of blocks for sale can proceed.

The Board has made many suggestions on how to improve the overall performance of the project. In most cases, our joint venture partners have been difficult to persuade.

Zoning approval has now been obtained for the development and construction of canals which of course will require further borrowings. The project is already in a precarious financial position and I am reluctant to increase borrowings, in fact they should be reduced not increased.

My opinion is that we should either sell our share, or purchase Parry Corporation's share or onsell the project in its entirety.

I have had discussions with the Parry Corporation and they refuse to be realistic regarding the suggestions.

The time has come for some hard decisions to be made and I am now seeking your advice as to the Board's legal options in this matter. I appreciate that this is a difficult task, however, it must happen."

In response to that letter, Mr Hunt sent Mr Brush a memorandum of advice dated 21 April 1986. Mr Hunt summarised his advice as follows:

"The Board is not in a position to withdraw from its obligations under the [joint venture] Agreement of its own volition. It is dependent on the co-operation of the Parry companies and in the absence of this co-operation it will be necessary to adopt a course of action which may possibly have serious consequences.

Litigation may ensue if the Parry companies become sufficiently displeased with the actions of the Board. Obviously if the Board wishes to avoid this, it will have to proceed with caution."

5.17.4 In a letter dated 3 September 1986, Mr Barton advised Mr Brush as follows:

- (a) The joint venture agreement was not an equal partnership. It was weighted in the Board's favour in that:
  - (i) Interests associated with the Parry group would not be credited with any profits from the development until the Board received a return of 22.5% on its funds deemed to be invested.
  - (ii) The Parry group could not draw funds from the joint venture unless the joint venture's assets covered 150% of the amount needed to secure the Board's return.
- (b) A logical basis for the acquisition of the Board's interest by the Parry group would be:
  - (i) The Board make no further payments under the joint venture agreement.
  - (ii) The Parry group pay the Board an amount equal to funds already invested by the Board, credited with interest at the rate implicit in the original price arrangements and value.
  - (iii) The Board have no further responsibilities for debts of the joint venture nor any further claim on the Parry group.
- (c) An alternative basis for the acquisition of the Board's interest by the Parry group would be:
  - (i) The Board make no further payments under the joint venture agreement.

- (ii) The Parry group pay the Board an amount equal to funds already invested by the Board, credited with interest at the rate of 22.5% per annum thereon.
- (iii) The Parry group pay the Board's costs.
- (iv) The Board have no further responsibilities for debts of the joint venture nor any further claim on the Parry group.

Mr Brush said in evidence that the assumptions on which Mr Barton's advice was based were not achievable because they required the co-operation of Mr Parry.

5.17.5 Mr Brush also said in evidence that he sought informal advice in connection with Halls Head from Mr Doherty (the employee of Tricontinental Corporation who originally advised the Parry group in connection with Halls Head), and Mr Ivan Hoffman (a businessman and former associate of Mr Parry).

5.17.6 At a meeting held on 12 September 1986, Mr Parry and Mr Brush orally agreed that the Board would purchase the interest of Esplanade Mandurah in the development. However, a short time later, at the same meeting, they orally agreed to reverse the transaction so that Esplanade Mandurah would buy out the Board. On 16 September 1986, the Board formally approved the agreement negotiated by Mr Brush.

5.17.7 On 10 March 1987, a formal document was signed to evidence the sale by the SB Investment Trust to Esplanade Mandurah of the Trust's 50% interest in Halls Head. The sale price was \$4.2 million. This amount was paid on 22 April 1987.

5.17.8 Although the SB Investment Trust disposed of its interest in the Halls Head development in March 1987, the Trust nevertheless remained under an obligation to pay the balance of the purchase price owing under the original contract of sale entered into on 23 June 1983. As at March 1987, the relevant liability was \$25.5 million, payable free of interest over the next 11 years.

5.17.9 On 12 November 1987, Perpetual Trustees as trustee of the SB Investment Trust, Esplanade Mandurah and the Board entered into a Deed pursuant to which the SB Investment Trust paid Esplanade Mandurah \$12.1 million in full

satisfaction of its obligation to pay the balance of the purchase price under the original contract of sale.

5.17.10 The Board reported a loss of approximately \$12.8 million in connection with its involvement in the Halls Head development. Mr Simon Cubitt, a chartered accountant, prepared a report and gave evidence concerning this loss. The Commission accepts his report and evidence and, in particular, where there is any conflict, prefers his evidence to that of Mr Brush. The Commission notes that the loss of approximately \$12.8 million was properly calculated and brought to account by the SB Investment Trust in the year ended 30 June 1987 in accordance with Australian Accounting Standards.

5.17.11 Mr Brush said in evidence that the \$4.2 million purchase price was calculated as follows:

"We [meaning Mr Brush and Mr Neville] did a number of calculations and we plucked figures out of the air and we negotiated with Parry. It was a combination of the whole lot, which culminated in, really, the best deal that could be done."

5.17.12 Mr Brush knew that if the Board sold its interest in the Halls Head development for \$4.2 million, the Board would incur a substantial loss. Mr Brush gave evidence as follows:

Q: Now, having done those calculations, did you make some assessment as to the likely loss, if any, that the Board would incur if it sold out to Parry for the price you had in mind in the order of \$4.2 million?

A: What comes to mind is, I think, that after we'd done our net present value calculations I believe we came to a figure of around about \$10 million we were going to burn on the project.

Q: Now, in your view, was it proper to proceed with negotiations and to conclude a sale of the Super Board's interest to Parry knowing that, in your view, the Board was likely to realise a loss of some \$10 million without seeking some expert advice as to whether it was better for the Board to buy Parry's interest rather than sell, or to adopt some other tactical position?

A: I had taken advice from Barton. I had spoken to the Board's solicitors about our position. But basically — I mean, you can only

go to a valuer, and a valuer just — will just predict into the future what land will be. I mean, we knew what the availability — we had all of the information there inhouse ourselves about the availability of land, the take-up rate, the increase in the population, the opposing people — companies, what they were doing, how that would impact. I mean, we had a very fair idea as to what the situation was. I mean, I was of the opinion, if we had have taken control of it, that there was a possibility that it could have been turned around. But it was a very difficult assignment. The costs of development that were built into the project down there were, in my opinion, excessive. To remain with Parry was very, very, very difficult. And, I mean, that's — that's my assessment. My assessment was to stay there the Board would have lost more money.

The Commission observes that although Mr Brush took advice from Mr Barton, he did not follow that advice.

5.17.13 Mr Brush further said in evidence that he thought "disaster was around the corner" for the Halls Head project. Nevertheless, Mr Brush said he did not think that it was necessary for the Board to obtain some independent expert advice as to the probable correctness of his view before entering into negotiations with the Parry group.

5.17.14 The Board did not obtain an independent valuation of the Halls Head land prior to negotiating the sale with the Parry group. Mr Brush said in evidence that the obtaining of such a valuation would have been academic because "the deal that [Mr Parry] would accept was whatever you could negotiate with him". Mr Brush further said:

"The valuation of the properties at the time was a take it or leave it from both parties' point of view. I mean, there were some swings and merry-go-rounds in the deal."

5.17.15 When asked whether he thought it would have been helpful to have had an independent valuation, Mr Brush said that he didn't think the deal would have been done differently with a valuation. He said that "the deal that was done ... had blood dripping from it anyway". Similarly, Mr Brush said that he did not think it was appropriate for the Board to instruct a merchant bank or an investment bank to advise prior to the Board selling its interest. He didn't think it would have made any difference to the end result of the negotiations with the Parry group. He believed the Board achieved the best commercial deal it could.

5.17.16 There is no doubt that the Halls Head development was a long term project. Mr Vince Pental was employed within the Parry group from 1974 until about June 1984. He was responsible for a range of financial and investment matters. Mr Pental gave evidence as follows:

Q: Is it your recollection that the Halls Head project was a long term project?

A: Oh, absolutely. I mean, 20 to 30 years. It was always looked at as 20 years or more because it was an enormous parcel of land that would one day accommodate a population — a city in its own right.

Q: With a project of that type, would the outgoings or expenditure be distributed uniformly over the life of the project, or would they tend to be concentrated in different time scales?

A: No, there were a lot of factors that governed it — the economic sales, zonings, approvals, and obviously the market conditions at the time. Because being what was regarded as a future city in its own right, then considerations were given to things like schools and high schools and retirement villages, shopping centres; all of the community services that were required. So that — I mean, at any particular point in time, interests have an effect on those particular projects, market conditions. I mean, obviously the canal developments were one that, had they got off the ground much earlier than they did, would have had a major impact on it.

Q: So in a nutshell, the Halls Head project was not the type of project which was conducive to the making of a quick profit in the short term?

A: No.

Mr Humphry gave evidence to similar effect. Mr Barton agreed that the Halls Head development was a long term project, and that the Board would be unlikely to recoup a significant amount from its investment until a substantial number of years had elapsed.

5.17.17 The 50% interest of the Board in the Halls Head development had the potential to be significantly more valuable than the 50% interest held by Esplanade Mandurah. Mr Humphry said:

"My understanding of the formula was, after lengthy discussions with Dick Yorg and also getting independent advice from Joe Wong, that the project would have to return the Superannuation Board an internal rate of return per annum of 22.5% before [Esplanade Mandurah] could draw any of its emerging profits. One would have normally expected a project of that nature to produce an investment rate of something like 30%. If the project got off to a slow start, or didn't come up to expectations in terms of rates of sales and amounts for the residential blocks there, then the profits would have been reduced, the State Super Board would have had first draw on the amounts emerging to the extent that it returned 22.5% on their investments at any particular time, because they were making payments, instalment payments. Given that the project never returns more than 22.5% — if that was the case — then, in effect, [Esplanade Mandurah] would never, ever get a return. So, further down, looking further down the track, it would really mean that we'd sold the whole of Halls Head for the \$30 million."

This evidence is consistent with Mr Barton's advice to Mr Brush that the "joint venture agreement was not an equal partnership".

5.17.18 Mr O'Hara gave evidence as to the manner of calculating the net present value of the future instalments that were payable by the Board under the original contract entered into in June 1983 and as to the future cash flow to emerge from the Halls Head development. His evidence on the point was as follows:

- A: There are two sides to it; one is the cashflow to emerge from the project and the other is the payment of the instalments. The payment of the instalments is relatively simple. If you apply ... the 22.5 ... percent, you end up back at the \$5 million — that's fairly simple — but the cashflow to emerge from the project requires developing an understanding of what ... lands are going to be developed, when they're going to be marketed, the costs of marketing, the costs of development, the timeframes in which that expenditure is going to be undertaken, the sales commissions involved, holding costs, advertising.
- A: You then say 'Well, what's our projection on Halls Head price values in the year 2000?' which is only 15 years hence but who is to guess that. You then get into the world of sensitivity analysis and start playing around with that to get a feel, to start massaging the equation to see how it really feels and if you jump in prematurely and start making decisions on the initial base model

without understanding the assumptions and the impact of the sensitivities then you can jump to the wrong conclusions very quickly.

Q: You, obviously, need particular skills in order to be able to prepare that sort of sensitivity model. Is that the sort of thing that is done by a chartered accountant or an actuary or an investment adviser? What sorts of people have these skills?

A: Quite a wide ranging group in the community have those skills now, property developers, chartered accountants, investment advisers, actuaries. Actuaries are very good at it as they're trained.

5.17.19 Mr Neville gave evidence that he had advised Mr Brush to defer making a decision to sell the Board's interest in the Halls Head development. Mr Neville also gave evidence that he suggested to Mr Brush that other alternatives be explored before the Board decided to withdraw from the joint venture. Some of these alternatives were explored, but others were not.

5.17.20 On 15 September 1986 (the day prior to the Board formally approving the agreement negotiated by Mr Brush with Mr Parry), Mr Neville sent Mr Brush a memorandum expressing his concern about the proposed sale to the Parry group. The memorandum, so far as material, read:

"I am still concerned about the proposed arrangement with Parry. My major concern is the effect it will have on our balance sheet. It may be seen that we did not take sufficient steps to minimise the loss.

A suggestion is that we ... ask for further time and explore the possibility of a joint venture with Cheng.

I am unhappy about procrastinating over this matter, however, you will appreciate I am extremely worried."

Mr Brush said in evidence that he did not recall receiving the memorandum, but the Commission accepts Mr Neville's evidence, and finds that he sent the memorandum to Mr Brush who received and ignored it, as he did the advice of Mr Barton.

5.17.21 The Commission finds that the Board (which was then constituted by Mr Brush and Mr Markey) knew that it would incur a substantial loss if it sold its

interest in the Halls Head development to the Parry group for \$4.2 million. Further, the Commission finds that the Board knew or should have known that the Halls Head development was a long term project, and that the Board's interest was potentially worth significantly more than Esplanade Mandurah's interest. In those circumstances, common prudence should have dictated that the Board obtain a valuation and formal advice from an independent expert such as a merchant bank or investment bank before the Board entered into negotiations with the Parry group, and sold the Board's interest in Halls Head.

5.17.22 The Commission finds that the Board acted recklessly and in dereliction of its duty in selling its interest in Halls Head, without having first obtained a valuation and formal advice from an independent expert such as a merchant bank or investment bank. The circumstances which demanded that the Board obtain a valuation and formal advice from such an independent expert were these: the Board was proposing to sell for \$4.2 million without discharging its continuing liability to pay the balance of the instalments under the original contract of sale and, in consequence, the Board would realise a loss in excess of \$10 million; the Halls Head development was a long term project (20 years or more); profits from cashflow were unlikely to emerge in the early years of the project; the Board's interest in the development had the potential to be significantly more valuable than Esplanade Mandurah's interest; although the calculation of the net present value of the instalments payable under the original contract of sale was relatively simple, the calculation of the likely cashflow to emerge from the development required particular skills not possessed by Mr Brush or the Board's staff, and the calculation of that cashflow was relevant to the value of the Board's interest; Esplanade Mandurah was apparently willing to either sell or purchase, and analysis by an independent expert may have revealed that the Board's interests were better served by purchasing rather than selling. The Commission finds that this recklessness and dereliction of duty constituted impropriety on the part of the Board.

5.17.23 The Commission finds that primary responsibility for the improper conduct falls upon Mr Brush. He was the Chairman of the Board and, to all intents and purposes, the decision maker in these matters. Mr Brush's approach to the negotiations and sale demonstrates gross incompetence and dereliction of duty. His conduct was most definitely improper.

## **5.18 Conclusion**

5.18.1 This term of reference concerned about 1000 hectares at Halls Head, near Mandurah, which was bought in 1977 for subdivision by Esplanade (Mandurah) Pty Ltd, a subsidiary of Parry Corporation. In early 1982, Parry Corporation considered selling half its interest in Halls Head, preferably to a State or Commonwealth superannuation fund, entities which did not have to pay income tax. By 23 June 1983, the Superannuation Board had signed a joint venture deal to buy 50 per cent of the development for \$30 million, payable over 15 years, interest free.

5.18.2 **The Superannuation Board.** Under the Superannuation and Family Benefits Act, the Board was not empowered to enter a joint venture to develop land or, indeed, for any purpose. Further, no other law covering the Board's investment of trust funds authorised it to enter a joint venture. To get around this problem, the Board bought a shelf trust, invested in units of that trust, and appointed a trustee and manager of the trust which then concluded the joint venture agreement on the Board's behalf.

5.18.3 The Commission has found that the use by the Board of the SB Investment Trust to enter into the joint venture to have been contrary to the spirit of the applicable legislation. The failure to comply with section 16(5) of the *Trustees Act* accentuated the failure by the Board to respect the spirit of the legislation. Such conduct by a government instrumentality is undesirable and to be avoided.

5.18.4 **Election under section 36A(2) of the Income Tax Assessment Act 1936.** When the board and Esplanade Mandurah signed the Halls Head joint venture in June 1983, both parties agreed to treat the purchase and sale in a way that potentially maximised tax benefits to Esplanade Mandurah's parent, Parry Corporation.

5.18.5 Parry Corporation's advice on the taxation implications ranged from favourable to unfavourable, and the Superannuation Board disclosed the arrangement to the Deputy Commissioner of Taxation so it was not "seen in any way to be utilising our exempt status for any tax avoidance purpose". The Board acted appropriately in advising the tax office. The agreement with Parry Corporation was not corrupt, illegal or improper.

5.18.6 In April 1984, the then Under Treasurer, Mr Les McCarrey, and Board director Mr Richard Yorg were taken to task by the new Premier, Mr Brian Burke, over their failure to tell him of the Board's tax "deal" with Parry Corporation. Mr Burke demanded Mr Yorg's removal from the Board.

5.18.7 The Commission has found no corruption or illegality in the non-disclosure, nor any impropriety by the Board, in particular, Mr Yorg, or by Mr McCarrey. While it may have been desirable for the Board to have told Mr Burke of the tax matter before he consented to the joint venture in June 1983, the matter was handled appropriately as a matter of public administration by senior public servants.

5.18.8 Mr Burke's response to learning of the non-disclosure was disproportionate and remarkable in the circumstances. A "tax deal", similar to the one about which Mr Burke and Mr Brush complained so loudly, was agreed when the Board sold its Halls Head interest, at a time when Mr Burke was Treasurer and Mr Brush was Board chairman.

5.18.9 **The appointment of Mr Brush.** The move sideways of Mr Yorg to a new public service position did not serve or advance any legitimate aspect of public administration. Likewise, the Commission has found that Mr Brush's appointment as full-time Board chairman, as well as the treatment of Mr Yorg, give rise to considerable disquiet, and have a tendency to undermine public confidence in appointments to senior Public Service positions.

5.18.10 **The donation.** In 1985, a \$150,000 donation was made to the ALP by the then chairman of Parry Corporation Limited, Mr Kevin Parry. Half of that donation was financed, effectively, by the Superannuation Board from trust money that had been paid by contributors to the superannuation fund.

5.18.11 The Commission has found that the only communication to the Superannuation Board about the donation was a passing mention of it by Mr Parry to Mr Brush in the nature of a private aside in the course of a meeting of the management committee. Mr Brush apparently indicated acquiescence but did not share the information with any other members of the Board or with Mr Neville. Mr Brush's acquiescence was highly improper, allowing as it did for Superannuation Board funds to be used for a purpose wholly outside the Board's statutory purposes and objectives.

5.18.12 The donation had not been provided for in the joint venture budget and Mr Laurie Humphry, a director of Esplanade Mandurah, fabricated a letter to the R&I Bank, the project's bankers, explaining the expenditure as development costs. Fortunately for Mr Humphry, the evidence clearly shows that the letter did not induce the bank to extend credit to the joint venture. Nevertheless, we have found

Mr Humphry, an honest witness who readily admitted his role in the donation, acted improperly.

5.18.13 It was also improper of Mr Parry and Mr Humphry to have failed to take reasonable steps to ensure that the donation was properly disclosed in the financial statements and taxation returns of the joint venture. Mr Parry, as the Chairman and Chief Executive of the Parry group at the relevant time, should carry primary responsibility.

5.18.14 The Commission has found the Board's investment manager, Mr Brian Neville, did not know of the donation until recently. The evidence does not justify a finding that either Parry Corporation director Mr Stephen Parry or Parry group financial manager Mr John Gardner knew of the donation when the fabricated letter was sent to the bank.

5.18.15 **The resale by the Board to Esplanade Mandurah.** In September 1986, the Board sold its share of the Halls Head joint venture back to Esplanade Mandurah for \$4.2 million at a total loss of about \$12.8 million.

5.18.16 The Commission has found that Mr Brush acted improperly when, on behalf of the Board, he negotiated the sale of the Board's interest in the joint venture back to Esplanade Mandurah. It was a complex transaction and he should have obtained a valuation of the Board's interest and independent professional advice from an expert such as a merchant bank or investment bank. His failure to do so reflected gross incompetence and mismanagement.

5.18.17 Although the Board approved the sale, we find that responsibility for its decision must fall squarely on Mr Brush. He was full time chairman of the Board, and, for all practical purposes, the decision-maker in these matters. His conduct was most improper.

5.18.18 **Matters for further consideration.** Finally, reverting to the term of reference, the Commission reports:

- (a) There are matters referred to in this chapter which are addressed in a confidential appendix to this report; and

- (b) Various issues arising from our inquiry in this term of reference will be considered in Part II of our report, including: the independence of statutory authorities; the appointment as members of such authorities of people who are members of the Public Service; the mode of appointment of senior public sector officers, such as Mr Brush; and the disclosure of donations to political parties, especially in circumstances such as those in the donation authorised by Mr Parry.

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## **4.1 The term of reference**

4.1.1 The Commissioners are required by their Commission, as affected by the *Royal Commission into Commercial Activities of Government Act 1992*, to inquire and report whether there has been —

- (a) corruption;
- (b) illegal conduct; or
- (c) improper conduct,

by any person or corporation in the affairs, investment decisions and business dealings of the Government of Western Australia or its agencies, instrumentalities and corporations in respect of financial assistance by Government to Bunbury Foods Pty Ltd and further to report whether —

- (d) any matter should be referred to an appropriate authority with a view to the institution of criminal proceedings; or
- (e) changes in the law of the State, or in administrative or decision making procedures, are necessary or desirable in the public interest.

## **4.2 The overtures**

4.2.1 On 13 July 1977, Mr Mac Shannon, a business consultant from Sydney, commenced inquiries related to the proposed establishment of an edible oils refinery in Western Australia. The source of the proposal, and of his retainer, was a London-based entrepreneur who called himself Dr Shrian Oskar. Over the ensuing fortnight, Mr Shannon consulted widely. Notable among those approached were Mr A A Lewis, who was then a member of the Legislative Council and of the governing Liberal Party and officers of the Department of Industrial Development. The Department's description was subject to variation over time, but for ease of reference it will be referred to as "DID" throughout this chapter. Mr Shannon obtained an introduction to Mr Lewis from Mr Lewis's brother, a former Premier of New South Wales, and to DID from Mr George Hodgson, the WA Government Trade Representative in Sydney.

4.2.2 In his report to Dr Oskar of 25 July 1977, Mr Shannon observed:

"On advice of Hon A A Lewis, a frontbench (*sic*) State Government MP, I did not meet the Minister for Development on this visit. The department concerned will recommend favourably to the minister. Lewis is aware of your offer to lend to enable shares to be purchased. Will meet minister next visit if we proceed further."

4.2.3 A DID file note dated 18 July 1977 recorded a meeting on that day with Mr Shannon, at which the proposal was adumbrated as involving a capital cost of around \$3.8 million, of which Dr Oskar was prepared to furnish 40%, with the other 60% being provided by "local participation". The only discernible explanation of the penultimate sentence in the above-cited passage of Mr Shannon's report is that Dr Oskar intimated a willingness to assist in financing the proposed local participant or participants. Ironically, local equity participation in the project as it ultimately proceeded was negligible and loan funds flowed, not from Dr Oskar to local entities, but effectively in the opposite direction.

4.2.4 Mr Shannon's report reflected his exploration, during that first visit to Western Australia, of several sites for the refinery, but Bunbury was not among them. Mr Lewis subsequently suggested Bunbury as a suitable site and Mr Shannon travelled there on his next visit to the State. At that time he also retained, on Dr Oskar's behalf, Mr E L Bolto of solicitors Stone James & Co and Mr Michael Wilkinson-Cox of accountants Peat Marwick Mitchell. Discussions proceeded with the State Government and the Bunbury Council.

4.2.5 In a letter dated 16 September 1977, the late Mr Andrew Mensaros, the Minister for Industrial Development in the WA Government, asked Mr Shannon to "convey to Dr Oskar my deep interest in his project" and continued:

"I would be pleased to have my Department closely involved in any developments and provide assistance in the most advantageous form where possible.

I am only sorry that time did not allow me to personally discuss the project with you. However, I am aware that Dr Oskar is contemplating visiting Australia in October and, if his itinerary permits, I would be delighted to discuss the matter in more detail with you both."

4.2.6 On 14 October 1977, the Minister met with Dr Oskar and Mr Shannon, Mr Bolto and Mr Wilkinson-Cox, at which the project was discussed in detail and he indicated that Industrial Lands Development Authority land could be used and that he would support any application to the Federal Government for assistance.

4.2.7 In November 1977, DID received a detailed submission from Dr Oskar and his associates under the name "Bunbury Foods" in connection with an application for State Government assistance under the *Industry (Advances) Act 1947*. That Act authorised the provision of financial assistance by the State Government for the purpose of fostering industrial development in Western Australia. In 1977, DID had responsibility for supervising the Act's operation and DID officers investigated the merits of applications for assistance. The Department's Chief Financial Officer, Mr Graeme Rolfe, instructed a Senior Investigations Officer, Mr John Christmass, to investigate the Bunbury Foods application. Mr Christmass delegated the task to Mr John Herman.

4.2.8 A further meeting of Dr Oskar and his associates with the Minister and DID was held on 29 November 1977 and was followed by international inquiries by DID at the Minister's direction in relation to the *bona fides* and reputation of Dr Oskar. Telexes seeking information went to the Western Australian Agent-General in London and to Australian Trade Commissioners in Brazil, Dubai, New Zealand and Fiji on the basis that Dr Oskar was alleged to have business investments in those places.

4.2.9 On 8 December 1977, a shelf company called Temblador Pty Ltd had its name changed to Bunbury Foods Pty Ltd ("Bunbury Foods"). Its four directors had already been appointed and were Dr Oskar, Mr Bolto and Mr Lewis, with Mr C T Pullan as Chairman. Mr Pullan was a respected Western Australian businessman who had been invited to serve on the Board on Mr Bolto's recommendation. The overwhelming majority of shares ultimately allotted were held by Food Industry Holdings Pty Ltd ("Food Industry Holdings"), with small parcels being taken up by Mr Pullan and Mr Lewis. Food Industry Holdings was in turn controlled by a foreign company with which Dr Oskar was associated called Sunflower Investments Ltd.

4.2.10 Responses to DID's requests for information concerning Dr Oskar were received in early December 1977. Australian representatives in Dubai and Brazil were

unable to discover anything about him. Indeed, the company name which DID had been given, as being the entity with which he was involved in Dubai, was "not registered by Dubai Chamber of Commerce and obviously [could not] be traced", while the Australian Consulate General in Sao Paulo reported that "our numerous contacts in edible oil industry unaware of his person or activities". However, the Austrade office in Suva was able to report Dr Oskar's extensive involvement in Fiji's food industry, noting that it had "resulted in friction with Fiji Government due to his dictatorial business style".

4.2.11 During Mr Herman's investigations, a check was made with the credit agency Dun and Bradstreet, who advised they had no information about Dr Oskar. This seemed peculiar to Mr Herman, in view of Dr Oskar's alleged international business profile, though not particularly discouraging given the absence of anything adverse.

4.2.12 The results of these inquiries may well have formed a basis for grave doubts about Dr Oskar's *bona fides*, but for the advice from London. On 6 December 1977, Mr J Richards, Agent-General for Western Australia, telexed:

"Have had discussions with Barclays at very high level. They report that Dr Oskar has been well-known to them for years, that they believe him to be held in high regard and genuine in all his dealings. He is a man of substance."

On 7 December 1977, Mr Rolfe wrote in a memorandum to DID's Co-ordinator, Mr E R Gorham, that Mr Richards' reply indicated Dr Oskar had "a good record with Barclays Bank. Therefore, one could presume that he is OK". Contemporaneously, the R & I Bank obtained a report from Barclays Bank in the following terms:

"Re S O

A respectable and trustworthy customer who has been known to us for approximately 4 years. We are not certain as to his total wealth but currently he has assets with us valued in excess of £400,000 sterling. We know of his involvement in several food manufacturing projects and we do not think he would enter into a commitment he could not see his way to fulfil."

4.2.13 DID was yet to hear from New Zealand, and on 9 December 1977, the Minister telephoned Mr P I Wilkinson, the NZ Attorney-General and Minister for Customs. Mr Wilkinson confirmed Dr Oskar's business activity in New Zealand and

affirmed that Dr Oskar had completed all he had undertaken to that point. The NZ Government had no complaints about his performance. Mr Wilkinson further observed that in his judgment Dr Oskar was "a very accomplished although sharp businessman" and emphasised that while he too had seen good bank references, he would also welcome some additional information. He suggested that further inquiries could be pursued with the Imperial Foods company in the United Kingdom. The Australian Trade Commissioner in New Zealand subsequently sent further advice elicited from the New Zealand authorities. This included descriptions of Dr Oskar's business operations (Kaipara Edible Oils Refinery Ltd and United Kaipara Dairies Ltd) and conduct, such as that he often used another name and was a very "shadowy" figure, though he had been found to be a "reasonably satisfactory" investor and partner in enterprise.

4.2.14            However, the most valuable assessment of Dr Oskar's elusive persona was to come from a representative of Imperial Foods, who had been contacted by the Agent-General at the direction of Mr Mensaros. The representative expressed a high regard for Dr Oskar's entrepreneurial capacity but, with considerable prescience, noted that:

"It was highly desirable to tie him down to a performance schedule where Dr Oskar was required to carry out his part of the agreement. He was inclined to initiate a number of actions which could be interlocking and/or complementary in a number of ways, and unless he was prompted by his own commitment, the other parties, such as Government, could be disadvantaged. It was best to have Dr Oskar indebted and obliged than the other way around with someone else holding the can." [As recorded in a file note by Mr Gorham]

4.2.15            The biographical summary presented by Dr Oskar claimed affluent origins, with an education at Harrow, Cambridge and the London School of Economics entitling him to the appellation "Dr". In court proceedings later on he was to admit that his alleged attendance at these institutions was a fabrication. While an investigation by DID officers of Dr Oskar's biographical details might readily have exposed this dishonesty, those details were understandably of less concern to the Department than his current financial and business standing. And that standing was borne out not merely by the references of the reputable Barclays Bank, but also by the respectability and competence of those whom he engaged to assist him in the venture. Indeed, it may be that those persons were in some sense "taken in" by each other — each looking to the

reputations of others with whom the entrepreneur ostensibly associated in forming judgments about Dr Oskar's suitability as a business partner.

4.2.16 Mr Shannon, the initial consultant, made inquiries concerning Dr Oskar and received positive reports from the London offices of two of the world's leading banks.

4.2.17 When Mr Bolto was retained by Mr Shannon, he was told that Dr Oskar was a respected client of Barclays and of prominent London solicitors, Norton Rose. Thereafter, all the anecdotal evidence from his direct contacts with Dr Oskar pointed to the conclusion that the latter was precisely the prosperous businessman he purported to be. Dr Oskar spoke of his worth in terms of tens of millions of pounds and when Mr Bolto called on him in London in October/November 1977, he displayed a lifestyle of conspicuous consumption consistent with significant wealth — from a grand house in Hampstead Heath with apparently permanent staff, to a chauffeur-driven Rolls-Royce which conveyed him to a well-appointed office in Grosvenor Street. Mr Bolto dined with Dr Oskar in the company of persons from Imperial Foods and noted their obvious respect for the man. Moreover, Dr Oskar showed talent for persuading persons of substance and distinction to take seats on the boards of his companies — directors of Food Industry Holdings at various times included banker Sir Robert Norman and former Australian Government Minister Sir Gordon Freeth.

4.2.18 Yet glimpses of the darker aspects of Dr Oskar's character were afforded to some in those early days of the proposal. When asked whether to his knowledge Dr Oskar had ever sought to bribe any politician or public servant, Mr Lewis testified: "... he [Oskar] did come out here with that sort of idea ... (h)e just said 'Well, if we pay this one off or we pay that one off' and I said 'Well, we don't do business that way' and 'We won't have any more of that sort of thing'". However, no evidence has been found to relate that reference to events surrounding the project.

4.2.19 The minutes of the 29 November 1977 meeting, to which reference is made earlier in this chapter, disclose palpable evidence of Dr Oskar's evasiveness where they record the following exchange:

"Hon Minister — Dr Oskar has on a previous occasion fully explained his proposals to me. However, I have two questions ...

2. Finance Guarantee - Is Bunbury Foods a subsidiary of another company?

Dr Oskar — No it will be a personal investment."

In fact, Bunbury Foods was a subsidiary of a subsidiary of a company incorporated in Liberia.

4.2.20 Hence the emerging picture which confronted DID in mid-December 1977 was of a wealthy and well-connected entrepreneur with both the will and the means to pursue his proposal to completion, albeit with some disturbing signs of lack of personal integrity. DID officers could quite properly have concluded that nothing within their knowledge of Dr Oskar at that time warranted a veto of Government support for an otherwise meritorious proposal.

### **4.3 The agreement**

4.3.1 The merits of the proposal formed the subject of a report by Mr Herman to Mr Christmass dated 7 December 1977. During Mr Herman's investigations, he had sought to verify the feasibility study submitted by Bunbury Foods and explore such matters as the company's proposed financial and management structure, the availability of raw materials and the accuracy of sales projections both as to price and volume. His report addressed the benefits of the venture in these terms:

"The following benefits are expected from the venture —

- (a) Import Replacement — The new industry will replace imports to the State from overseas and the Eastern States.
- (b) Exports — Sales of 1,000 tonnes per annum (ie in excess of \$1 million) have been guaranteed by Dr Oskar to his supermarket interests in the Middle East.
- (c) Decentralisation — The venture will provide a valuable boost to the Bunbury area both in the project itself and in support industries and in the Port.
- (d) Employment — There will be some forty people employed directly by the company.

- (e) Sunflower Production — Once the project is established there will be a major incentive to establish sunflower production in this State which will be promoted by the company."

The report concluded with a recommendation that, subject to certain advice regarding sales projections requested from the Department of Agriculture and verification of Dr Oskar's standing, the Government should support the project by way of guarantees for loans of \$2,118,000 for plant construction and \$500,000 for working capital.

4.3.2 On the same day that Mr Herman's report was produced, Mr Rolfe sent a minute to Mr Gorham expressing qualified support for the Bunbury Foods application, at least for borrowings for plant construction, but noting that "the `time' factor has not permitted the Finance Branch to conduct our investigations as thoroughly as we would normally do". At the bottom of the minute, he handwrote, "I removed the file from the Senior Investigations Officer before he could comment. You may wish to obtain his views."

4.3.3 On 8 December 1977, Mr Christmass wrote a short note to Mr Rolfe indicating that, in his view, Mr Herman had not had the opportunity to subject the proposal to the rigorous analysis it needed before an informed decision could be made. He suggested that a closer examination was required. However, on that day Mr Gorham sent a submission to the Minister which included much of the content of Mr Herman's report and recommended Government support in the form of the \$2,118,000 guarantee for capital assets and asked that consideration be given to provision of a guarantee to meet any shortfall of working capital between \$1.5 million and \$2 million. His recommendation was subject to the same qualifications expressed in Mr Herman's report. It also reiterated some of the concerns outlined by Mr Rolfe.

4.3.4 The apparent haste with which DID considered Bunbury Foods' application and formulated a recommendation was attributed by Mr Rolfe, in his statement to the Commission, to requests by the company for an early decision to enable a prompt commencement of construction. This was said to be necessary because the plant was to be the key link in a "world-wide chain", encompassing similar activities in Fiji, New Zealand and perhaps elsewhere. The deadline for receipt of submissions to be considered by Cabinet prior to the Christmas break was undoubtedly imminent. However, a further week was to elapse before the Minister prepared a submission to Cabinet, which may provide some support for Mr Rolfe's statement that "all the normal

procedures and checks and balances in assessing the application were undertaken in relation to the Bunbury Foods project". He recalled that the application received a "priority running", but observed that "there was nothing particularly unusual about that, given the size of the project". Mr Herman said that while they were "under some pressure to make decisions quickly ... there was nothing exceptional about that". He further noted that "we were very thorough in our work".

4.3.5 The Treasury played an important role in the "checks and balances" leading to approval of an application for assistance. On 15 December 1977 the Assistant Under Treasurer (General Finance) reported to the Under Treasurer, Mr Les McCarrey, that he had studied the Bunbury Foods proposal. He observed that the company's feasibility study predicted a highly profitable operation after the first two years. However, he went on to say:

"I would consider it extremely optimistic and unlikely to be achieved at the levels suggested. In particular, there seems to have been little time for the Department to study sales potential. The ability to gain 70-80% of the local market within four years, for instance, must be viewed with some doubt. Nevertheless, a slower profitability achievement need not detract from the overall advantages of the proposals."

The report concluded with a recommendation of Treasury support for approval of the financial assistance recommended by DID. On the same day, Mr McCarrey wrote a memorandum to the Premier and Treasurer, Sir Charles Court, in the following terms:

"Successful establishment of the proposed industry would obviously be an advantage for Bunbury in particular and to the State generally. Provided the *bona fides* and good standing of the promoter, Dr Oskar, are accepted I would recommend approval for the issue of the guarantees on the conditions proposed by the Department of Industrial Development."

4.3.6 Also on 15 December, Mr Mensaros signed a submission to Cabinet which recommended approval for assistance to Bunbury Foods "by way of Government guarantees for \$2,118,000 and \$500,000 subject to the conditions as detailed in Appendix `A' attached hereto". Appendix A contained a list of conditions which had been drafted by DID to protect the State's position as far as possible and to create an obligation on the company to perform as promised. The first of these specified that the \$2,118,000 was to be applied toward "capital expenditure required for the establishment

of a refinery at Bunbury for the refining and processing of soft and hard vegetable oils" and the \$500,000 was to be available for "working capital purposes. These funds only to be advanced after the company's overdraft facilities reach \$1.5 million. Working capital accommodation to \$1.5 million must be arranged on a normal bank risk basis". Another condition stipulated that the release of funds was to be controlled by DID. Before each draw-down pursuant to the guarantees, the prevailing position of the company was to be reviewed. Mr Herman's understanding was that under the guarantees, DID would be obliged to authorise the release of the funds as long as the company had met the conditions which had been imposed. Mr Herman observed that the insertion of conditions "tailor made" to a project was the usual course which DID adopted. The Cabinet submission indicated that the expected total funding requirement for the project would be \$5,418,000, of which \$1,300,000 was to come from share capital and shareholders' loans, \$2,118,000 from the Government-guaranteed term loan and \$2,000,000 from a working capital fluctuating overdraft facility.

4.3.7 Cabinet approved the Minister's recommendation on 20 December 1977, "subject to a satisfactory arrangement about the progressive expansion of local seed production to replace imported oil, and satisfactory information about the *bona fides* of the local shareholder(s) and Board". As there were ultimately no significant local shareholdings and Mr Pullan, Mr Lewis and Mr Bolto were thoroughly reputable, the latter qualification was readily satisfied. The former appears to have contemplated the next stage of the project, namely, construction of an oil extraction plant to transform locally produced oil seeds into crude oil for use by the refinery.

4.3.8 The Commission finds that none of the persons involved in the decision-making process which culminated in the approval of assistance on 20 December should be criticised in respect of their conduct in that process. Mr Rolfe attested that Bunbury Foods met the criteria of the *Industry (Advances) Act 1947* for financial assistance to decentralised industries. The machinery established by this Act enabled the R & I Bank, on receipt of a certificate from the Minister, to provide guarantees in support of the developer. The project clearly furthered the twin goals of decentralisation and diversification which the State Government was fervently seeking to promote in relation to manufacturing industry. Furthermore, the legislative purpose underlying the statute was to provide encouragement to those industries which were considered to be in the interests of the State, even though they might present a measure of financial risk. The then Premier and Treasurer, Sir Charles Court, said in evidence that he expected the Minister for Industrial Development to look for opportunities and have an innovative

approach to new or proposed projects. As to the *bona fides* of Dr Oskar, Sir Charles said that he was advised of Dr Oskar's credentials by Mr Lewis and Mr Mensaros and that he was "quite relaxed about that aspect because Mr Mensaros was a very conservative Minister". In relation to the adequacy of DID's international inquiries, it is noteworthy that in Mr Herman's recollection it was the first occasion on which an application for financial assistance under the Act had been made by someone located outside Australia and thus it was DID's first experience of overseas investigations. Under these circumstances, the extent of those investigations and the inferences drawn from their results were quite reasonable. The available evidence suggested that Dr Oskar's reason for seeking assistance was not financial inadequacy, but rather an understandable desire to take advantage of whatever incentives might be forthcoming from Government to attract his project to Western Australia. Like many astute entrepreneurs before and since, he was happy to have Government share the project's risks, while retaining the equity for himself. To adopt words used in evidence before this Commission by a witness in another term of reference he was content to capitalise his profits and socialise his losses.

4.3.9 In a letter dated 23 December 1977, Mr Mensaros advised the Chairman of Bunbury Foods that its application for assistance had been approved "subject to Bunbury Foods Pty Ltd entering into a satisfactory arrangement about the establishment and progressive expansion of local oil seed production to replace imported oil .... Bunbury Foods Pty Ltd are to ensure that arrangements satisfactory to the Government are made so that existing local companies engaged in mixing and packaging edible oil products for the Western Australian market are not inconvenienced or displaced". The letter noted the fact that it was contemplated that the \$1.3 million from share capital and shareholders' loans would be divided into 60% from Dr Oskar and 40% from local shareholders. In his final paragraph, the Minister referred to a discussion on "the subject of local shareholding responsibility and Board representation" and continued "I would appreciate your advice in due course in order that action may be initiated in respect to the documentation". This last reference appears to relate to a subject raised by Mr Gorham in a memorandum to another officer dated 20 December 1977 in which he observed:

"I understand that the guarantee has been issued on the basis that it is free of any Government involvement on the board. This will mean that Mr Sandy Lewis will have to withdraw from his position as a Director of the new company."

4.3.10 On 7 March 1978, Mr Pullan wrote to Mr Mensaros to advise:

"BUNBURY FOODS PTY LTD

With reference to your letter of 23rd December, 1977, I have to inform you that there has been a change in the composition of the above company's Board of Directors.

Hon A A Lewis tendered his resignation as a Director and the Board accepted it at a meeting held this morning.

The company has now engaged Mr Lewis as a consultant and he will give especial emphasis and impetus to the promotion and development of sunflower seed."

Mr Lewis testified that he resigned his directorship of his own volition on discovering that a Government guarantee had been obtained. He said that before doing so he had taken advice from the Clerk of the Parliament and the Crown Law Department and that his resignation was tendered at the company's first Board meeting. He asserted that he had no involvement in the company's application for Government assistance and that assertion is consistent with the available evidence.

4.3.11 Early in the New Year, the approved assistance was formally offered by DID to Bunbury Foods, which replied with a qualified acceptance, seeking modifications to the list of conditions in the offer. After protracted negotiations on this subject, a certificate was issued pursuant to section 4 of the *Industry (Advances) Act 1947* on 10 March 1978. That document was signed by the Treasurer and addressed to the Commissioners of the R & I Bank. It certified that Bunbury Foods Pty Ltd was entitled to financial assistance under the Act and directed the Commissioners to guarantee Bunbury Foods' debt to the Western Australian Superannuation Board ("the Board") up to a sum not exceeding \$2,118,000 plus interest and other charges detailed in the conditions of assistance.

4.3.12 Bunbury Foods had initially contemplated a different lender for the guaranteed term loan and the company did not reach agreement with the Board until early 1978. Subsequently, the National Bank agreed to provide a \$2,000,000 overdraft facility for working capital, secured by second mortgage and second debenture over the company's assets. The securities would have ranked behind those which the State had obtained in support of its \$2,118,000 guarantee and hence the National Bank sought

priority of \$1,000,000 for its proposed mortgage and of \$1,500,000 for its debenture as a condition of making the overdraft facility available to Bunbury Foods. Mr Herman advised the Under Treasurer that the National Bank's request was reasonable and consequently the R & I Bank was instructed to grant the priority.

4.3.13 On 8 November 1978, an agreement under seal was executed by the Premier and Bunbury Foods. Its primary purpose was to impose clear obligations on the company in relation to local oil seed production, though it also reiterated the agreed conditions of assistance which had been expressed in earlier documentation.

#### **4.4 The increased guarantee**

4.4.1 On 20 November 1978, Bunbury Foods wrote to Mr Mensaros requesting approval in principle for a further Government guarantee to facilitate the company proceeding immediately with construction of a solvent oil extraction plant. The plant was to be built adjacent to the refinery which was then still under construction.

4.4.2 In a memorandum to the Minister dated 7 December 1978, Mr Gorham recommended as follows:

"On the basis of agreement in principle I consider it appropriate for you to advise the company that you would be prepared to recommend to Cabinet a Government Guarantee for the oil extraction plant as outlined hereunder and subject to conditions as specified —

1. ... the Government would be prepared to consider an additional guarantee of \$2.78 million for the solvent extraction plant, and support an application by the company for a loan from the Decentralisation Advisory Board (established by the Commonwealth) ..."

4.4.3 On 10 December 1978, the Minister handwrote a note to Mr Gorham at the bottom of the latter's memorandum. It read:

"Co-ordinator

I have discussed the above with Dr Oskar. He is quite prepared to put in more capital than originally planned and requested, as he is

convinced the project being a very remunerative business. His only proviso — for that very reason — is to get residence visa. Otherwise, according to FIRB negotiations, he would have to offer 40% of his equity shares to local residents, which he does not want to do, hence he asked for more Government guarantee ... In the meantime, we should go ahead with Cabinet minute on the above basis."

4.4.4 In a submission to Cabinet dated 18 December 1978, Mr Mensaros recommended that he be authorised to offer an additional guarantee of \$2.78 million or 34% of the total funds required for the extraction plant, whichever was the lesser, and to support an application for additional funds to the Decentralisation Advisory Board. His authority was to be subject to submission of an application for assistance on completion of a detailed feasibility study, the requirements for which would be negotiated with the company.

4.4.5 On 19 December 1978, the Under Treasurer reported to the Treasurer, expressing support for the Minister's recommendation with approval in principle being subject to verification of the feasibility study when available.

4.4.6 Cabinet approved the recommendation on 3 January 1979.

4.4.7 In the first half of 1979, Bunbury Foods produced the requisite feasibility study and made two requests relating to its plans for an oil extraction plant. The first was that the Government guaranteed \$500,000 for working capital be made available for expenditure on plant and equipment. The second was that the \$2.78 million guarantee which had been approved in principle be approved formally. The first request was perceived by the DID as an attempt to financially commit the Government to the extraction plant at a time when the latter was still the subject of DID investigations. Thus, the Department recommended to the Minister that he decline the \$500,000 conversion request.

4.4.8 A comprehensive report on the question of whether Cabinet's approval in principle to the further guarantee should be formally approved was prepared by Mr Gould, a DID Investigation Officer, and tendered to Mr Christmass on 18 May 1979. The report contained a disconcerting passage which read:

## "7. CONCLUSION

On the basis of the information I have at this point (it is inadequate in some critical areas) I can only come to the following conclusions about the proposed Solvent Extraction Plant and the associated Refinery Project.

- 7.1 A Solvent Extraction Plant as proposed at best would be marginally viable.
- 7.2 The proposed Solvent Extraction Plant would be a very risky operation being very sensitive to changes in raw material prices. As a result to even maintain marginal viability the company will have to be very careful about the management and timing of oil seed purchases.
- 7.3 The Refinery which should commence operations in August 1979 will have to contend with fierce marketing competition in the first two years of its operations. Even with the resources that the company has there is some risk that it will not be able to capture the market share it is aiming for.
- 7.4 The Refinery's viability does not appear to depend on the proposed Extraction Plant. If in fact the Extraction Plant is built and it is not viable the profitability of the Refinery will be reduced.
- 7.5 Increased costs of the Refinery project will increase the finance costs borne by the company particularly in the critical early years.
- 7.6 The company does not appear to have a definite marketing policy for planned meal production.
- 7.7 The company does not appear to have arranged adequate funding for both operations that will satisfy the Department's security requirements. It may be that Dr Oskar will be able to take up any short falls in funding but we have no real evidence of this so far."

4.4.9 Mr Christmass relied upon this assessment in reporting his own view:

"6. Conclusions

The profitability indications for the refinery are still favourable despite having to pay duty on imported oil and the company would be well advised to make a success of this first and contribute the funds that will be required to ensure its success before embarking on another venture.

The profitability of the solvent extraction plant is doubtful and it would no doubt jeopardise the refinery's chances if it was not a success.

If we did push on with additional assistance for the solvent extraction plant we would need to be certain that Dr Oskar has the several millions to finance the project. We could perhaps consider standing back on security to allow some supplementary borrowings on the project, but even this could only be in circumstances where Dr Oskar has contributed most of the funds."

4.4.10 The essence of these adverse reports was conveyed to the Minister by Mr Gorham, and over the days that followed the company sought to address the Department's concerns with additional information.

4.4.11 On 5 June 1979, Mr Gould furnished a second report which finished in these terms:

"CONCLUSION — RECOMMENDATION

The further information obtained from the company and the Department of Primary Industry tends to confirm the risk involved in the Extraction Plant. While the company may have the expertise to cope with this risk it still appears that proceeding with the Extraction Plant will put at risk the Refinery's viability. While the company has given some evidence to suggest that the Refinery would be viable even with considerably reduced sales, I recommend that the State should be prudent and put off further involvement until the company has been able to demonstrate its ability to operate the Refinery successfully.

If however further assistance is given to the company it should be on the basis that;

- (a) Dr Oskar demonstrates, with bank letters addressed to this Department, his ability to fund overruns on capital costs and if necessary give further support to the operation in the event of a loss situation on the Extraction Plant project.
- (b) The best possible security is obtained so as to minimise the risk to the State."

4.4.12 That report was received by Mr Herman, who was Acting Senior Investigations Officer. On the same day he in turn reported:

"8. Conclusions

I consider that assuming —

- (a) the margins used in the feasibility study for sunflower seed and soybean are reasonable and
  - (b) that the company will attain an average world margin (for the last three years) of \$23/tonne for rapeseed
- then the Solvent Extraction plant venture should operate on a 'break even' basis.

If the company is able to consistently purchase seed astutely and obtain above average margins, then there is a reasonable chance the solvent plant operation will be viable.

However based on the limited information available and past world seed margins, it appears the viability of the solvent project is 'marginal' and as the margins of the various seeds are subject to considerable fluctuations, the 'risk factor' is increased accordingly."

4.4.13 The next day the recipient of that report, Mr Christmass, prepared a two page report to the Executive Officer Industries which concluded:

"CONCLUSION AND RECOMMENDATION

I consider that there is a high level of risk associated with this additional venture and one that is even greater than we have been prepared to take in assisting larger ventures in the past.

I recommend that any additional assistance to the venture should be limited. I would suggest a total of no more than \$4 million to the company as a whole."

4.4.14           The essence of the advice which climbed the bureaucratic ladder within DID was that the proposed extraction plant was neither necessary for, nor conducive to, the success of the existing venture. The soundness of this advice is evidenced by the fact that the refinery has continued as a viable operation and there is no reason to doubt that it could have done so under Bunbury Foods' proprietorship, had not the fateful step of proceeding with the extraction plant been taken in 1979. Hence the circumstances in which this step received Government support warrant strict scrutiny.

4.4.15           On 14 June 1979, Mr Gorham wrote to the Under Treasurer enclosing a draft minute to the Premier from Mr Mensaros for "urgent consideration". The minute included the following observations:

"9. The figures included in the current feasibility study submitted for the solvent extraction plant venture are generally reasonable, and provided the company is able to consistently purchase oilseeds at the 'right price' and sell its products astutely, then the project should also be viable, although its profitability appears somewhat marginal." ...

"12. Despite the risk factor involved I still believe the merits of the industry are such that every encouragement should be given for its establishment here."

It then recommended that approval be given to increase assistance to Bunbury Foods by way of guarantees from the existing level of \$2,118,000 for capital expenditure and \$500,000 for working capital, to a total of \$4.4 million subject to the conditions detailed in an attached "Appendix A". In his covering letter, Mr Gorham recommended "that the \$500,000 be included as part of the additional assistance for capital costs of the extraction plant venture in lieu of refinery working capital". The State's total assistance would thus consist of guarantees for two term loans, namely, "\$2.282 million from the National Bank and \$2.118 million from the Superannuation Board". The first two conditions in "Appendix A" were:

- "1. Funds to be applied towards capital expenditure required for the establishment of a vegetable oil solvent extraction plant at Bunbury.
2. The total cost of the combined refinery/solvent extraction plant project is now estimated to be \$17.3 million for:

Capital Cost	\$12.5 million
Pre-operational expenses	1.3 million
Working Capital	3.5 million
	_____
	\$17.3 million
	=====

which is to be funded by -

Government guaranteed loans	4.4 million
National Bank	5.2 million
Dr Oskar	6.1 million
Commonwealth Decentralisation Advisory Board	1.6 million
	_____
	\$17.3 million
	=====

Any cost overruns including working capital or other funding which may arise on the above estimate of \$17.3 million are to be met by Dr Oskar as and when they become apparent."

4.4.16 Mr Rolfe, who had by then moved to Treasury, was charged with preparing a report on the proposed increase in assistance. His report, dated 18 June 1979, made the following assessment:

"In conclusion it must be conceded that the venture has potential problems but at the same time it must also be noted that with prudent management the industry could be very successful.

Furthermore, Cabinet has indicated previously that it will support the project subject to its viability and the Department of Industrial

Development through the Minister has indicated the project has prospects of being viable.

Therefore, I suggest that the Government has little choice but to proceed along the lines recommended by the Minister for Industrial Development, as follows:-

- (a) Government's total involvement in the project not to exceed \$4.4 million and relate solely to capital expenditure.
- (b) Government agree to allow the National Bank of Australasia Ltd priority security of \$5.2 m on the fixed assets of the company and rank `pari passu' with the Bank in respect to current assets."

4.4.17 On 19 June 1979, the Under Treasurer wrote to Mr Gorham and expressed his perspective on the proposal in telling terms:

"To sum up, may I say I have grave misgivings about the prospects of this venture. At the exposure of \$6 million of taxpayers funds we may obtain 82 new jobs in and around Bunbury. It seems a high price to pay especially as at least some of those may be at the expense of other meal and produce dealers.

However, in view of your conclusions about the viability, a view I must say I am not nearly so sanguine about, and the 3 January 1979 agreement in principle by Cabinet I believe the Government is committed to the project and the associated financial assistance.

To refuse the bank priority could be tantamount to destroying the project and place the Government in a position in which it could be highly criticised. Therefore I am agreeable, with reservations, to the request for priority of \$5.2 million being approved subject to:-

- (a) the State ranking `pari passu' with the National Bank in respect to all current assets
- (b) the existing securities as held by the State remain intact, the Bank register its securities behind the State and rely on a letter of priority in respect to the fixed assets as evidence of its prior call on any proceeds from realisation of these should such action occur.

- (c) your Department monitor the financial affairs of the company very closely in an endeavour to ensure that the State's exposure under the guarantees is kept at minimum risk, particularly in the early years of operation.

I would like to see an undertaking from the major shareholder, Dr Oskar, in regard to additional security to the State, but in view of his requirement to provide the additional funding over and above \$11.2 million, it is doubtful if any security would be available except perhaps a Shareholders Guarantee.

In conclusion, I would like to stress three points which I believe are very essential to protect the State's interest in this project, these being:-

- (i) The shareholders be advised that any approval to provide assistance to \$4.4 million is contingent on the Government being satisfied that they have the funds (\$6.1m) as required by condition 9.1 of Appendix A as attached to the Minister's draft and that these are spent prior to any release of guaranteed funds.
- (ii) The Shareholder's be firmly advised that the Government limit is \$4.4 million and under no circumstances can it be exceeded.
- (iii) The approved repayment programme of 8 years with a 3 year moratorium for each guarantee is to be strictly adhered to."

4.4.18 In view of the above correspondence, the Commission concludes that substantial support for, as distinct from acquiescence in, the proposal to increase Government assistance in June 1979, was not forthcoming from the Government's advisers. On the other hand, despite his natural conservatism, Mr Mensaros was enthusiastic. Given his death and consequent unavailability to assist the Commission, his correspondence on the subject must be relied upon in an endeavour to ascertain the basis for his attitude. On 19 June 1979, Mr Mensaros wrote to the Acting Premier as follows:

"HON ACTING PREMIER

## Bunbury Foods Pty Ltd

In January 1979 Cabinet approved in principle to provide the Company with a further guarantee of up to \$2.8 million (making a total of \$5.4 million including the \$2.6 million already granted for the Refinery) to enable the Company to establish a solvent extraction plant. The Company was obliged to submit a feasibility study as evidence of the project's viability.

The attached papers refer to the study which has been under review within my Department and the subject of discussion with the Company and with Treasury officers.

Although the Solvent Extraction Plant profitability would be considered marginal in early years, the integrated Refinery/Extraction plants together indicate a satisfactory return. Also they give greater flexibility and depth to the Company's operation at Bunbury.

The Departmental report points to the possible risks in the oil seed market and the limited security available.

However, I believe a pioneer industry such as this in a decentralised location such as Bunbury has to accept some element of risk. It is a novel exercise where Bunbury becomes a world trading centre, importing unrefined oils and utilising imported and/or local seed, and exporting refined products as well as supplying home markets.

My contacts with the principal, Dr Oskar, bankers and others indicate the family has substantial international strength in the vegetable oil market and the experience and capacity to ensure the viability of the enterprise.

After preliminary assessment of this proposal, I renegotiated with Dr Oskar to increase his equity share and reduce the call on the Government for a guarantee to a total of \$4.4 million; and for Dr Oskar to give an undertaking to meet any over-runs in establishment costs.

I firmly believe that this type of industry — processing of primary rural products which may be ultimately supplied from local sources, and designed to be a competitive purchaser of oil seed and supplier of refined products on the world market — is one which the Government should encourage and support.

Your confirmation of the Government's agreement to assist by way of a supplementary guarantee totalling \$4.4 million in all and subject to the conditions as detailed in the Appendix hereto is recommended."

The evidence is convincing that Mr Mensaros genuinely held a vision of the total project's long-term potential benefits to the State which transcended, at least in his mind, concerns about the difficult financial position from which it was likely to suffer in the immediate future. Indeed, it was the Government which had pressed the company in relation to the question of the latter's involvement in promoting increased local oil seed production. Yet for the refinery to utilise local oil seed, rather than imported crude oil, the extraction plant was required. Moreover, Mr Mensaros clearly displayed much greater faith in Dr Oskar's willingness and capacity to underwrite the project than his departmental officers possessed by that time.

4.4.19 In his statement to the Commission, Sir Charles Court observed that it was not unusual for public servants and their Minister to have differing attitudes to a given industrial development project, with the Minister looking to broad issues such as economic growth and decentralisation while the public servants sought satisfactory technical and administrative details. Such differences are readily understandable; indeed it might be said that political life is all about reasonable risk, while bureaucratic life is all about security. The tension between the two within our traditional model of Government is directed to generating decisions which permit innovation while preserving good financial management. It is inevitable that occasionally a decision will be made which fails to live up to its promise. It does not necessarily follow that those persons who actively promoted the decision behaved improperly. The increase in assistance allowed in 1979 was such a decision. The Commission finds no basis for a conclusion of impropriety in relation to the conduct of any of the persons involved in making it.

4.4.20 The Commonwealth became involved and this complicated the analysis of reasons for the decision to increase Government assistance. On 5 June 1979, the Commonwealth Minister for National Development, Mr Kevin Newman, wrote to Mr Mensaros to advise that the Decentralisation Advisory Board had recommended, and he had approved, a loan to Bunbury Foods of \$1.6 million to assist in construction of the oil seed solvent extraction plant. This development had a significant impact upon the State's decision-making process in at least one respect, and probably in two. The

definite impact was to hasten a decision by the State. In a minute from the Under Treasurer to the Acting Treasurer dated 21 June 1979, it was noted that:

"3. The Commonwealth has approved a loan of \$1,600,000 to the company, but before it can proceed with security documents and release of funds, it requires our advice in respect to:-

- (a) whether the further assistance of \$1,782,000 is approved; and
- (b) will the Rural & Industries Bank release the title deeds to enable the Commonwealth to register its securities.

4. The Commonwealth require the State's advice urgently to enable its security documents to be registered and the loan advanced before 29 June 1979 or the appropriation will cease and the offer of the loan may be withdrawn."

Mr Rolfe recalled that consideration of the proposal to increase assistance had received a "priority running" at least in part because of "the need for an early decision in order to meet a funding requirement with respect to the Commonwealth budget". The other probable impact of the Commonwealth approval was to make a refusal of additional State assistance too embarrassing to contemplate. With Cabinet approval, the State had supported Bunbury Foods' application to the Decentralisation Advisory Board for assistance in relation to the extraction plant's construction. For that construction to be precluded by the State refusing to provide any assistance for it, after the Commonwealth had agreed to do so under the influence of the State's advocacy, would have placed the State in an invidious position. The balance of the Under Treasurer's minute of 21 June 1979 read:

"5. I have previously given my views to the Department of Industrial Development on the viability of this project and, quite frankly, I consider it is a very high risk venture. However, I believe that the State is committed to continue its assistance to the project.

6. On the question of the "pari passu" ranking on securities, I would support the Commonwealth's request because the alternative is the State would be called upon to provide the assistance should the Commonwealth withdraw.

7. I therefore recommend that you endorse the recommendation of the Minister for Industrial Development to increase our financial assistance to \$4,400,000 and agree to the requests submitted by the Commonwealth in order to enable its loan of \$1,600,000 to be advanced this financial year."

On 22 June 1979, the Acting Treasurer signed his approval on the bottom of the minute.

4.4.21 In July 1979, Mr Mensaros and Mr Lewis travelled to New Zealand to attend the opening of Dr Oskar's Kaipara edible oils refinery at Helensville and observe its operations. One of Dr Oskar's companies paid their airfares and accommodation expenses. This was a circumstance which might have been expected in the case of Mr Lewis, as he was acting as a consultant to several of Dr Oskar's companies and was not involved in the State Government's decision-making on Bunbury Foods, but which was not so justifiable in the case of Mr Mensaros. If the payment of his expenses had constituted a personal benefit to the Minister, his acceptance of that benefit would have amounted to at least improper, if not corrupt, conduct, in view of his central role in the decision of the previous month to increase State assistance to Bunbury Foods. However, this Commission considers that the trip in question could not be characterised as a personal benefit to the Minister. Its purpose was of real relevance to an important matter within his portfolio and he would have been entitled to make the trip in his capacity as Minister at taxpayers' expense. Thus, the highest criticism which can be made of Mr Mensaros's conduct is that he was unwise to have saved public money by permitting Dr Oskar to meet his expenses. Doing so was unwise because of the perception of influence to which it might have given rise. That the possibility of such a perception did not occur to Mr Mensaros is evident from the fact that details of the arrangement were documented in Treasury's files. Some attempt at concealment might have been expected had he regarded the matter as other than perfectly innocuous.

4.4.22 In due course the increased assistance to \$4.4 million was formally offered, discussed and accepted. The conditions of assistance which were ultimately applied reflected a \$500,000 reduction in the estimated total cost of the project from \$17.3 million to \$16.8 million, with Dr Oskar's contribution to total funding being diminished by that amount. On 4 October 1979, DID received a letter of undertaking from Dr Oskar in the following terms:

"I, DR. SHRIAN OSKAR, of 64/65 Grosvenor Street, London in the United Kingdom hereby irrevocably undertake in respect of the solvent extraction plant to be established at Bunbury, Western Australia by Bunbury Foods Pty. Ltd. and in respect of an offer of assistance from the Government of Western Australia pursuant to your Department's letter of 26 June 1979, to provide funds to meet any cost over-runs, including working capital or other funding which may arise over and above the estimate of \$16.8M as set out in paragraph 2 of the conditions for further assistance for solvent extraction plant issued by your Department in conjunction with the said letter. These funds shall be provided as and when the cost over-runs become apparent in accordance with the provisions of that letter.

Dated the 3rd day of October 1979."

This document supplemented an undertaking which Dr Oskar had given on 2 March 1978 for construction costs and working capital needs of the refinery.

4.4.23 A certificate under section 4 of the *Industry (Advances) Act 1947* was issued on 26 October 1979. It certified that Bunbury Foods Pty Ltd was entitled to financial assistance under the Act and directed the Commissioners of the R & I Bank to give a guarantee in favour of the Chase-NBA Group Ltd, as distinct from the National Bank itself, guaranteeing Bunbury Foods' debt to that entity up to \$2,282,000 plus interest and other charges detailed in the guarantee.

4.4.24 Meanwhile, the Bunbury Foods edible oil refinery was officially opened by the Premier on 11 October 1979. Trial production commenced in December of that year. The entire refinery was operational by March 1980.

## **4.5 Dr Oskar's reputation**

4.5.1 December 1977 did not mark the end of the State Government's interest in Dr Oskar's personal *bona fides*. In fact, the officers of DID continued to monitor all available information concerning his character and activities.

4.5.2 On 28 November 1978, Mr Rolfe, who was then still Chief Finance Officer at DID, included in a file note the following passage:

- "2. I have also had discussions with the Chief Industries Officer (Mr. Greenwood), who has expressed concern about the project and Dr. Oskar in particular.

Mr. Greenwood has provided the following information —

- a) Dr. Oskar attended a Middle East Study Group Meeting on June 21, 1978 and he did not show up in glowing terms in fact it was the reverse — copy of minutes attached.
- b) He has had recent discussions with the Department of Trade [Commonwealth] and was advised that Food Holdings Ltd. (Dr. Oskar's major company here in Perth) had written to the Department of Trade seeking statistics such as population figures, food preferences etc. on residents in Saudi Arabia, Jeddah etc. which seems strange for an organisation which has an associate with a major investment in a Super Market complex in the area.
- c) Department of Trade had also confirmed that Dr. Oskar had been given approval in principle to charter 6 flights from Australia to the Middle East areas over a period of twelve months subject to certain conditions but when asked to advise what they proposed to export, no answer was given except mention was made of back loading tea from Sri Lanka to Perth for processing and then shipping to Saudi Arabia. Mr. Greenwood advises that he was not aware the Saudis drank tea as has always been given coffee on his visits to the area.

*Very strange indeed.*" [our emphasis]

4.5.3 On 10 May 1979, DID received a copy of a letter from Mr B Eaton, joint assistant manager of the Hyde Park Corner branch of Barclays Bank, to the Under Secretary of the Oman Ministry of Commerce and Industry. The document was marked private and confidential. It was dated 19 January 1979 and read as follows:

"Your Excellency

We understand that Dr S Oskar is entering into a joint venture with His Excellency The Ambassador in London and others in Oman, and has asked us to write to you concerning his background.

He has been known to us for at least six years and has always honoured his commitments to us. We are not aware of the total extent of his wealth as this is spread over several countries and many involvements. We have reliable evidence that part of this amounts to US \$10M. We do not think that he would enter into a commitment which he could not see his way to fulfil.

Dr Oskar is known to be a Partner with Government and Statutory Bodies in connection with the following Edible Oil Refineries:—

- |                |   |                                      |
|----------------|---|--------------------------------------|
| 1. Fiji        | — | Fiji Foods Limited                   |
| 2. New Zealand | — | Kaipara Edible Oils Refinery Limited |
| 3. Australia   | — | Bunbury Foods Limited                |

If you require any further information, please do not hesitate to contact me."

On 18 July 1979, Mr Gorham wrote to the Western Australian Agent-General in London, who was then Mr L W Slade, in the following terms:

"Please find attached two letters submitted by Dr. S. Oskar to this Department as evidence of his financial standing and the transfer of D.M. 1,673,000 to Extraktionstechnik of West Germany.

A Dun and Bradstreet report (also attached) on Dr. Oskar raised the question of the authenticity of these letters. Enquiries to the Western Australian representative of Barclays Bank concerning these letters have failed to confirm their origin or the reliability of the information contained therein. The Bank simply advised that the Chief Inspector of their London Branch had requested that no comment be made regarding Dr. Oskar or the authenticity of the copies of letters submitted to this Department.

The Department has approved Government guaranteed assistance of Aust \$4.4 million to a Western Australian Company, Bunbury Foods Pty. Ltd., of which Dr. S. Oskar is the major shareholder. Although there seems little doubt of Dr. Oskar's financial standing and genuineness, it would be appreciated if you could make very discreet enquiries with Barclays Bank London in order that the

origins of the said letters can be confirmed. The Department is particularly interested in confirming the transfer of funds to Extraktionstechnik as this transaction is related to a condition of the Government assistance given to Bunbury Foods Pty. Ltd.

It is realised that Barclays Bank may not be in a position to release information regarding Dr. Oskar, but perhaps you may be able to obtain at least informal verbal assurance that the Department has no reason for concern in regard to this matter."

Mr Slade responded by a telex received on 2 August 1979 which advised:

"The present manager of Barclays Bank Hyde Park Corner branch confirms that person concerned does have an account there. He further confirms that the two letters, copies of which you enclosed, were written by the Assistant Manager of the day without specific authority but copies do exist on the Bank's files."

4.5.4 On 13 June 1980, Mr Slade telexed the Premier who was then in Tokyo, with some novel news, namely:

"Dr. Oskar of Bunbury Foods proposing establishment of a merchant banking operation in Perth.

Proposed partner is German merchant bank Richard Daus and Co of Frankfurt. This is a consortium. Bank shareholders are Richard Daus, Lazard Bros. of London and Westdeutsche Landsbank Girozentrale of Dusseldorf each with a one third interest.

Besides project financing in Aust. financing of Bunbury Foods expansion in WA as well as financing of their operations in the Mid East is proposed. Apparently Richard Daus currently finance Bunbury Foods operations in WA.

New merchant bank would have equal shareholding between Richard Daus, Lazard Bros, Westdeutsche Landsbank and Dr. Oskar's group.

Dr. Oskar has requested permission to quote your name as a reference to the banks. Representatives of the bank will probably visit WA in near future for on the spot studies."

The Premier replied that he had no objections to his name being quoted as a referee and within a month he received a request from Mr Richard Daus for "an independent opinion on the personal background and integrity of ... Dr Shrian Oskar. If you were in a position to let me know your personal impression and view you would help us considerably". On 17 July 1980, the Premier responded guardedly, observing that "... [t]o date, Dr Oskar has met all commitments to the Government, both financial and otherwise. Dr Oskar is not well-known to me personally although I have had official dealings with him. One of my ministerial colleagues has had considerable contact and dealings with Dr Oskar. Neither he nor I have any reason to doubt his integrity, based on our experience ... All inquiries I have made do not detract from what I have said above".

4.5.5            On 4 August 1981, Mr Daus wrote to the Premier to advise:

"We have now been working both with Dr. Oskar and the company for about one year and our experience to date has, unfortunately, not always been satisfactory. As I am especially disappointed with Dr. Oskar's personal performance, I have regrettably decided that my bank terminates this relationship.

I am sorry to give you such unpleasant news, but I feel it only fair to keep you informed about the developments."

On 7 September 1981, Mr Mensaros sent a minute to the Premier which read:

"The Acting Under Secretary of your Department has sent me a copy of Mr Richard Daus's letter dated 4th August to you dealing with the severance of his business relationship with Bunbury Foods and Dr Oskar.

I have some knowledge of this matter which might be of interest to you.

My understanding — from unsolicited conversation with Dr Oskar during his last stay in Perth about four weeks ago — is that Oskar and Daus fell out on a personal basis. They have planned to establish jointly a merchant bank in Perth for some time now. When Daus informed Oskar that the bank had to be established in Melbourne instead Oskar disagreed and told him that he would rather terminate the planning.

Thereupon, Daus charged him with dm 250,000 for his work of preparation in connection with the establishment of the merchant bank, which Oskar apparently refused to accept.

This terminated Daus' bank's credit arrangements with Bunbury Foods but all indebtedness has been honoured in time by Bunbury Foods to Daus."

4.5.6 Mr Mensaros may have been impressed with the probable veracity of information proffered without request and without any apparent cause for defensiveness or obfuscation. However, the credibility of Dr Oskar's voluntary outburst may have been diminished in the Premier's eyes had he noticed the notation at the bottom of Mr Daus' letter which indicated that a copy had been forwarded to Dr Oskar. In any event, the Premier wrote to Mr Daus on 22 September 1981, seeking advice "... if there were any matters, particularly of a financial nature, which in [his] relationship with Dr Oskar were found to be unsatisfactory."

Mr Daus's letter in reply of 15 October 1981 read:

"In the beginning of this year, we concluded a verbal agreement with Dr. Oskar, which provided for a payment of DM 250,000. — to my bank for services rendered to him and his companies in 1980. Dr. Oskar informed us that he wanted to channel this payment through his companies in the course of the four months to come. But he never kept his promise.

Furthermore we had to observe that Bunbury Foods was heavily dependent on injection of fresh capital, which was confirmed to us by the Company's Secretary. Consequently, with special regard to the difficulties to get clear information on the Company's financial situation and, last but not least, the distance between our two countries, we terminated the relationship with Bunbury Foods. This decision was proved by the fact that Bunbury Foods did not meet a maturity on 4th September 1981.

You will surely understand that we are disappointed as — despite all our efforts — Dr. Oskar's conduct and also that of the Company prevented the development of a solid and reliable business relationship.

Moreover, we are inclined to believe that our aforementioned experiences do not constitute the exception to the rule."

Upon receipt of this advice, the Premier sent a note to Mr Mensaros in which he said:

"I thought I should let you see the latest letter I have received from Richard Daus & Co. It is rather disturbing.

I do not know of any action we should take in the matter if we do not appear to have any legal or moral responsibility, but it does leave me with a rather anxious feeling about Dr. Oskar if, in fact, Richard Daus is correct and fair in his statement of the position."

On 6 November 1981, Mr Mensaros furnished the following detailed rejoinder:

"I refer to your personal note dated October 27 in connection with Daus' complaining letter about Dr Oskar.

Although I knew something of this matter from casual conversation I had with Dr Oskar when he was here last time, I contacted him again to be able to let you have his response.

Dr Oskar says that the agreement between Bunbury Foods and R.D.B.S. (a subsidiary of R. Daus) was terminated on June 11, 1981 by R.D.B.S. because "they were of the opinion that Bunbury Foods suffered from financial weakness which would prevent the Company from effecting payments on their respective due dates of June 29, July 6 and September 4, 1981." Dr Oskar apparently did not intend to argue this obviously unfounded statement.

Up to that date (June 11) all payments due from Bunbury Foods to R.D.B.S. had been made on the due date. Subsequent to the termination of the agreement Bunbury Foods paid the amounts due on June 29 and July 6 on these respective dates. With regard to the payment of DLRS 568,000 due on September 4 this was paid by Kraft Foods Ltd under terms of their guarantee to R.D.B.S. Kraft in turn were repaid the same amount by Bunbury Foods under an arrangement agreed between the two Companies. Dr Oskar tells me that Bunbury Foods has a continuing good business relationship with Kraft.

Dr Oskar strongly denies any inference that his conduct or that of Bunbury Foods would have prevented the development of a solid and reliable business relationship between either of them and Daus.

A personal fall-out between Dr Oskar and Richard Daus — about which I have reported to you on September 7, 1981 (copy enclosed) — caused the termination of the business relationship between their respective Companies, in this case Bunbury Foods and R.D.B.S.

I have heard a lot for quite some time about the proposed merchant bank which was planned to be established with Dr Oskar's and Daus' participation in Perth. I have no knowledge of the claimed verbal agreement between them for Dr Oskar to pay DM 250,000 to Daus for the planning of this bank ...

"I cannot see even indirect evidence of any incorrect or improper, let alone illegal action or omission by Dr Oskar."

4.5.7           The above correspondence with Mr Mensaros was undoubtedly pursued by the Premier because Mr Mensaros was the member of Cabinet with the greatest knowledge of Dr Oskar's business affairs, a circumstance perhaps better expressed as being the least ignorant of them. However, he had ceased to be Minister for Industrial Development in March 1980, when Mr Peter Jones had assumed the portfolio and Mr Barry MacKinnon had been appointed an honorary Minister with de facto responsibility for the operations of DID under Mr Jones' authority. The concept of "honorary Ministers" arose as a result of the Premier's decision to enlarge the Cabinet. The additional appointees discharged their ministerial functions in an honorary capacity from March 1980 until the necessary legislation was enacted. Thereafter Mr MacKinnon held the portfolio as Minister for Industrial Development.

4.5.8           In May 1980, Bunbury Foods had difficulty arranging for a 500 tonne shipment of soya bean oil to be delivered direct to Bunbury, with the consequence that the consignment had to be transported by road between Fremantle and Bunbury at greater cost. Mr MacKinnon approved a once-only freight subsidy of up to 60% of the additional expense.

4.5.9           Early in his time as Minister, Mr MacKinnon and his wife were invited to dine with Dr Oskar in the latter's suite at the Parmelia Hilton Hotel. During the evening, Dr Oskar presented Mrs MacKinnon with a pearl necklace. Mr MacKinnon testified that the gift appeared to be quite valuable and that, notwithstanding his discomfort at being the recipient of such a gift, he was reluctant to refuse it immediately for fear of causing unnecessary offence. After the dinner, Mr and Mrs MacKinnon went directly to his ministerial office and Mr MacKinnon dictated a note to his private

secretary, instructing the latter to return the pearls personally to Dr Oskar on the following day, together with a covering note from Mr MacKinnon which explained his (or rather, his wife's) inability to accept them. The pearls remained at the office overnight. While Mr MacKinnon's conduct was impeccable, the incident should have afforded him some insight into Dr Oskar's character.

#### **4.6 A \$700,000 question**

4.6.1 To the casual observer during 1980 and 1981, the Bunbury Foods project would have appeared, as Mr Bolto described it, to be "basically on track". The refinery was operating, sales were being made and the solvent extraction plant had been manufactured in Germany and shipped to Western Australia. However, there was mounting disquiet within DID concerning the ultimate viability of the project. Departmental officers were acutely conscious of the repayment obligations which loomed in 1982 and were disturbed by the attitude evinced by Dr Oskar's failure to meet his commitments to the venture. In the words of Mr Tek Poh, a DID Investigations Officer, that attitude was one of "let others put their money in first, and he guaranteed to put in his money later".

4.6.2 On 4 December 1981, Mr A Barber, the Chief Executive of Bunbury Foods, wrote a letter to the Minister, Mr MacKinnon, in which he stated, *inter alia*:

"Firstly my thanks to you for making the time available to discuss the present position of Bunbury Foods ...

As explained at the meeting, Bunbury Foods is a financial victim of its own success. Our sales effort particularly in the Eastern States has brought us business in excess of immediate expectations ...

Not to put too fine a point on the matter our sales expansion has outstripped our available working capital and to alleviate the immediate problems I would ask your approval to vary the terms of the facility available at Chase-NBA so that we can draw down \$700,000 as a loan. I enclose a cash flow forecast for the next twelve months, which details our course. Sunflower Investments is prepared to guarantee the loan against default by Bunbury Foods.

We need the facility of \$700,000 immediately to secure a shipment of oil otherwise we will be unable to meet our contracted obligations and protect the future operations of the factory ...

With respect to the funding of the Solvent Plant nothing really changes in that the Chase-NBA money would become a temporary loan and repayable within the time span required for the Solvent Plant construction ..."

4.6.3           The letter was sent to DID and on 16 December 1981, Mr Tek Poh delivered a detailed report on the company's request. He noted that when arrangements surrounding the guarantee to Chase-NBA had come to be finalised, the National Bank had reduced the unguaranteed working capital facility it was prepared to grant from a maximum \$5.2 million to just \$3 million. Consequently, Dr Oskar had been "forced to look elsewhere for finance to compensate the loss of the \$2.2 million facility from the National Bank. To his credit, two replacement loans, one from Richard Daus (\$1 million) and the other from the Bank of New South Wales for \$1.66 million were arranged ..." The Bank of New South Wales facility had since been reduced to \$1.16 million. At 10 December 1981, Bunbury Foods' working accounts with both the National Bank and the Bank of New South Wales were close to the limit of their facilities. Drawings were, in the former case, \$2,947,994 of an available \$3 million and in the latter, \$1,156,752 of an available \$1.16 million. The facility from Mr Daus had by then been terminated. Mr Poh observed:

"I am under the strong impression that the termination of the credit facility from Richard Daus has a strong bearing on the company's current approach to the Department for the urgent assistance by way of varying the purpose for which the second guarantee was approved."

4.6.4           Scrutiny of the cash flow estimates enclosed with Mr Barber's letter revealed the ominous discovery that they:

"... did not include loan repayments to:

Guaranteed Superannuation Board - (\$212,203 plus interest) due 1.4.82, and the Decentralization Advisory Board due 31.12.81.

Mr Pember advised that the exclusions were deliberate. Apparently the company is in no position to meet the above

obligations on their due dates and Dr Oskar is either unwilling to or does not appear to have the capability of meeting them from his own resources. Hence, the company is now being forced to re-negotiate the terms of the loan repayments with the two lenders, which may ultimately affect the State."

4.6.5 Mr Poh indicated that Bunbury Foods had breached the conditions relating to Government financial assistance. Among other things, the company had made loans to its holding company, Food Industry Holdings, which were regarded as withdrawals of shareholders' loans, without the Department's prior approval. Moreover, it had chosen to acquire its seed storage facilities through a new company (Bunbury Port Installations Pty Ltd) and by inter-company loan arrangements with that entity it had caused funds to escape the existing lenders' securities and had disguised the full extent of establishment costs in its own books.

4.6.6 On the subject of establishment costs, Mr Poh demonstrated that the estimated total cost of the refinery-extraction plant complex exceeded \$16.8 million and, depending on the level of working capital required to operate the business, might well be in the region of \$20 million. He noted that it was clearly Dr Oskar's responsibility to provide the necessary additional working capital in accordance with the terms of his two Letters of Undertaking dated 2 March 1978 and 3 October 1979.

4.6.7 Mr Poh expressed frustration that he had "to date had great difficulty in getting the company to impart pertinent financial information", but was able to conclude:

"As can be seen from the cash flow, the \$700,000 now requested from the Government is not the end of the company's current requirements."

The refinery was making only "gradual" progress and was "not a financial victim of its own success as claimed".

4.6.8 On the vexed question of security, Mr Poh found that the proposal to use Sunflower Investments Ltd as guarantor for the \$700,000 draw-down was not practical, as that entity was a trustee company registered in Liberia and of unknown financial strength. He questioned the credibility of Bunbury Foods' management, observing:

"On the one hand, Mr Barber claimed that Dr Oskar is currently away somewhere and cannot be contacted to provide the urgent funds now needed, and on the other, he said, if the Department or the Government is agreeable to allow his company to draw the funds from the Chase NBA account now for working capital purposes, he would be able to get in touch with Dr Oskar and get his permission to use Sunflower Investments Pty. Ltd. as security (ie guarantor) for supporting repayment of the \$700 000 drawdown from the Chase NBA Bank. What an amusing contradiction! If Dr Oskar does not have the high level of resources which he often led others to believe he has, then it is high time he says so."

4.6.9 Mr Poh suggested that the proposal to draw the \$700,000 from the fixed term Chase-NBA loan and then repay it so it was available to be drawn for its original purpose, namely, the extraction plant, might be unworkable. It would, he considered, involve obtaining a new approval from the Treasurer, issuing a new guarantee and entering new security and priority arrangements with other lenders to the company.

4.6.10 Mr Poh alluded to previous occasions on which Bunbury Foods had approached the Government requesting use of the Chase-NBA funds for purposes other than capital works and opined:

"I don't think the company is having the degree of regard to the seriousness of the Hon Treasurer's approval that the funds are for capital works only, and the balance of \$927,000 is reserved to ensure the local cost contents for establishment of the extract plant are covered."

4.6.11 Finally, Mr Poh observed that release of \$700,000 for working capital "could also weaken the State's security as no firm plan (was) on hand as to where the solvent extraction plant would be installed". There was a "slight possibility" that the plant might be taken from its location at the dockside and shipped elsewhere — a reference to advice received by DID that Dr Oskar was negotiating with the Queensland Government on establishing an oil processing project in that State.

4.6.12 Mr Poh's devastating analysis ended with a recommendation that the company's request be declined.

4.6.13 The next day, 17 December 1981, Mr Herman, the Senior Investigations Officer to whom Mr Poh's report had been addressed, sent his own report, which

enclosed that of Mr Poh, to Mr Christmass, who was by then Assistant Director — Finance. Mr Herman's report noted that as at 30 June 1981, Dr Oskar had contributed less than \$5 million in share capital and shareholder's loan (Mr Poh's report indicated a total of \$4,938,287, including \$262,887 capitalised interest on a \$900,000 loan), notwithstanding that on 14 August 1980 he had advised the Minister that he would increase the paid-up capital by 30 June to \$6.589 million. Mr Herman indicated:

"Should the balance of guaranteed funds be diverted for working capital purposes there would be serious doubts as to the company's ability to obtain sufficient funds to pay for the installation of the extraction plant. It has always been our expectation that the total capital costs of the combined refinery/extraction plant would be completed and thereby giving the secured lenders (including the State) at least the level of security by way of fixed assets that was originally anticipated."

He concluded that there were "serious doubts as to the company's ability to repay the \$700,000 as proposed", and supported Mr Poh's recommendation that the request be declined.

4.6.14 Two days later, on 19 December 1981, Mr MacKinnon wrote to Dr Oskar in the following terms:

"Further to our discussions of Friday, December 18th, concerning the request made by Mr. Tony Barber, Chief Executive of Bunbury Foods in his letter to me dated December 4th, I wish to draw to your attention the following facts :—

Firstly, you will see that I have attached a copy of a letter dated September 4th, 1980, addressed to Mr. Barber quite clearly pointing out to him our understanding with respect to the funds to be drawn down under the Chase-NBA guarantee.

You will see quite clearly that in that letter we have indicated 'all working capital and other capital expenditure are therefore to be the responsibility of your company'.

I also draw to your attention copies of undertakings given by yourself to the Department both in March 1978 and October 1979, concerning your undertaking to provide funds to meet any cost over-runs including working capital or other funding, which may arise in terms of our agreement.

However, after giving consideration to all of the matters raised by both yourself and Mr. Barber, I am prepared to agree to the release of the funds providing that you and the company would be prepared to meet with the following conditions :—

1. That I am able to satisfy myself that the amount to be released for working capital would be secured by the securities supporting the guarantee to the Chase NBA Bank.
2. We would also need to be satisfied that real and worthwhile assets are owned by Bunbury Port Installations Pty. Ltd. and that these assets are not already over-encumbered and that appropriate security charges can be taken over them. Once this was determined, securities would then need to be taken over these assets to secure the \$700,000 all of which would be released as soon as the funds were repaid.
3. A complete review of the assets situation of Bunbury Foods would need to be made to ensure that existing charges over them secure the State's position.
4. We would need to satisfy ourselves that the extraction plant has become the property of Bunbury Foods and that there has been no transfer of these assets to other companies. We would also need to satisfy ourselves that the assets do actually exist and are properly being maintained.
5. I would also need to be assured that we can take such other security as may be considered necessary to ensure that the State is fully secured. This would necessarily include a personal guarantee from yourself confirmed by legal agreement.
6. As soon as repayment of the \$700,000 and the custody of the \$700,000 when it is to be repaid, will need to be the subject of our seeking Crown Law advice as I understand there are some legal problems if we do not process this matter properly.
7. We would need an undertaking that the Solvent Extraction Plant will be proceeded with as soon as possible and that all costs and all future working capital for any of the company's operations will be totally the responsibility of the company

and that the Government's commitment will only be to the Chase — NBA guarantee and will be reserved for capital expenditure to cover the local costs of completing the Solvent Extraction Plant.

8. If any other companies are to be formed, for legal, taxation or other reasons, then the Government must be given the opportunity to take security over any of the assets of these companies to ensure that its position is fully secured.

I would hope that these conditions are acceptable to you and would appreciate your earliest advice so that we can now proceed to have these conditions met."

4.6.15 In a memorandum also dated 19 December 1981, Mr MacKinnon handwrote:

"Director.

For your information and Finance Director I discussed the detail of this letter with Hon Treasurer who approved the action taken."

4.6.16 On Monday, 21 December 1981, Dr Oskar wrote to MacKinnon which read:

"I, Dr Shrian OSKAR hereby accept the terms and conditions for the advance to Bunbury Foods Pty. Ltd. of \$700,000.00 from the existing Chase—N.B.A. facility as defined in your letter dated 19th December, 1981.

I further undertake to execute the necessary documents to fulfil the specified conditions. I also enclose similar undertakings from Bunbury Foods Pty. Ltd. and Bunbury Port Installations Pty. Ltd. signed by the authorised directors."

Mr Barber also sent a letter to the Minister on that day in the following terms:

"On behalf of Bunbury Foods Pty. Ltd. I hereby accept the terms and conditions for the advance to Bunbury Foods Pty. Ltd. of \$700,000.00 from the existing Chase-N.B.A. facility as defined in your letter dated 19th December, 1981.

The Company also undertakes to execute the necessary documents to fulfil the specified conditions."

4.6.17 In a file note, Mr Poh detailed the following:

"Record of meeting at 6th Floor, 32 St. George's Terrace, Perth on Monday 21st December, 1981, commencing 2.30 p.m.

Present:	Hon. Minister	B. McKinnon
	Director	R. Fisher
	Conveyancer, C.L.D.	B. Saunders
	A.D.F.	J. Christmass
	S.I.O.	J. Herman
	I.O.	T. Poh

1. It was pointed out (by Conveyancer and A.D.F.) to the Hon. Minister that: the financial assistance was approved by the Hon. Treasurer on June 22nd, 1979 for Capital Expenditure towards purchase of a solvent extraction plant. The loan was for a fixed term. No provision was made for draw-down, repayment and redraw again such as a fluctuating overdraft account. To accede to the company's request would mean new security arrangements, etc.
2. The securities in support of the \$2.282 million guarantee to the Chase NBA Group Ltd. clearly spelt out the purposes for which the funds are to be used.
3. The Conveyancer advised that the funds, if released for purposes other than Capital Expenditure would constitute a breach of the conditions of assistance under the security documents.
4. As regards the company's threat to cease operations if the State refused to immediately release \$700,000 to the company for working capital also constitutes a breach of the conditions in the securities.
5. The use of the guaranteed funds, when released, for working capital purposes would also constitute a 'cross default' under the terms of the 'Priority' agreement dated 27.12.1979 between the various interested Mortgagees whom the State would be obliged to advise under Clause 13(c) of the above Agreement.

6. Advised the Hon. Minister that it was now clear for Dr. Oskar to meet his obligations under his letters of undertaking dated March 2, 1978 and October 3, 1979 to contribute additional necessary funds into the company.
7. The Hon. Minister advised that he had already discussed the matter with the Hon. Premier who has also agreed to immediately release \$700,000 to the company. He stressed that the Government has already made verbal commitment to Dr. Oskar on the matter and would not deviate from it.
8. Advised the Hon. Minister that almost \$1 million worth of the extraction plant has been held in a Fremantle `Customs Bond Store' for a considerable period and ownership of plant may be in dispute.
9. The Hon. Minister directed the Department to ignore the existing legal documents which encumber the present situation and proceed to release the funds (\$700,000) to the company provided it can satisfy the Department on the following matters:
  - 9.1 The plant held at the Fremantle `Customs Bond Store' is owned by the company and
  - 9.2 that it is adequately insured, maintained and in good condition.
10. The Hon. Minister directed the Department to proceed with the `notification of cross-default' to the interested mortgagees.
11. The Hon. Minister also instructed the Conveyancer to proceed with immediate preparation of the necessary securities to support the release of the \$700,000 to the company.

Meeting ended 2.40 p.m."

4.6.18 It is unclear whether the Minister's letter of 19 December 1981 was actually conveyed to Dr Oskar on that Saturday or on Monday, 21 December 1981. However, irrespective of whether or not it had been sent by the time of the Minister's

meeting with his officers on the Monday afternoon, the brevity of the meeting and the tone of the minutes suggest a futile attempt to dissuade the Minister from a course of action to which he by then considered himself irrevocably committed.

4.6.19 On Wednesday, 23 December 1981, Mr Christmass forwarded a minute to the Director of DID, Mr R Fisher, in which he indicated that the preconditions concerning the extraction plant which had been specified by the Minister at the 21 December 1981 meeting had not been fully met. A detailed investigation report on the subject was still being prepared. However, he observed, "in view of the Minister's comments to the effect that he would honour the commitment the State had made to the company on this matter", the Director might "wish to authorise the release of funds regardless of the doubts that ... existed". Mr MacKinnon said in evidence that this suggestion was probably prompted by his unavailability to give a direct instruction due to his absence from the ministerial office.

4.6.20 A memorandum from Mr Fisher to the Minister which embodied the Department's advice on the \$700,000 question and essentially reflected the key conclusions of Mr Poh a week before, was dated 23 December 1981 and marked "For File Record Only". It observed that "[t]he company's current request is in effect a new proposal to vary the approved purpose for which the guarantee was issued" and that "[i]f the Letters of Undertaking of Dr Oskar cannot be relied on now, then any guarantees or indemnities issued by Dr Oskar would also be considered of doubtful worth". It concluded:

"In view of the need to protect the State's security position and also of the practicability of the proposal, it is recommended that the company's request be declined.

Submitted for your consideration please."

The whole document purported to address the merits of the Bunbury Foods request as if the Government's accession to it was still a live issue. It appears to constitute the official Departmental advice on that issue which would have been prepared and forwarded to the Minister in the days following Mr Poh's report of 16 December 1981, but for the events of 18-21 December, of which it took no account. Thus, for example, it contained the statement:

"The \$700,000 now required is urgent, and in a time of apparent financial crisis, Dr Oskar appears to have disappeared and is out of immediate contact."

This was certainly the position when Mr Poh delivered his report, yet on 18 December 1981 Dr Oskar had materialised in Perth and it appears unlikely that the above statement would be a reference to his movements after 21 December 1981. The statement bears an obvious similarity to Mr Poh's observations. No doubt the document was prepared as a file note to complete the record so far as the views of the DID were concerned.

4.6.21 On the same day, 23 December 1981, Mr Fisher wrote to the Manager of the Perth office of the R & I Bank as follows:

"You are hereby authorised to release a further amount to a maximum of \$700,000 from the Chase-N.B.A. Group Ltd. guaranteed account for working capital purposes.

Following the release of these funds, the total amount released from the account will be \$2,055,000.

Please advise Chase-N.B.A. on this matter.

Your urgent attention would be appreciated."

4.6.22 On 24 December 1981, that letter came to the attention of the State Treasury and was enclosed with a memorandum from the Director (Industry and Welfare) to the Deputy Under Treasurer which read:

2. As indicated in the letter, the Bank is requested to release \$700,000 from the guaranteed account with Chase - N.B.A. Group Ltd. to be utilised for working capital purposes.
3. The conditions of approval require that Government assistance be applied to capital expenditure and that any cost overrun including working capital or other funding are to be the responsibility of Dr. Oskar.
4. It would appear that a balance of \$227,000 remains to be released.

5. The above is submitted for your information, please."

4.6.23 On 29 December 1981, the Deputy Under Treasurer, Mr Boylen, handwrote a note to the Director (Industry and Welfare) at the bottom of the latter's 24 December 1981 memorandum, in which he said:

"I am disturbed that the R & I has been requested to release \$700,000 for working capital purposes. The request seems contrary to the conditions of the guarantee and coupled with the letter on folio 15 requires some explanation.

Would you request DIDC to supply financial details and an explanation of the circumstances which have required this 'authorization' to the bank."

4.6.24 One month later, Mr Fisher wrote to the Under Treasurer in the following terms:

- "1. Reference is made to your minute of December 31, 1981 enquiring as to the circumstances which led to the recent release of guaranteed funds of \$700,000 to the above company for working capital purposes.
2. You are advised that the release was made in the wake of advice from the company (see letter attached) that if a sum of \$700,000 was not immediately made available to Bunbury Foods Pty. Ltd., it would be unable to meet payment on a shipment of crude vegetable oils considered essential to the company's continued operation.
3. The company maintained that it was in a position where it would soon run out of oils for refining and be forced to shut down its plant. If this occurred the consequential damage to the company's credibility would be significant and its marketing progress to date ruined to the point where it may not recover.
4. Following approval to release the guaranteed funds, the company made satisfactory alternative arrangements with Nissho Iwai Australia Ltd., importers of the crude vegetable oils, as regards payment for the shipment. Under the arrangements the company was required to pay immediately \$300,000 to Nissho Iwai and meet the balance, being

\$284,000, by March 17, 1982 on the condition that security by way of a debenture over the assets and undertaking of the company was made available to support the outstanding debt.

5. The balance of the funds released (\$400,000) were used to meet overdue interest and sundry creditors which were outstanding since September and October 1981, as follows:-

Superannuation Board — (interest)	68 400
Omicron — (margarine containers)	65 000
Van Leer — (steel cans)	38 000
Jackson West — (advertising agency)	20 000
Harvey By-Products — (tallows)	89 000
Michael Downing — (market feasibility study)	5 000
National Bank Australia — (interest)	5 000
Refinoil — (oils)	12 000
Miscellaneous Creditors — small amounts	97 600
	—————
	400 000
	=====

6. The company has been experiencing financial difficulties for sometime mainly because of lack of market for its products. Although Dr. Oskar, the principal shareholder of the company, has given the State his Letters of Undertaking plus a number of promises by letter that he would contribute further funds as and when required to ensure its economic welfare, he has not carried out this obligation.
7. The release of the \$700 000 to the company was made on the verbal direction of the Hon. Minister who advised he had previously consulted the Hon. Premier on the matter.
8. It may be noted, the funds released were for short term usage only and the company proposes to repay the loan between February and June 1982 (refer to cash flow attached). A copy of the letter dated December 23, 1981 from the Chase - N.B.A. Group Limited on the matter is also attached for your records.
9. Submitted for your information."

4.6.25           Critical to a consideration of the propriety of Mr MacKinnon's conduct over the three days leading up to 21 December 1981 is the question of whether he consulted his Departmental officers before committing the Government to a release of the requested funds for working capital. To have made such a commitment without first receiving advice as to its implications from the most suitable and readily available source would have left him susceptible to a finding of impropriety. However, Mr MacKinnon's evidence to the Commission was that he did apprise himself of the views of his Department prior to reaching the decision at issue. He testified that the meeting between himself and Dr Oskar on Friday, 18 December 1981 would have been at his office and that "it would have been unusual for me not to have had Mr Fisher or Mr Tek Poh [present] ... there certainly would have been an officer there but who, I'm not sure". He could not recall precisely what Dr Oskar's explanation had been for failing to furnish the required working capital himself, though he did not doubt that he had been served with some story about logistical difficulties in making funds available at that time. The events which followed, as recalled by Mr MacKinnon, are of primary importance to the Commission's evaluation of his conduct.

4.6.26           After the meeting, and prior to his preparation of the letter to Dr Oskar dated 19 December 1981, Mr MacKinnon had a discussion with Mr Fisher. Mr MacKinnon recalled that by then the Department's advice that Bunbury Foods' request should be declined had been clearly and forcefully put to him. Mr MacKinnon informed Mr Fisher that he intended to accede to the company's request notwithstanding that advice and asked about conditions which should be placed on the release. Mr MacKinnon personally drafted the letter of 19 December, assisted by DID officers "who would probably have been Fisher and Poh at that particular time" on the detail of its terms. Mr Fisher advised Mr MacKinnon to obtain the Premier's concurrence with the decision prior to giving any undertaking to Dr Oskar and on the Saturday, 19 December 1981, Mr MacKinnon called upon the Premier at the latter's office. Mr MacKinnon took the whole DID file with him and gave Sir Charles a full explanation of the nature of and reasons for his decision. The Premier perused the file and consented to the release of the funds. Thereafter Mr MacKinnon probably telephoned Dr Oskar and conveyed to him the Government's decision to release the \$700,000 for working capital. Mr MacKinnon acknowledged the likelihood that this occurred, though he had no independent recollection of it.

4.6.27 The Commission accepts Mr MacKinnon's evidence of the circumstances in which his decision to release the funds was made. That testimony is supported by the letter of 19 December 1981, which subjected the release to a list of conditions for the formulation of which departmental advice would almost certainly have been required. Mr Fisher advised the Commission that he had no specific recollection of discussing the contents of the letter before it was sent to Dr Oskar, but that it was not inconceivable that such a discussion occurred.

4.6.28 The haste with which a decision was made reflected the company's perilous position. Mr MacKinnon observed that "it was a matter of we either agreed to it over that weekend or the company was going to, in fact, stop trading. That was the urgency of it".

4.6.29 As to the considerations which prompted his decision, Mr MacKinnon recognised that his patience with Dr Oskar exceeded that of his officers. Perhaps this was partly because he had been associated with the project for only two years. Moreover, association at ministerial level would not have afforded him the kind of intimate observation of the venture which informed Mr Poh's judgments. He perceived Mr Pullan and Mr Barber to be persons of competence and credibility and they had explained that the company was in the process of negotiating sales contracts which would significantly bolster its cash flows. Mr Poh's report partially corroborated such claims, for it noted that "the new McMahon Dairy Products order is worth about (2600 m/t) \$3.614 million in sales p.a. to the company, provided it can sustain the pressure of competition from the Eastern States producers".

4.6.30 At a more general policy level, he testified that:

"... it was a project that I felt was in the interests of the State that other ministers and I had worked hard to achieve; the plant was sitting ... from my recollection had just arrived; we could get into the next stage of the project quickly if Dr Oskar could come up with the funds. Now, in hindsight he probably was never going to but at that time I felt that he probably may and we should at least give him one last chance to prove those bona fides before we, in fact, pulled the pin on a project we'd worked on for quite some time."

A weighty factor in Mr MacKinnon's assessment of the company's fortunes was that Dr Oskar had, in fact, channelled substantial funds into the venture, albeit not as much

as promised. For Dr Oskar to fail to honour his undertakings would involve him, as surely as the Government, in exposure to significant losses. The Minister did not require a charitable view of Dr Oskar's character to anticipate that the entrepreneur would do his best to keep the operation afloat.

4.6.31 Further, the Minister discounted his officers' fears that the solvent extraction plant might depart for Queensland. He was convinced that Dr Oskar's negotiations with the Queensland Government were essentially a device for extracting greater concessions from the Western Australian Government for Bunbury Foods.

4.6.32 Mr MacKinnon's conclusion was:

"... that [the project] still had some chance of success so I felt that it was worth at that time the risk, and clearly there was a risk, and clearly I was taking a risk myself acting against what was pretty clear advice ..."

4.6.33 The Commission accepts that Mr MacKinnon's decision was made for legitimate reasons, after due consultation with DID officers. Where a Minister consults his Department but reaches a decision contrary to their advice, such decision cannot be impugned as improper merely because it exposes Government to risk, even if that risk be considerable. It required the balancing of risks and was essentially a political decision for which the Minister was accountable to the Parliament.

4.6.34 The failure to consult Treasury officers prior to releasing funds on terms at variance with those to which Treasury had agreed was undoubtedly attributable to the genuine urgency of the company's need, which expedited the decision-making process. To the extent that at least telephone communication might have been expected, the failure was on the part of DID officers, not the Minister, and it was they who were requested to account for it. Had DID shared their concerns with Treasury, the latter would have been able to brief the Treasurer, who in turn might have affected the outcome of his meeting with Mr MacKinnon on Saturday, 19 December 1981.

4.6.35 On 25 January 1982, the National Bank provided Mr Fisher with a copy of a letter which had that day been sent to the Chairman of Bunbury Foods. That letter read:

"By a letter dated 24th December, 1981 the Department of Industrial Development and Commerce advised of the release of \$700,000 of Chase-N.B.A. Group Limited guaranteed funds for urgent working capital requirements. These funds were originally intended to be used for construction of Stages 2 of the refinery concerning which the Bank has a discharge and priority. The Bank ranks only pari passu in respect of non-fixed assets and to that degree has been prejudiced.

By letter dated 13th January, 1982 the Department of National Development and Energy gave notice pursuant to Clause 13C of the Deed of Priority that your Company was in default under the Commonwealth Securities in that it had failed to pay to the Commonwealth an amount \$178,996.69 due on the 29th December, 1981.

We also note that notwithstanding the release of the Chase-N.B.A. Group guaranteed funds that on 29th December, 1981 the Company gave a charge over certain tanks and oils at Bunbury in favour of Nissho Iwai Australia Limited to secure an unlimited amount. It is not known whether the security is intended to rank prior, pari passu with or subsequent to the Bank's securities.

The Bank views these matters with the utmost concern. The Bank specifically reserves all rights which it now has or which may arise in future against your Company arising out of these and any other matters and must not be taken to have waived any such rights by reason of any action or lack thereof at present by the Bank.

By reason of these matters stated above the Bank has determined that it will withdraw the Company's present credit facilities as detailed hereunder :-

<u>Facility</u>	<u>Amount</u>	<u>Balance</u>
Overdraft	\$2,960.000	\$2,872,964.62
Guarantees by the Bank	40,000	40,000.00
Travel Booking Limit	10,000	6,160.40

This will apply from the date of this letter and any drawings presented hereafter will be returned unpaid.

Subject to any other action any secured creditor, including the Bank, may take in the interim by reason of the default of your

Company we expect that the Company will forthwith advise the action it will be taking to cure its present default position if it is to be cured and to prevent such a position arising hereafter.

We are sending copies of this letter to each of the other secured creditors."

For Bunbury Foods, gaining the release of the \$700,000 was to prove a short lived victory indeed.

#### **4.7 The road to receivership**

4.7.1 Over the summer of 1981-82, Bunbury Foods defaulted on several of its loan repayments. As noted in the National Bank's letter of 25 January 1982, the company failed to pay the Commonwealth Government an amount of \$178,996.69 due on 29 December 1981 (Decentralisation Advisory Board loan). It also failed to meet an interest payment of \$61,000 due to the Superannuation Board on 1 January 1982 in respect of the first State-guaranteed loan. Meanwhile, solicitors acting for the German manufacturers of the solvent extraction plant advised the R & I Bank that Dr Oskar had failed to adhere to an undertaking to provide security for a promissory note in their favour for about \$347,000.

4.7.2 On 10 February 1982, the Under Treasurer wrote to Mr MacKinnon, enclosing a file note from Mr Rolfe which set forth minutes of a meeting of all secured creditors of Bunbury Foods, convened by the Commonwealth, which had occurred on 3 February 1982. Within those minutes it was noted:

"15. Concern was expressed by the Commonwealth and N.B.A. at the D.I.D. & C. action in releasing \$700,000 for working capital when it was approved for capital expenditure. Tek Poh replied that it was only a short term or bridging loan and was due to be repaid by 30 June 1982 and that had the funds not been released the company claimed it would have been in serious financial trouble."

4.7.3 In his covering letter, Mr Boylen, on behalf of the Under Treasurer, observed that:

"... the action by the National Bank in freezing the Company's overdraft facility — although justifiable — must inevitably result

in cessation of trading and ultimately lead to calls upon the State under its guarantees to Chase-N.B.A. and the Superannuation Board.

I believe that the Company should be given an opportunity to resolve its difficulties.

At the same time, I could not support any request by the Company for an increase in the level of State support if that, in fact, is what the Company is seeking."

4.7.4 Mr Bolto recalled that:

"[t]owards 81/82, the National Bank cynics of the project were starting to take control, they wanted out and wanted their money back. They didn't want to be involved anymore. So from that point of view, it wasn't really a question of how well or otherwise the refinery was doing, they had had enough. At some time around March or April of 1982 after visiting Australia to try and put together a working arrangement between all of the project financiers, I told [Dr Oskar] that I could not help him as a director anymore."

4.7.5 On 8 April 1982, the National Bank appointed a receiver-manager to Bunbury Foods and on 19 April, Mr MacKinnon took a submission to Cabinet which concluded:

"16. On the assumption therefore that the receivership will continue the State is faced with two courses of action —

- Similarly appoint a Receiver (probably the same one as National Bank) and salvage something out of the exercise so far.
- The State, in conjunction with a substantial injection of funds by Dr. Oskar, issue a Government guarantee for \$2 million that would result in The National Bank being paid out or the remaining debt of \$2 million being guaranteed either of which would lead to removal of the Receiver.

17. If the receivership is continued, it seems likely that the following would occur —

- The State would incur a loss of approximately \$1.7 million in respect of the Government guaranteed loans of \$4.424 million based on estimated realisable value of the company's assets.
  - The refinery would be purchased by one of the other Australian manufacturers of margarine and would continue operating at Bunbury.
  - The solvent extraction plant would not be completed and the plant acquired to date disposed of elsewhere.
18. The alternative proposal of issuing another Government guarantee for \$2 million strictly in accordance with the conditions yet to be finalised with Dr. Oskar. It is expected that the outcome of these negotiations would achieve the following —
- Reduction of the National Bank debt by Dr. Oskar of \$1.19 million.
  - Clearance of or guaranteeing of the balance of The National Bank debt by the Government guarantee and removal of the Receiver.
  - Further immediate injection of substantial funds by Dr. Oskar to meet other creditors of the company.
  - Independent monitoring on a monthly basis of the company's affairs.
  - Legal guarantees from Dr. Oskar to continue funding the losses of the company on a monthly basis in the hope it can achieve profitability.
  - Improve the State's immediate security position.
  - Ensure that the solvent extraction plant as acquired to date is owned by the company and under proper control and storage.

- Payment of interest arrears on the Chase - N.B.A. and Superannuation Board guaranteed loans.
- May still lead to completion of the solvent extraction plant and Dr. Oskar has been asked to submit fresh proposals as to timing of completion and financing of the additional capital expenditure.

19. In all the circumstances I am of the opinion, particularly in view of the agreements which I have already reached in discussions with Dr. Oskar and his intention to immediately inject substantial funds into the company to give the company and Dr. Oskar another chance to continue operating and prove viability of the venture.

20. Recommendation

The Minister for Industrial Development and Commerce be authorised to continue negotiations with Dr. Oskar, in consultation with The Treasury, on the basis of that in return for the issue of a Government guarantee for \$2 million Dr. Oskar will immediately inject substantial funds into the company and enter into firm commitments to ensure continuance of the venture in the foreseeable future."

4.7.6 Cabinet's decision on that day was recorded as being "that the Minister is to confer with the Premier and Treasury before a decision is made".

4.7.7 On 21 April the Acting Under Treasurer, Mr Boylen, sent a minute to the Premier, who was then Mr Ray O'Connor, which advised:

"16. Currently the State has a contingent liability of \$4.4 million and I believe that it should be most circumspect in increasing that liability.

17. In my view it would seem prudent to let the current receivership take its course (or alternatively to join that receivership) to avoid the prospect of the State incurring a greater level of loss.

18. However, in the event that the Government wishes to extend further support I consider that the immediate injection of \$4,685,000 (or whatever greater amount is required to clear all

outstanding debts) by Dr. Oskar to be a pre-requisite to any negotiations for increased support."

On 27 April 1982, Mr O'Connor handwrote at the bottom of the document:

"Advised Mr MacKinnon Govt not anxious to inject further funds unless security can be obtained."

4.7.8 The Premier had met Mr MacKinnon on Saturday, 24 April 1982 relating to the proposal to offer Bunbury Foods further guaranteed assistance. Prior to that meeting, Mr MacKinnon had received an hour-long briefing on "the latest position of the company" from Mr Fisher and Mr Christmass. In a file note of that discussion, Mr Christmass summarised as follows:

- "7. I explained to the Minister that I was well aware of all the pros and cons of the matter and that an argument could be made out to provide financial assistance particularly if substantial funds were to be injected by Dr. Oskar. In many respects it could be argued that we had nothing to lose.
8. However, in conclusion I made it quite clear to the Minister and the Director that in the long run I could not see the company ever being successful ... I summed it up by saying that based on the present capital structuring of the company I regarded it as a "mathematical impossibility" for the company to ever be successful."

4.7.9 Nevertheless, the Minister's subsequent discussions with the Premier resulted in agreement that the Minister should make a further offer of assistance, subject

to stringent conditions, including conditions precedent. On 28 April 1982, a seven-page letter of offer from the Minister was sent to Dr Oskar. It set forth 20 detailed conditions, and included the following passage:

"This offer of additional assistance of \$2 million as agreed to by the Hon. Treasurer was approved strictly on the basis of the following conditions and in this regard I quote directly from the submission approved by the Hon. Treasurer —

1. The purpose of this assistance is for refinancing of the present debt of \$3.215 million (plus interest at a daily rate of \$956.16) owing to The National Bank of Australasia and for no other purpose whatsoever.
2. Dr. Oskar shall immediately upon acceptance of this offer pay \$4.706 million into an appropriately styled Deposit Account at the R. and I. Bank to meet the following creditors of Bunbury Foods Pty. Ltd. —

Nissho-Iwai Australia Ltd. as the creditor having\$ a Bill of Sale over oil stocks	125 000
To creditors having a lien over warehouse stocks	30 000
Part reduction of The National Bank of Australasia Limited's debt (plus interest at daily rate of \$956.16)	1 215 000
Chase-N.B.A. Guaranteed Loan - Interest due 31.3.82	85 000
Superannuation Board of W.A. - principal due 31.3.82 - interest due 31.12.81 - interest due 31.3.82 - interest due 30.4.82	106 000 66 000 96 000 4 000
Department of National Development - principal due 29.12.81 - interest due 29.12.81	101 000 78 000
Extraktionstechnik - West Germany	1 000 000
Trade Creditors	1 800 000
	<hr style="width: 100px; margin-left: auto; margin-right: 0;"/>
	4 706 000
	<hr style="width: 100px; margin-left: auto; margin-right: 0;"/>

3.
  - 3.1 Dr. Oskar to submit conclusive evidence of action for the immediate supply to Bunbury Foods Pty. Ltd. of edible oils in sufficient quantities to ensure that there shall be no interruption to production or employment at Bunbury as a result of the company running out of unprocessed oil.

3.2 Purchase of the oil to be in the first instance a personal liability of Dr. Oskar."

4.7.10 On 5 May 1982, solicitors Robinson Cox wrote to Mr MacKinnon on behalf of Dr Oskar and Bunbury Foods, to announce their clients' acceptance of the Government's offer "subject to your approval to the few variations set out below".

4.7.11 On 12 May 1982, the Under Treasurer, Mr Les McCarrey, sent a minute to the Treasurer which outlined the Government's position as it then stood:

"On 21 April I informed you of the situation confronting Bunbury Foods Pty. Ltd. which is the subject of Government guarantees totalling \$4.4 million issued to the Chase - N.B.A. Group Ltd. and the Superannuation Board of W.A.

2. I understand that, following a discussion with the Minister for Industrial Development and Commerce, you agreed to the issue of a further Government guarantee for \$2 million to secure borrowings necessary to alleviate the situation provided Bunbury Foods Pty. Ltd. met certain conditions, the most important of which was the immediate injection of \$4,685,000 by the Company's principal, Dr. S. Oskar, to service outstanding creditors.

3. Subsequent negotiations between the Minister and Dr. Oskar led to counter proposals being made which, I understand, are not in the main acceptable to the Minister.

4. I also understand that the Minister has now given Dr. Oskar until 5 p.m. on 14 May to comply with the conditions.

5. Today, the Commissioners of the Rural and Industries Bank as agents for the State were served with a notice of demand by the solicitors acting for the Chase - N.B.A. Group for an amount of \$84,800 interest outstanding.

6. On 21 April the Superannuation Board served a notice of demand upon the Commissioners for payment of \$270,700 in outstanding principal and interest.

7. Payment by the State under its guarantees is obligatory and I have accordingly arranged for the Department of Industrial Development and Commerce to arrange for immediate payment.

8. I shall minute you further in the light of subsequent developments."

4.7.12 On 14 May 1982, Robinson Cox responded to the Minister's deadline with a letter which advised:

"On behalf of the Directors of Bunbury Foods Pty. Ltd. and Dr. Shrian Oskar personally the offer and all of the conditions contained therein are hereby accepted."

The dialogue which ensued over the next three months revealed the mastery of Dr Oskar, assisted by his solicitors, of the art of brinkmanship.

4.7.13 On 18 May 1982, the Minister wrote to Robinson Cox seeking confirmation that those conditions requiring immediate implementation would in fact be implemented forthwith. The letter continued:

"Furthermore would you in your response please advise:

- (i) when the sum of \$4.736 million will be deposited with the Rural and Industries Bank, which I expect to be not later than 5.00 p.m. Friday, 21st May, 1982;
- (ii) the arrangements which have been made for the supply of oil;
- (iii) the details requested in my letter of 12th May, 1982 in relation to condition 4.1 [details of the assets of Bunbury Port Installations and proposals for taking effective security over them];
- (iv) the source of funds of \$2 million for the proposed guarantee."

4.7.14 In a letter received by the Minister on 21 May 1982, Robinson Cox advised:

"Dr. Oskar has given a personal guarantee to the Bank of New South Wales to secure a loan from that Bank to Bunbury Foods Pty. Ltd. As the Company is in default, the moneys owing under

the Guarantee are now due and the Bank has indicated that it will exercise all possible powers, for example a Garnishee Summons, to obtain access to any funds over which our client has some degree of control.

Condition 2 of the Government's offer which was accepted requires Dr. Oskar to pay the sum of \$4.736 Million into an appropriately styled deposit account with the Rural & Industries Bank. Our instructions are that until the Receiver is discharged (and this of course cannot be done until the \$2 Million Guarantee is provided by the Government), our client cannot safely pay those moneys into the Rural Industries Bank first because if the account is held in his name the Bank of New South Wales will be able to garnishee the funds. Secondly, if the fund is in the name of the Government, our client loses control over the funds with no security. Thirdly if the fund is in the name of the Receiver, the Receiver will apply the money in satisfaction of the debt due to the National Bank and this is clearly contrary to Condition 2 which provides that the \$2 Million Guarantee from the Government is to be used for this purpose together with \$1.2 million from Dr. Oskar's funds.

In view of the fact that the acceptance was only given last Friday, our client unfortunately finds himself unable to comply with the time limit requested. Although the Government has agreed to give a Guarantee, it is still necessary for our client to make suitable arrangements with an appropriate bank.

As to paragraph (ii) it is confirmed that arrangements are in hand and will be finalised upon the removal of the Receiver."

4.7.15 By 27 May 1982, Mr MacKinnon had received advice which satisfied him that arrangements could be made to immunise any funds deposited by Dr Oskar from garnishee proceedings. It is surprising that Dr Oskar's solicitors were content simply to convey to the Minister the "instructions" they had received from their client instead of advising him as to the manner in which the spirit of the Government's conditions, namely the secure lodgment of Dr Oskar's funds in excess of \$4 million could be met. It seems obvious to us that Dr Oskar was negotiating in bad faith. The Minister's departure on a trip to the United States was imminent, and hence he decided to recommend to Cabinet that the offer to Dr Oskar be terminated and, depending on legal advice, that a receiver and manager be appointed to Bunbury Foods to act on behalf of the Government. However, just as he was about to act upon his decision, Mr MacKinnon was contacted by Dr Oskar, who assured him that bank cheques to the

value of \$4.8 million were being handed to Robinson Cox and that he, Dr Oskar, would attend to all of the other matters raised in the Minister's letter of 18 May 1982.

4.7.16 In a letter dated 3 June 1982, Robinson Cox informed the Minister as follows:

"As agreed, in an effort to overcome the problems outlined in our earlier letter and to demonstrate our client's willingness and ability to perform his obligations in this matter, Dr. Oskar has lodged bank cheques totalling AU\$4,800,000 with ourselves for safekeeping on his behalf.

Our instructions are that these cheques are not to be negotiated until either undertakings have been received from both the Bank of New South Wales and Department of National Development or documentation is complete, whichever occurs first."

4.7.17 The Minister was sufficiently mollified by this development not to recommend revocation of the offer prior to travelling overseas. During his absence, DID officers did their utmost to entice performance of the terms of his acceptance from Dr Oskar. They instructed the Crown Law Conveyancer to proceed with preparation of the necessary securities, on the assumption that Dr Oskar's performance would eventually permit the further guarantee to be given. Meanwhile, the Bunbury Foods refinery had ceased operations during the month of May.

4.7.18 On 28 June, Mr Fisher and Mr Christmass met Dr Oskar, Mr Barber and Mr Paul Blackman of Robinson Cox. An extract from the file note prepared by Mr Christmass on the following day read as follows:

"Sighting of Cheques

In accordance with discussions that Director already had with Mr Blackman that we wanted to sight the cheques at this meeting, the Director asked whether they had the cheques on them for sighting by us.

Answer, no. Dr. Oskar said he was not prepared to allow this because he was not prepared to run the risk of anyone knowing where he had any funds in view of all the various parties who were taking or threatening legal action against him and who might garnishee the funds."

During the meeting, Dr Oskar produced a copy of a document which purported to be evidence that crude vegetable oils had been purchased by him and were available for delivery to Bunbury Foods upon his request. Subsequent inquiries by DID officers disclosed that the consignment to which the document referred was a past delivery to Bunbury Foods. Departmental records indicate that the misrepresentation constituted by Dr Oskar's use of the document was not an isolated incident, but rather reflected a pattern of obfuscation and deception which characterised the entrepreneur's behaviour throughout negotiations with the Western Australian Government in 1982-83.

4.7.19 Mr MacKinnon returned to the State at the beginning of July 1982 and during the month obtained advice from the Crown Law Department that there was no legal reason why the State could not proceed with the appointment of a receiver to Bunbury Foods if it wished to do so. On 30 July 1982, the Minister prepared a submission to Cabinet, in which he observed:

"Despite lengthy negotiations with Dr. Oskar and his solicitors over the last few months, and several extensions of the time limit for the implementation of these requirements, I am unable to report any meaningful performance by Dr. Oskar in these matters."

His submission concluded as follows:

"Recommendation

9. In the light of these circumstances, I recommend that Cabinet approve the following action:-
  - 9.1 Termination of the current negotiations with Dr. Oskar and his solicitors and the immediate withdrawal of the State's recent offer of the additional \$2.0 million Government guarantee, and,
  - 9.2 the appointment of a Receiver/Manager over Bunbury Foods Pty. Ltd; who will have as his immediate objective the sale of the refinery on such terms as will ensure the continuance of its operations at Bunbury."

4.7.20 The recommendation received Cabinet's approval on 2 August 1982 and the Minister conveyed its effect to Robinson Cox in a letter dated 5 August 1982. There were, however, certain formalities requiring attention to enable the appointment of a receiver to be finalised. There was also an understandable caution exercised to ensure that any appointment would withstand legal challenge. The appointment by the National Bank, in April 1982, of a receiver and manager had been challenged by the Company in the Supreme Court of Western Australia and a decision in those proceedings was awaited.

4.7.21 On 26 August 1982, the appointment of the National Bank's receiver-manager was declared invalid by the Supreme Court. As the State was yet to appoint a receiver-manager, control of Bunbury Foods reverted to its Board of Directors. On the same day, Mr Blackman of Robinson Cox telephoned Mr Fisher, who recorded the substance of the call as follows:

- "— I received a telephone call from Paul Blackman of Robinson Cox on 26 August, 1982, to advise me of the outcome of the court case between the National Bank and Bunbury Foods.
- Mr Blackman placed me on notice that he presumed that the State would not be taking any precipitative (*sic*) action.
- I asked him to be specific and he stated that, in view of the decision, he presumed the State would not be proceeding with the appointment of a receiver.
- I indicated to Mr Blackman that the State would be examining the judgment before making any decision and that in this sense it would be true to say that the State is/was proceeding with the appointment of the receiver.
- I asked Mr. Blackman whether damages had been assessed and he indicated that the judgment had been on the question of liability and that the question of damages would be a separate issue. He added however, that the damages would 'run into millions'."

It is apparent that Mr Blackman's words were received as a blunt warning to the Government not to act hastily in the appointment of a replacement because the damages would "run into millions".

4.7.22            Nevertheless, steps were taken to obtain advice from the Crown Law Department and to involve the R & I Bank as the debenture holder, culminating in the appointment on 30 September 1982 of Mr Maurice Levi as receiver and manager, to which reference will be made later in this chapter. Unfortunately, in the period of five weeks during which the control of the company reverted to its directors and Robinson Cox were acting as its bankers, \$460,000 found its way to Dr Oskar. That sum should have been available for the benefit of the creditors of the company.

4.7.23            Mr MacKinnon met Dr Oskar on 17 and 20 September 1982, and after the second meeting he sent a memorandum to Mr Fisher outlining the scope of discussions. That document contained the following passages:

"I indicated to Dr. Oskar that whilst the State was in a position to appoint a Receiver, that I had decided not to do so for the period of one week, in which time he should put together a proposal in an effort to convince me that the company had addressed itself to the problems at hand and why the Government should not proceed with the decision to appoint a Receiver.

I outlined to Dr. Oskar that the two most important issues from my point of view were that the company be re-established with the prospects for long term viability, especially relating to the Refinery Plant and secondly, that the taxpayers' funds if possible and as far as possible should be protected ...

He ... once again repeated to me that he would not be bringing funds into the country as he believed that they would be garnisheed, one way or another, by the other parties to whom he owes money or has a dispute with at the current time ...

I arranged to meet him again on the following Monday, September 27 at midday, when I could discuss with him the proposals he may have then put together.

I hasten to add that all of these discussions were held and emphasised by both myself and himself to be without prejudice to any legal proceedings or further proceedings that the State may take or he may take with respect to our activities."

4.7.24            On 22 September 1982, Mr Pullan on behalf of Bunbury Foods wrote to the Minister, advising optimistically that "the company and Dr S Oskar, as its principal shareholder, have decided to recommence operations at Bunbury on

28th September, 1982" — one day after Mr MacKinnon's deadline to Dr Oskar for submission of a constructive proposal for a viable operation.

4.7.25 On 27 September 1982, Mr Poh of DID sent a minute to his superiors in which he assessed Dr Oskar's plans to resume production in the following terms:

- "1. Reference is made to the letter dated September 15, 1982, (ref. folio 41-42) from Peat Marwick, Mitchell & Co. regarding a proposed plan to re-start the operation of Bunbury Foods Pty. Ltd ...
9. The Peat, Marwick Mitchell letter suggests Dr. Oskar is either unwilling or incapable of providing the funds for the company. Dr. Oskar has previously supplied misleading and unreliable information to the Government, and on this occasion, the letter from the firm of Chartered Accountants is considered yet another one of Dr. Oskar's ineffectual ploys to lock the Government in a long and fruitless discussion.
10. I believe the practical solution for the present problems now faced, and the long term interest of the State, would be best served by the Department not entering into further discussions with either the Company or Dr. Oskar on the matter of restructuring or deferment of instalments for the guaranteed loans.
11. I suggest we simply advise Dr. Oskar and the Company to get on with the job as the Receivership situation has now been removed and they are now in full control of the Company's own destiny."

4.7.26 On 30 September 1982 the State Government appointed Mr Maurice Levi of Coopers and Lybrand to be Receiver and Manager of Bunbury Foods. In a press release on that day, Mr MacKinnon said that after giving "exhaustive consideration" to Dr Oskar's proposals to restart operations, he was not convinced that they could assure a long-term future for the company.

4.7.27 Mr Levi continued negotiations with Dr Oskar in relation to possible resumption of operations, but all proposals submitted by the latter were considered to be thinly disguised attempts to recover control without further tangible commitment.

4.7.28 On 4 November 1982, Dr Oskar tried the tactic of a direct approach to the Premier, who sought Mr MacKinnon's response. That response was swift and dismissive, branding Dr Oskar's latest proposal "completely meaningless in relation to the complex nature of this Receivership". Furthermore, the Minister warned the Premier with the words:

"Given the circumstance of this particular case and the real possibility of some future litigation by Dr. Oskar, I consider it highly undesirable for you to enter into any form of written communication with Dr. Oskar at this point of time.

I understand the Receiver-Manager has invited Dr. Oskar to approach him with any meaningful proposals which he may have with regard to the future operation of Bunbury Foods Pty. Ltd. and, accordingly, I strongly suggest Dr. Oskar be verbally advised to approach Mr. Levi direct."

4.7.29 On 21 December 1982, the Full Court of the Supreme Court of Western Australia allowed an appeal against the decision of 26 August 1982 and affirmed the validity of the appointment of the National Bank's receiver-manager. Thereafter, Bunbury Foods had the benefit of two receivers supervising its unhappy affairs.

## **4.8 The aftermath**

4.8.1 In a report to the Director of DID dated 10 December 1982, Mr Levi, as receiver and manager of Bunbury Foods, summarised his conclusions concerning the company's prospects as follows:

"(a) As a result of my investigations it is clear that the company is in dire financial straits and that as a Receiver and Manager I could not possibly contemplate a trade out of current financial difficulties within a reasonable time without massive injection of equity and working capital on terms which are favourable to the Receiver and Manager and all other creditors of the company.

(b) Despite numerous requests from me to Dr. Oskar that he clearly set out his intentions in writing he has failed to do so in any way."

4.8.2 In a complementary report of 14 December 1982, Mr Levi made the following recommendation:

"If Dr. Oskar fails to respond by 31st January 1983 with a proposal that is worthy of consideration or if he indicates prior to that time that he is unable to meet the requirements, that I forthwith proceed to dispose of the Refinery and related land and buildings at Bunbury."

4.8.3 On 2 February 1983, Premier O'Connor issued a news release which announced that the Bunbury Foods edible oil refinery would be offered for sale "as a going concern". The statement quoted the Premier as saying that the two receiver and managers "were co-operating fully and no conflict of interest was envisaged". Mr Levi placed advertisements for the sale, with a closing date for tenders of 11 March 1983.

4.8.4 In the interim, the election of the Burke Government galvanised the indefatigable Dr Oskar into a fresh flurry of self-promotion. On 2 March 1983 he wrote to Mr Lewis as follows:

"Many thanks ... for your kind hospitality last Saturday.

As you know I have to go to New Zealand for a few days and it would be helpful to put on record my proposal in relation to the re-starting of Bunbury Foods so that it can be considered by Mr. Bryce during my absence."

Dr Oskar proceeded to set forth a new proposal, and then continued:

"In view of the lack of progress made in earlier negotiations with the Department of Industrial Development and Commerce I have reservations about the way the above proposals might be treated by the executives of that Department but I would hope that the new Minister's judgment would not be clouded by earlier attitudes.

You will be doing a great service by putting these facts to the new Minister so that I can pick up the ball again when I return to Perth. Please also emphasise to the Minister that I migrated to Western Australia in 1979 and that my interests are those of a West Australian."

4.8.5 On 9 March 1983, Mr Lewis wrote to the new Minister, Mr Mal Bryce, in the following terms:

"Herewith a letter I have received from Dr. Oskar. As you know originally I was a consultant and director until a Government guarantee was involved. I believe we could get the show on the road again, but would need to tie Oskar down very firmly. Apparently he has talked to Mr. Levi, the receiver, but I only have Oskar's version of that.

The attached letter makes sense to me, but if you wish to discuss it with me, please ring me."

4.8.6 On the same day, the Premier's assistant private secretary wrote to Dr Oskar, acknowledging the latter's congratulatory letter of 25 February 1983 and directing him to Mr Bryce as the responsible Minister.

4.8.7 At the close of tenders, some 40 inquiries had been received by Mr Levi, of which only two were considered worth pursuing. The first was an offer of \$2 million for the land, buildings and refinery. The prospective purchaser was willing and able to give an undertaking to re-open the refinery promptly and would not have required any State Government assistance. However, it was unlikely that that purchaser would agree to increase its purchase price to an amount sufficient to clear even Bunbury Foods' indebtedness to the National Bank, which effectively held first charge over the company's fixed assets. Moreover, the purchaser had no interest in acquiring the solvent extraction plant, which continued to deteriorate on the dockside.

4.8.8 The second offer was to pay a sum of \$4.326 million for the land, buildings, refinery and solvent extraction plant, together with an *ex gratia* payment of \$917,887, which equalled amounts owed to the company by associated entities and persons previously in control of its operations. The total consideration of \$5.24 million was sufficient to permit a complete recovery by the National Bank and leave a significant residue to reduce the State's losses. However, there was one small complication - the identity of the purchaser. Like a recurring nightmare, Dr Oskar returned to haunt the officers of DID, though at least on this occasion they could share the nightmare with the receivers.

4.8.9 Dr Oskar found an unlikely ally in the National Bank. The Bank indicated to DID that it was prepared to accept the offer from Dr Oskar's Food Industry

Holdings and that if the Government, through its receiver, delayed a decision on the matter, the Bank would exercise its priority rights by instructing its receiver to take charge of the receivership and execute the proposed agreements. Further, the Bank intimated that if the Government decided to deal with another party for a lesser sum, the Bank would demand State compensation for the extent to which its recovery was thereby diminished.

4.8.10 On 14 June 1983, the Premier, Mr Brian Burke, consented to the Government's receiver proceeding with the proposed sale to Food Industry Holdings and over the next three months, Mr Levi attempted to do so. On 8 July 1983, Robinson Cox conveyed their instructions that Dr Oskar found the contracts which had been prepared by the receiver's solicitors to be acceptable and that he would execute them on or before 29 July 1983. He did not do so, and subsequently sought the receiver's assent to a proposal that the contracts be signed in Zurich. Dr Oskar's reticence to return to Australia was explained by the fact that, after consenting to judgment in the amount of \$1,910,520.70 in litigation brought against him by the Commonwealth, he had fled the jurisdiction and an Absconding Debtors Warrant for his apprehension had been issued on 3 June 1983. The receiver arrived in Zurich on 20 August 1983 only to find that Dr Oskar had resiled from the terms of his offer, and was proposing payment of a much reduced amount. On 6 September, the receiver advised DID:

"My response to Dr. Oskar was that so far as I am concerned I am coming home to Perth empty handed.

I am not prepared to deal with him any longer nor do I believe that my principal would want me to deal with him ...

I informed Dr. Oskar that on my return to Perth I would be entering into immediate negotiations with other parties for the sale of the Refinery.

I have instructed my solicitors today to cancel all negotiations with Dr. Oskar and am now making plans to close the Perth office of Bunbury Foods."

4.8.11 In a subsequent minute to the Minister, DID Acting Director, Mr Greenwood, advised:

"20. The Assistant Director, Finance and Administration discussed the latest position with the Receiver early this afternoon (Monday 12 September, 1983) and the Receiver advised as follows:-

- Dr. Oskar has telephoned him every evening (except Thursday 8/9/83) over the past week.
- Dr. Oskar has hinted he may now increase his offer to \$3.9m.
- However, the Receiver regards the 'FIH offer' as now behind us unless a substantial amount of money was deposited to the Receiver's account and Dr. Oskar has been advised accordingly.
- The \$6 500 'accommodation and airfare expenses' cheque has been dishonoured for the second time 'Refer to Drawer'.
- The CIB has a warrant out for the arrest of Dr. Oskar. It is not known what action is proposed about extradition. Apparently the grounds for issue of the warrant are perjury resulting from a review by the CIB of evidence given by Dr. Oskar at the Commonwealth case against him."

4.8.12 Fortunately, however, a further offer to purchase the refinery had been made by Allied Mills Ltd. On 26 September 1983, Mr Fisher prepared a minute to the Premier recommending the sale of the refinery to this company which the Under Treasurer, Mr McCarrey, supported in the following terms:

"I endorse the recommendation of the Director, Department of Industrial Development that the Receiver/Manager appointed to Bunbury Foods Pty Ltd be authorised to accept the offer by Allied Mills of \$3,455,000 for the refinery.

2. Further negotiations with Food Industry Holdings Pty Ltd appear to be pointless and it is evident that further delays in disposing of the assets will only serve to increase the State's liability.

3. Dependent upon whether the solvent plant is subsequently sold the State faces the prospect of paying out a further \$3,675,000 under its guarantees to the Superannuation Board and Chase/N.B.A. However, I can see no other alternative."

4.8.13 On 4 November 1983, the sale to Allied Mills Ltd was completed, notwithstanding threats of litigation pursuant to the *Trade Practices Act (Commonwealth)* delivered on that very day by Dr Oskar's solicitors, Robinson Cox.

4.8.14 In a letter to the Director of DID dated 20 December 1983, Mr Levi noted that the solvent extraction plant was yet to be sold, negotiations with several parties having failed to reach any positive conclusion, that such sale would have to be pursued on a "break-up basis" in 1984.

4.8.15 On 13 December 1983, the recommissioned refinery was officially opened by the Minister, Mr Bryce.

4.8.16 In a memorandum to the responsible Minister dated 10 June 1988, Departmental officers recommended:

"In view of the considerable length of time already taken to finalise the Receivership, and the uncertainty of the Receiver/Manager making a distribution in the immediate future or for that matter what the amount of the final distribution will be, it is recommended that a partial writeoff of \$6 million be made this financial year as this amount is irrecoverable. The recommendation is supported by the Treasury Department as the debt is still on the books and accordingly, it limits the borrowing ability of the State."

In an attached appendix, it was noted that, subject to any amount received upon the receiver's final distribution, the total loss to the State as a result of its \$4.4 million in guarantees would be \$6,397,949.60, due to accumulation of interest charges.

4.8.17 On 29 November 1989, Mr Levi wrote to announce the final distribution under his receivership of Bunbury Foods. The amount recouped by the State was \$91,495. Hence, the State's total loss in consequence of its grant of financial assistance to Bunbury Foods exceeded \$6.3 million. Moreover, such monetary estimates take no account of the cost to the State of the time of Departmental officers and successive Ministers which was absorbed by the project.

4.8.18 In his report to the Director of DID dated 10 December 1982, the receiver, Mr Levi, made an assessment of the discernible impact of the Bunbury Foods venture upon Dr Oskar's financial position. The Commission considers that a portion of that commentary warrants inclusion in this report as follows:

"(a) The company was under the control of its directors including Dr. Oskar for a period of approximately five weeks to 30th September 1982. In that time the company made a payment to Dr. Oskar of \$460,000 being a payment to replace a cheque provided to him in October 1981 for certain costs that he claims to have paid on account of Bunbury Foods Pty. Ltd. and for which he received a cheque at that time which could not be dealt with because of liquidity problems in the company. The manner by which the payment was made to Dr. Oskar is most unusual and is therefore worthy of comment in this report :—

- i) As Messrs. Robinson Cox were acting as Bankers for the company during that period they made three payments to Mr. A. Barber namely \$60,000 on 30th August 1982, \$100,000 on 15th September 1982 and \$300,000 on 16th September 1982.
- ii) On questioning Mr. Barber about these transactions he admitted that the cheques were received by him and banked into his personal account.
- iii) Mr. Barber further admits that he remitted a total of \$460,000 to Dr. Oskar in return for the Bunbury Foods cheque given to Oskar in October 1981. It is not clear as to whether one or more payments were made by Barber to Oskar in line with the cheques he received from Messrs. Robinson Cox.
- iv) I have questioned Mr. Barber at length on the above transactions and suggested to him that the manner in which they took place are likely to be classed as devious and not the usual way of doing business as between an employer and an employee. He indicated that the transactions were done on legal advice and because of this were perfectly in order.
- v) Mr. Barber also agreed with me that at the time the payments were made to Dr. Oskar that the company was insolvent which, from a legal point of view, is

simply that the company could not pay its debts as and when they fell due. Despite this, Mr. Barber was unaware as to whether any consideration had been given to the question of the payment to Dr. Oskar being classified as an undue preference and indicated that such issues were a matter between Dr. Oskar and the company ...

(c) In addition to the cheque that the company gave to Dr. Oskar in October 1981 and referred to above there is a further cheque that the company gave to Dr. Oskar at the same time, being for an amount of \$788,220 also on account of various amounts which Dr. Oskar claims to have paid on behalf of Bunbury Foods. This amount is recorded separately in the list of unsecured creditors of the company as at 30th September 1982.

(d) You have requested that I summarise the actual cash injection by Dr. Oskar in Bunbury Foods Pty. Ltd. and this is set out below:-

i) 30th June 1978 - payment on account of equity and plant purchases	1,300,00
ii) 30th April 1980 - on account of construction of plant	2,600,000
iii) 1980 - various deposits	438,000
iv) 1981 - various deposits	355,400
v) October 1981 - various payments on account of Bunbury Foods Pty. Ltd. as referred to above	788,220

Cash contributed	5,481,620
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From an investigation of the records of the company it is clear that the majority of all of the above funds were contributed overseas, direct to various parties such as the German supplier of equipment for the refinery and other parties for supply of goods, (\$788,220). I have not investigated the documentary evidence of overseas transactions and am not in a position to say categorically that the records of the company are correct and that Dr. Oskar or some other related party actually made the contributions referred to above. Some reliance can be placed on the fact that the company had independent auditors at the time the transactions took place."

4.8.19 The Commission does not consider it to be within its terms of reference to embark on a consideration of the behaviour of the directors of the Company or its solicitors during the period of five weeks following the successful challenge to the appointment of the receiver by the National Bank before another receiver took control of the Company. Mr Levi has provided the Commission, by letter dated 22 July 1992, with a history of subsequent events. The review concludes with the following passages:

"Action was pursued against Dr Oskar and several related entities but there was no success in recovery. Oskar was in fact declared bankrupt in Australia and the United Kingdom and claims made against his estates. It is my recollection that there was no recovery.

With the benefit of hindsight it is clear now that when Dr Oskar first challenged the appointment of the Receiver and Manager by the National Australia Bank that either the Federal or State Governments as secured creditors ought to have acted immediately on their securities so as to prevent control of the Company passing to its directors."

The Commission endorses the view expressed by the receiver in the paragraph last quoted. Nevertheless, the evidence does not reveal any impropriety in the manner in which the Minister or DID handled the matter.

## **4.9 Conclusion**

4.9.1 The Commission found no evidence of corruption, illegality or impropriety in its investigation of financial assistance by Government to Bunbury Foods from 1977.

4.9.2 We note that the total loss to the State from its venture with Dr Oskar was more than \$6.3 million. This estimate takes no account of the considerable time expended by departmental staff or ministers.

4.9.3 The Commission adopted an expedited procedure for receiving evidence on this term of reference, involving the tender of a full "brief" of relevant documentation and witness statements. Only three witnesses, Mr MacKinnon, Mr Lewis and Mr Christmass were called to give oral evidence. The Commission deemed such action appropriate because:

- (a) The files provided to the Commission by the relevant Government departments set out a detailed and comprehensive record of the Government's involvement in the Bunbury Foods venture.
- (b) No person made any allegation of corruption, illegality or impropriety to the Commission on this term of reference, notwithstanding the Commission's advertised invitation, repeated by Counsel Assisting the Commission in his televised opening address, for persons with pertinent information to make it available. Invitations to comment or advance allegations were also extended by letter to those members of Parliament who had shown particular interest in the subject in the course of parliamentary proceedings.
- (c) Scrutiny of the files and of witness statements taken from key participants in the events at issue disclosed four persons whose roles called for the clarification which oral examination could afford. They were Mr Mensaros, Mr MacKinnon and Mr Lewis, and, of course, Dr Oskar. Oral testimony has been received from Mr MacKinnon and Mr Lewis.

4.9.4 **Dr Oskar.** The moral turpitude for the Bunbury Foods affair clearly resides with Dr Oskar. He was, in a sense, a man before his time in that his approach to business gave some taste of the corporate morality of the eighties in its reliance on debt, promises and a well-cultivated image rather than equity, performance and substance. He became a fugitive from Australia in 1983 and has not returned since. Consequently, he was not available to assist the Commission. In his absence, he was declared bankrupt in September 1984. He is presently serving a six-year gaol sentence for offences involving dishonesty in the United Kingdom, being due for release in 1993.

4.9.5 Dr Oskar was able to convince successive State Governments that he was worthy of support, despite the recurring financial nightmare imposed on the State by his involvement in the Bunbury Foods venture. We note that early warning signs about Dr Oskar were balanced against the perceived merits of the proposal and then put aside.

4.9.6 However, we have found that none of the people involved in the decision to approve the State guarantees for the project acted improperly (see paragraphs 4.2.15, 4.3.4 and 4.3.8 of this chapter).

4.9.7 **Mr Lewis.** The role of Mr Lewis in the Bunbury Foods project was carefully considered in view of his having been a Member of Parliament in the then governing Liberal Party and had a direct, albeit small, financial interest in the Government-assisted company.

4.9.8 The Commission has found he had no involvement in or influence over the decision to grant financial assistance to Bunbury Foods. His conduct in introducing the parties was consistent with the duties of a Member of Parliament whose electorate would have been favourably affected by the project's success.

4.9.9 His retention as a consultant to the company after he resigned as a director and the financial arrangements associated with it were not improper.

4.9.10 **Mr Mensaros.** Mr Mensaros died in 1990, before the Commission was constituted. We were therefore denied the benefit of his evidence. However, the records make plain his attitude and actions. He genuinely held a vision of the project's long-term potential benefits to the State which transcended, at least in his mind, concerns about the difficult financial position it faced. Mr Mensaros's faith in Dr Oskar and his project was clearly greater than that of his departmental officers.

4.9.11 In July 1979, Mr Mensaros and Mr Lewis travelled to New Zealand at Bunbury Foods' expense. The Commission has found Mr Mensaros's decision to do so to have been unwise, given his position and the perception of influence to which it might have given rise. However, Mr Mensaros made no attempt to conceal the trip or its funding, and the Commission accepts that the trip was relevant to an important matter within Mr Mensaros's portfolio. The payment of Mr Lewis's expenses, given he was a consultant to the company and not involved in Government decisions on Bunbury Foods, might have been expected (see paragraph 4.4.21 of this chapter).

4.9.12 **Mr MacKinnon.** The Commission has found that Mr MacKinnon acted properly in returning a pearl necklace given to Mr MacKinnon's wife by Dr Oskar at dinner one evening, though it notes the incident should have afforded him some insight into Dr Oskar's character.

4.9.13 We are also satisfied that Mr MacKinnon consulted his departmental staff and the then Premier, Sir Charles Court, before releasing a further \$700,000 for working capital to Bunbury Foods. We note Mr MacKinnon's observation that it was a matter of making the decision quickly or allowing the company to stop trading. We find the decision required the balancing of risks and was essentially a political decision for which Mr MacKinnon was accountable to Parliament (see paragraphs 4.6.27 - 4.6.32 of this chapter).

4.9.14 **Bunbury Foods' directors and solicitors.** On 26 August 1982, the Supreme Court of Western Australia ruled invalid the National Australia Bank's appointment of a receiver-manager over Bunbury Foods some four months earlier. For the next five weeks, control of the company reverted to its board of directors. The company's solicitors, Robinson Cox, acted as its bankers. During this period, \$460,000, which would otherwise have been available to the company's creditors, found its way to Dr Oskar. The Commission does not believe it to be within its terms of reference to consider the conduct of either the directors or Robinson Cox during this period.

4.9.15 We note, with hindsight, that the State or Federal Government should have moved immediately after 26 August 1982 to prevent control of the company passing to its directors by appointing their own receiver-managers. Nevertheless, for the reasons discussed earlier in this chapter, no impropriety is revealed in the manner in which either Mr MacKinnon or the Department of Industrial Development handled the matter.

4.9.16 **Further matters.** Finally, reverting to the terms of reference, the Commission reports:

- (a) There are no matters addressed in this chapter which should be referred to an appropriate authority with a view to the institution of criminal proceedings; and
- (b) The role of Mr Lewis in Bunbury Foods, when he was a Member of Parliament, raises as an issue the need for proper provision to be made for

the regulation of conflicts of interest of parliamentarians and possibly the introduction of a code of conduct to guide behaviour in such circumstances. These matters will be addressed in Part II of our report.

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### **3.1 The term of reference**

3.1.1 The Commissioners are required by their Commission, as affected by the *Royal Commission into Commercial Activities of Government Act 1992*, to inquire and report whether there has been —

- (a) corruption;
- (b) illegal conduct; or
- (c) improper conduct,

by any person or corporation in the affairs, investment decisions and business dealings of the Government of Western Australia or its agencies, instrumentalities and corporations in respect of the natural gas sales agreements entered into by the State Energy Commission of Western Australia for the purchase of natural gas from the North West Shelf Joint Venturers and the contracts relating to the Dampier to Perth natural gas pipeline project and further to report whether —

- (d) any matter should be referred to an appropriate authority with a view to the institution of criminal proceedings; or
- (e) changes in the law of the State, or in administrative or decision making procedures, are necessary or desirable in the public interest.

3.1.2 Separate hearings were conducted into the natural gas sales agreements entered into by the State Energy Commission of Western Australia for the purchase of natural gas from the North West Shelf Joint Venturers and the contracts relating to the Dampier to Perth natural gas pipeline project. This chapter deals with the second of those two matters.

### **3.2 Introduction**

3.2.1 The discussion of the North West Shelf gas project in chapter 2 provides a background to the pipeline project. Under the agreement with the Joint Venture Participants ("JVP"), the State Energy Commission of Western Australia ("SECWA") was responsible for the construction of a gas pipeline from Dampier to Perth, a distance

of 1483 kilometres. Pipeline construction commenced in March 1983 and was completed in April 1984 at a total cost of approximately \$930 million. Under arrangements with Alcoa of Australia Limited ("Alcoa"), SECWA agreed to supply gas from the North West Shelf to Alcoa at its Worsley alumina plant located south of Perth, and part of the pricing for that gas included a contribution to the cost of constructing the pipeline.

3.2.2 All the significant events relevant to this term of reference took place in the early 1980s, under the Government of Sir Charles Court and, following his retirement on 26 January 1982, under the Government of Mr Ray O'Connor. Mr Peter Jones was at all material times the Minister for Fuel and Energy, and the Minister responsible for SECWA.

3.2.3 The term of reference directs attention to the contracts involved in the pipeline project. Not surprisingly, a project of this size involved many contracts, relating to a wide variety of matters. During the Commission's investigations into the pipeline project, no less than 60 witnesses from Australia and overseas were interviewed, and numerous media reports and hundreds of documents were examined. From these investigations, three principal issues emerged as warranting public hearings:

- (a) why the Korean company, ICC Construction Company Ltd ("ICC"), was given the opportunity to participate in the construction of the pipeline;
- (b) why, instead of calling tenders, SECWA proceeded by way of a negotiated contract with ICC and Saipem Australia Pty Ltd ("Saipem") for the construction of the central and southern sections of the pipeline, and the additional cost, if any, resulting from that decision; and
- (c) the adequacy of the information which was given to Cabinet regarding the cost of ICC's participation in the construction of the pipeline.

3.2.4 These issues are discussed below in the context of a chronology of significant events.

### **3.3 Early decisions on construction of the pipeline**

3.3.1 SECWA was contemplating the construction of the pipeline from 1976. The minutes of a meeting of SECWA, held on 20 September 1976, recorded that it was agreed "that it would be preferable that the pipeline be funded from public resources and owned and operated by a semi-Governmental authority if the price of gas was to be held below oil parity", a situation which was considered to be highly desirable. In the following year, on 11 November 1977, a memorandum of understanding was entered into between SECWA and the JVP, in which it was stated that "SECWA will construct a pipeline from Dampier to Perth and will have complete responsibility for the financing and operation of that pipeline".

3.3.2 On 12 September 1978, a memorandum of understanding was entered into between SECWA and Alcoa with respect to the supply of North West Shelf gas by SECWA to Alcoa. The sale price of the gas comprised two components, the cost to SECWA of gas at its source of supply and a reservation charge, together with a transmission charge. The charges reflected the cost of constructing the gas pipeline and transporting the gas to Perth. Mr D L Saunders, SECWA's negotiator in relation to the Alcoa contract, explained that, under the arrangements eventually concluded between SECWA and Alcoa, Alcoa was required to contribute approximately half the cost of the pipeline, in addition to its contributing to its running and maintenance costs.

3.3.3 On 4 October 1979, SECWA approved the appointment of financial advisers in relation to the pipeline project. On 15 November 1979, it appointed Fluor Australia Pty Limited, a subsidiary of an American firm of consulting engineers, as its principal consultant for the engineering design and construction management of the pipeline. For the purposes of this project, Fluor Australia Pty Limited entered into an association with Maunsell & Partners, a prominent firm of civil engineers. Fluor Australia Pty Limited and Maunsell & Partners are described in this chapter as "Fluor Maunsell".

3.3.4 The securing of an aluminium smelter project in Western Australia had been, according to the evidence of Mr Saunders, "the central plank of the State's development agenda for 25 years". The first mention of the subject in the documents appears in the minutes of a meeting of SECWA held on 28 November 1979. Those minutes record that, at the request of the late Mr Andrew Mensaros, who was then the Minister for Fuel and Energy, a joint investigation had been conducted by the Department of Industrial Development and SECWA into the prospects for establishing an aluminium smelter in Western Australia. This resulted in a report entitled "A Review

of the Prospects For Development of Aluminium Smelting in Western Australia". SECWA endorsed the report's conclusions that the establishment of an aluminium smelter in Western Australia was feasible and that the Government should be encouraged to pursue such a development. The report recommended Bunbury as the preferred location for the smelter, and it identified the need for increased power generation and transmission facilities to service it. It was estimated that the necessary power facilities would cost about \$250 million. SECWA agreed to the preparation of a submission to the Australian Loans Council for the approval in principle of special borrowings to finance a power plant.

3.3.5 It was reported to a meeting of SECWA, on 16 April 1980, that its officers had been involved in discussions with several companies which were interested in establishing an aluminium smelter in Western Australia, including Alcoa, Shell Company of Australia Limited and CSR Ltd. Each of these companies was reported to be enthusiastic about the prospects for aluminium smelting in this State. The minutes of the meeting did, however, refer to the problem which an ongoing expansion of aluminium smelting operations could pose in relation to future fuel supplies. The concerns of SECWA regarding fuel supplies were shortly to change.

3.3.6 At the request of Mr Jones, who had now become the Minister for Fuel and Energy, the Commissioner of SECWA, the late Mr Bruce Kirkwood, prepared a draft submission to Cabinet on 12 January 1981. The submission sought Cabinet's approval for the Minister to continue negotiations for an aluminium smelter through SECWA and the Department of Resources Development with the Westal consortium (comprising Reynolds Metals Company Ltd, Shell Company of Australia Ltd and CSR Ltd) which was seeking to site a smelter near Worsley. It was indicated that a proposal for a smelter had also been received from Alcoa; but it was considered that Westal was the more attractive prospect, and that the interests of the State would better be served by proceeding to negotiate with Westal alone, while assuring Alcoa of an interest in pursuing a second aluminium smelter later in the decade.

3.3.7 Early in April 1981, Fluor Maunsell published an advertisement calling for organisations which were interested in tendering for contracts for the construction of the gas pipeline to apply for pre-registration. The advertisement stated that construction would be divided into three sections (or "spreads"), the northern and central sections each being approximately 600 kilometres in length, and the southern section being approximately 300 kilometres in length. It was indicated that construction

of the pipeline was to commence early in the third quarter of 1982, and that it was scheduled for completion by the end of June 1984. Applicants were required to demonstrate experience in gas pipeline construction in remote areas on a scale similar to the Dampier to Perth pipeline. Letters advising of the text of the advertisement were sent to a number of Consulates and Trade Commissions.

3.3.8 Pre-qualification documents, including a technical and financial questionnaire, were issued to 40 organisations, of which 16, including ICC, returned completed questionnaires. The questionnaire dealt with the technical ability, the commercial background and the experience of the organisation. Fluor Maunsell recommended that nine organisations, including Saipem SpA, an Italian company, should be invited to tender for the pipeline construction. The remaining seven organisations, including ICC and Spie Capag SA ("Spie Capag"), which was a French company working in conjunction with two Australian companies, Citra Constructions Ltd and Wesfarmers Limited, were eliminated.

3.3.9 At its meeting held on 5 August 1981, special consideration was given by SECWA to the applications of Spie Capag and ICC. The former company had been rejected by Fluor Maunsell on the basis that, although it had considerable experience in pipeline construction projects in southern Europe and in the Middle East, it had performed very poorly on the Sydney to Newcastle pipeline project, which was then running 18 months behind schedule and was well over budget. Fluor Maunsell identified managerial shortcomings and lack of appreciation of the industrial relations situation in Australia as major factors in the difficulties being experienced by Spie Capag in that project, and it expressed the fear that the bad relations known to exist between Spie Capag and unions would be transferred to the North West Shelf gas pipeline if it were to be the successful tenderer. ICC had only limited experience in pipeline construction overseas, and none in Australia, and was rejected by Fluor Maunsell because its local joint participants did not include an experienced civil engineering construction contractor, indicating that ICC would have to rely on expatriate Korean management and staffing. Fluor Maunsell believed that the Australian industrial relations climate would make such management and supervision exceedingly difficult and capable of leading to problems similar to those experienced by Spie Capag on the Sydney to Newcastle pipeline. SECWA accepted the recommendation by Fluor Maunsell of the nine organisation which should be invited to tender for the pipeline construction. Viewed in isolation, there were sound reasons for excluding ICC and Spie Capag from this group.

### **3.4 ICC'S expression of interest in a smelter project in the State**

3.4.1 Prior to the decision of SECWA at its meeting on 5 August 1981, by letter dated 29 June 1981, Mr Denis Horgan, the Chairman of Metro Industries Ltd ("Metro Industries"), had written to Mr Jones regarding a proposal for an aluminium smelter. Mr Horgan indicated that Metro Industries had become associated with ICC in connection with the tender for the Dampier to Perth pipeline, and he went on to say that "they have asked me to raise with the relevant authorities the possibility of them offering to build an Aluminium Smelter Plant to be located at Dampier, the financing of which will be their responsibility and for which they would be prepared to take the total production". Mr Horgan indicated that he had been advised that the Chairman of ICC had made approaches to the South Korean Government, whose response had been "very positive and encouraging", in view of the fact that South Korea imported in excess of 150,000 tonnes of aluminium ingots annually, which was increasing at the annual rate of 20 per cent. He said he had been asked to establish what the Western Australian Government's response to such a project would be.

3.4.2 Mr Jones replied to Mr Horgan's letter on 10 July 1981, indicating that the State's aluminium smelter project was temporarily suspended, due to the Commonwealth Government having, quite literally, "cut off the power". This was a reference to the decision of the Australian Loans Council in June 1981 to restrict borrowings by the Australian States, with the consequence that SECWA could not borrow the necessary capital to finance the construction of an additional power station to supply electricity to an aluminium smelter. As a result of that decision, the Westal consortium had been advised that the State was unable to proceed with negotiations for a smelter on the basis which had previously been advanced.

3.4.3 Mr Edward Gorham, Co-ordinator of the Department of Resources Development, spoke with Mr Horgan about ICC's expression of interest, and he reported on that conversation to Mr Jones in a memorandum dated 3 July 1981. Mr Gorham told Mr Horgan during their discussion that ICC's stated interest in the establishment of a smelter at Dampier was hard to reconcile with the practicalities of raw material supplies and energy costs. Mr Horgan indicated to him that the Chairman of ICC would be visiting Australia two months later and he anticipated that the Chairman would be seeking discussions with the Minister to see whether the Government could advance South Korean interest in aluminium metal from Western Australia.

3.4.4 At the request of Mr Horgan, Mr Gorham met Mr Song of ICC and Mr Barry Arnold of Metro Industries on 29 July 1981. He reported on that meeting to Mr Jones in a memorandum dated 4 August 1981.

3.4.5 On 8 July 1981, a public relations consultant working for ICC had written to the Premier, Sir Charles Court, seeking to arrange meetings with the Premier, Mr Jones, Mr O'Connor and Mr Barry MacKinnon for the Chairman of ICC, Mr Chung Mo Yang, who would be visiting this State with the President of ICC, Mr Jae Duck Chung. The letter included the following paragraph:

"You will be aware that ICC Construction Co Ltd is currently a Tenderer for part of the North West Shelf contract, and I wish to assure you Mr Premier that the visiting party are well aware that any courtesies extended them in respect to meetings with yourself or your Cabinet colleagues, will not be misconstrued in terms of support for such Tenders."

That paragraph displayed a delicacy absent in later negotiations.

3.4.6 The Premier and Mr Jones met with representatives of the Kukje Group, of which ICC was a member, on 5 August 1981, and were presented with a "plan" for the construction by ICC of an aluminium smelter in Western Australia. The plan envisaged a smelter producing 140,000 tonnes per year, preferably to be constructed by a joint venture between ICC and one or more of the aluminium companies operating in Australia. Prospective participants in the joint venture were listed in the plan as including, amongst others, Western Mining Corporation Ltd, CRA-Comalco Ltd and Alcoa. In addition to a smelter, the project contemplated the construction of a power plant (either coal or gas, although it would appear that, at that stage, ICC favoured the use of coal), an anode plant and supporting infrastructure, including roads and harbour facilities. The estimated budget for the project was approximately US\$700 million. A partial capital investment from the people of Western Australia, it was said, would be most welcome.

3.4.7 There was no reference to the gas pipeline in ICC's plan, and there was no suggestion that the subject of the pipeline was raised at the meeting in a memorandum from Mr Jones to Mr Gorham in which he discussed what had occurred at the meeting, although he concluded his memorandum by referring to a proposed visit to Sydney in connection with financing the pipeline. Nor was there any mention of the

pipeline in a memorandum from Mr Gorham to Mr Jones dated 18 August 1981 discussing the proposal and enclosing suggested responses to ICC and to Mr Horgan. The minutes of a meeting of SECWA held on 16 September 1981, referring to meetings with representatives of ICC in relation to the proposed aluminium smelter, made no reference to any interest in the gas pipeline. Notwithstanding this, the minutes of a meeting of SECWA held on 8 April 1982, some eight months later, recorded:

"The Commission is aware that since the earliest discussions between the Chairman of the Kukje Group, Mr Yang and the then Premier, Sir Charles Court, during 1981 the three projects referred to above have been treated by the Koreans as a single package."

The three projects referred to were the smelter, the power plant and the pipeline.

3.4.8 The SECWA Report C-28, dated 25 March 1982, similarly recorded that, during discussions held in Perth in 1981, representatives of Kukje/ICC indicated their objective to link the three development proposals in which they desired to participate.

3.4.9 In his evidence, Mr Jones did not accept that ICC had indicated during the discussions in August 1981 that it viewed the smelter, power plant and pipeline as a single package, although he did recall the pipeline being referred to as a matter of information and advice. Sir Charles Court also gave evidence about that meeting, and said that neither then, nor at any time before his retirement on 26 January 1982, could he recall the Koreans raising the question of the pipeline with him.

3.4.10 According to Mr Jones, the first advice of a package proposal came to him later in 1981, when he visited Korea. A record of the notion of a package concept having been mentioned to Mr Jones at that time is to be found in notes of meetings in Korea on 7 December 1981 between Mr Jones and representatives of ICC, SECWA and the Department of Resources Development. Those notes were made by Mr Stuart Hohnen of the Department of Resources Development. Mr Jones accepted that, at those meetings, ICC was not actively discouraged from pursuing a package concept; but he added:

"[I]t was also made clear that any involvement by ICC in the pipeline would only result from arrangements that were not within the Government's province to make, but would have to be made by SECWA on the advice of Fluor Maunsell and approved by the

Commission ... It's not anything the Government would instigate or negotiate."

3.4.11            However, in a letter to Mr Suk-Joon Suh, the South Korean Minister of Commerce and Industry, dated 15 April 1982, Mr Jones wrote:

"Chairman Yang has made clear to me at our several meetings that since the earliest discussions on the smelter and power station proposals outlined above, and of the ICC participation in construction work for the natural gas pipeline project, with Sir Charles Court who was Premier of Western Australia at the time of his visit to Perth in 1981, that all three initiatives formed part of a single package."

This letter had been drafted by SECWA, but Mr Jones said that he had a practice of reading his letters through and that he would not have signed it had he read something which was inaccurate. Although he still entertained some doubt as to the accuracy of the paragraph just quoted, he conceded that his memory could be incorrect.

3.4.12            We are left in some doubt as to whether, in August 1981, the representatives of ICC did make known to the Premier and to Mr Jones their wish to treat the three projects as a single package. The most contemporaneous documentary evidence contains no reference whatever to this fact. Only some months later, in documents which emanated from SECWA, and probably from Mr Kirkwood, is it suggested that the package was put forward prior to December 1981. The likelihood is that it was not.

3.4.13            The ICC visit to Perth in August 1981 was followed up by a letter from Mr Jones to Mr Yang dated 20 August 1981. Mr Jones explained the difficulties in negotiations for the construction of a smelter which had been brought about by the Australian Loans Council's decision, but he invited ICC's continued interest in the power station and aluminium smelter projects. He requested ICC, if it were interested in participating with other companies in such a venture, to confirm its interest so that further talks on a possible role for its involvement could be developed. The pipeline was not mentioned in the letter.

3.4.14            The minutes of a meeting of SECWA held on 16 September 1981 recorded that Mr Kirkwood, Mr Jones, Mr Gorham, and Mr Marwood Kingsmill, who

was the Assistant Commissioner of SECWA, had met with representatives of ICC. The minutes noted:

"It was felt that the initiatives being taken by ICC are most timely in relation to other developments being planned for Western Australia, and it is understood that ICC would be prepared to consider the funding of suitable power plant as well as the construction of the smelter itself."

Further discussions between ICC, the Department of Resources Development and SECWA were to be held over the ensuing weeks. In the meantime, the Government checked to ensure that ICC was genuine. Those checks included contacting the Korean Government, the Australian Embassy in South Korea and various banks. The results proved satisfactory.

3.4.15 Heads of agreement entitled "Proposal for the Construction of an Aluminium Smelter and Power Station in Western Australia" were signed on 20 October 1981 by Mr Kirkwood on behalf of SECWA and by a representative on behalf of ICC. The heads of agreement provided that ICC would seek to finance and construct an aluminium smelter near Bunbury with a capacity of between 200,000 and 220,000 tonnes of aluminium per annum. ICC was also to finance and construct a power station on a site owned by SECWA adjacent to its existing Bunbury power plant, with a design and construction ensuring its satisfactory integration into SECWA's overall interconnected transmission system. SECWA was to lease the power station. The heads of agreement were expressed to remain in force for two months, pending receipt by SECWA of advice from ICC of "very real interest". They did not preclude the right of SECWA to discuss similar schemes with other interested parties. The pipeline was not referred to in the document.

### **3.5 Events leading to the calling of tenders for the northern section of the pipeline**

3.5.1 In September 1981, Fluor Maunsell produced a construction plan in which it detailed the "procedures, guidelines and parameters for construction of the pipeline and associated facilities". The plan was submitted to a meeting of SECWA held on 30 September 1981 and approved. Pipe laying was to commence in mid-1982

and was due for completion in mid-1984. Fluor Maunsell concluded that construction in three sections was optimal, and stated:

"It is anticipated that each of the three sections would be constructed by a separate spread. [Fluor Maunsell] do not favour a situation where one contractor supplies all three. Award of the work to more than one contractor is expected to provide a higher degree of assurance against late completion."

According to Mr Neville Morrow, Fluor Maunsell's General Manager of Operations for the pipeline project, the plan allowed all sections to be completed at the same time, thus avoiding a large length of laid pipeline having to wait for the gas out of an incompleted section before gas could flow. It also provided a safety net by having two or three separate contractors so that, if one collapsed, another could take over.

3.5.2           The northern section was to be 760 kilometres long, commencing at the JVP's treatment plant on the Burrup Peninsula and terminating approximately 190 kilometres south of Gascoyne Junction. The central section was to be 521 kilometres long, commencing 190 kilometres south of Gascoyne Junction and ending approximately five kilometres north of Gingin. The southern section was to be 202 kilometres long, commencing five kilometres north of Gingin and terminating near Wagerup.

3.5.3           The plan considered the climatic conditions and the terrain in some detail. The pipeline was required to traverse terrain of considerable variation. The northern portion is in a sub-tropical zone, which although basically arid, is subject to tropical cyclone activity and heavy rains, particularly from November to March. The central and southern sections are exposed to winter rains from April to September. The soils in the northern area consist mainly of silts and clays, which become boggy when wet. From about 100 kilometres north of Carnarvon to about 100 kilometres north of Geraldton, the route is characterised by sand dunes. To the south, the pipeline traverses undeveloped rural land, farm land and urban areas of mainly sandy soils. It was decided that, primarily due to weather conditions, but also on account of logistics and industrial relations problems, the construction of all sections should progress from north to south.

3.5.4           Under the construction plan, the successful construction contractors were to be paid on a schedule of rates basis. SECWA was to supply all the major equipment, while the contractors were to supply all the necessary temporary and consumable

materials, plant and equipment required for carrying out the work within their respective contracts.

3.5.5 The contract for the northern section was planned to be awarded in February 1982 and work was to commence in July 1982, with an overall duration of 490 days. Awarding the contract in February 1982, it was said, would allow the contractor four to five months to mobilise equipment and establish temporary facilities, in order to be ready to utilise, as far as possible, the northern region's dry season. The contracts for the central and southern sections were planned to be awarded in May 1982. Work on the central section was to commence in October 1982 and take 385 days. Work on the southern section was planned to commence in July 1982, and take 236 days.

3.5.6 On 6 October 1981, prior to the signing of the heads of agreement, Mr Yang had written to Mr Jones. The letter began by pointing to South Korea's shortfall in aluminium production, with its domestic production in 1980 accounting for only 10% of total aluminium consumption. High electricity costs rendered the construction of another aluminium smelter in Korea unlikely. The main advantage in establishing a smelter in Australia was said to be its inexpensive energy, together with the easy procurement of alumina. Mr Yang wrote that he had personally discussed the smelter and power station projects with "top level Korean Government officials" and that his Government "has pledged their support to help us bring about the success of the projects in Australia". He then went on to say:

"As I am sure you are well aware that the Western Australia State Energy Commission is presently planning to construct a gas pipeline from Perth to Dampier.

Based upon our extensive experience in pipeline work in overseas as well as domestic and our highly talented staff and skilled craftsmen we employ, we feel confident that we are fully qualified to carry out the project. The construction of the gas pipeline will provide us with suitable opportunity to become familiar with the local condition and help us pave the way for a workable relationship for the smelter project. Furthermore, we would like to participate for this project on a negotiation basis and trust that you will advise us accordingly.

Therefore I humbly ask you to extend your support to our staff in Australia in securing the gas pipeline project. Through these

projects we can lay foundation for a successful relationship that will be advantageous for the Australians as well as Koreans."

The terms of this letter do not appear to be consistent with the three projects having been put forward as a package two months earlier.

3.5.7 Following the receipt of Mr Yang's letter, it appears that a proposal was developed within SECWA to include ICC in the list of pre-qualified organisations which were to be invited to tender for the construction of the pipeline. Reference to this proposal was made in a memorandum dated 14 October 1981 from Mr Colin Treloar, SECWA's Executive Engineer, Pipeline Project, to Mr Peter Lowe, SECWA's Chief Manager, Design and Construction. Mr Treloar had not been told why ICC was to be added to the list, and he was opposed to it. He strongly supported the recommendation of Fluor Maunsell that ICC should be excluded from the list of pre-qualified tenderers, on the basis that, while ICC was a very large construction company, it had a very limited, and only recent, pipeline experience. He suggested that on no reasonable basis could ICC's experience be compared favourably with that of the contractors recommended by Fluor Maunsell, or with that of Spie Capag. Mr Treloar added that, apart from his concern regarding its lack of general pipelining experience in handling such a major project, ICC's specific proposals in its pre-qualification application for the management and execution of the project were also of great concern. None of the other companies in the ICC consortium had any pipeline construction experience, so the project management and construction supervision in the field would be expected to be Korean, leaving SECWA open to the risk of industrial relations problems, a risk which it had declined to accept in the case of Spie Capag. Mr Treloar expressed his concern that, should ICC be admitted to the list, having regard to its enthusiasm, it could submit a very competitive tender which, although unworkable, SECWA might find very difficult to reject, having regard to the nature of the pre-qualification process. Its inclusion, he wrote, may have an inhibiting effect on some other pre-qualifiers.

3.5.8 A response to Mr Yang's letter was drafted by Mr J E Hayes, SECWA's Head of Engineering, on 20 October 1981 and hand-delivered to the Minister's office on the following day. In his covering memorandum, Mr Hayes stated that the draft had been prepared at the request of Mr Kirkwood, following a meeting between Mr Jones and Mr Kirkwood on 19 October 1981. In answer to ICC's suggestion of a negotiated contract for the construction of the pipeline, the draft letter read, in part:

"I have noted the proposal in your letter that the contract for construction of the Dampier to Perth natural gas pipeline might be a matter for negotiation between the State Energy Commission and your Company. I have given consideration to this suggestion, in consultation with the Energy Commission, and have concluded that, in view of the magnitude of the works involved, we have no choice but to seek competitive tenders from competent and experienced organisations.

In this respect your Company will be invited to submit a tender, and it is my hope that you will be able to take full advantage of the opportunity through entering into a consortium arrangement with suitable parties to ensure the breadth of experience that the Government of Western Australia and the Energy Commission are seeking."

3.5.9 By a memorandum dated 21 October 1981, Mr Hayes sought the approval of Mr Jones to issue tender documents to the nine pipeline construction organisations recommended by Fluor Maunsell, together with Spie Capag and ICC. The memorandum referred to discussions held with Mr Jones on the pipeline construction tenders. Mr Jones made a notation on the memorandum, agreeing to the recommendation "on basis that ICC will be aware of possible partnerships they could discuss". Mr Jones said in evidence that his reference to "partnerships" was to the local content requirement for the construction of the pipeline, and he did not recall, or think it likely, that he was referring to a major partner with more experience in pipeline construction.

3.5.10 In the opinion of Mr Hayes, the decision had been made to provide ICC with an opportunity to tender for the northern section of the pipeline having regard to the initiatives which were being taken to encourage the development of a smelter and a coal-fired power station. He was unclear who had made that decision; but he said that, with the knowledge which he had of the manner in which the whole process worked between the Commission and the Minister at that time, it would be very surprising if such a commitment had been given without, at least, the knowledge of the Minister.

3.5.11 According to Mr Lowe, the idea of adding ICC to the list of tenderers came from Mr Kirkwood, who had told a group of senior SECWA personnel that this was necessary because SECWA was trying to enter into smelter and power station projects with ICC. Mr Lowe could not recall any feeling within SECWA that the addition of ICC had been forced upon it by the Government. Mr Jones categorically

denied that the decision to add ICC and Spie Capag came from him. He could recall having been advised by Mr Kirkwood that it was intended to add ICC to the list and that it was intended to review one or two others. As to Mr Hayes' memorandum seeking his approval, Mr Jones explained that it had not been sought in relation to the decision to add ICC to the list, since SECWA did not require his approval to do so, but had been sought because SECWA required his approval for the issuing of tender documents where such a large amount of money was involved. This is not strictly correct, although any contract arising from the tender would certainly have required his approval.

3.5.12 On 27 October 1981, Mr Yang sent a telex to Mr Jones. It read, in part:

"On this occasion, I would like to reiterate our intention for gas pipeline project. ICC, as a leading company of the total package for the project, will cooperate with any company which S.E.C.W.A. chooses. I can assure you that this total package deal will be more beneficial to your Government as we mentioned earlier. I hope this proposal will be acceptable to you."

3.5.13 By letter dated 29 October 1981, Mr Treloar advised Fluor Maunsell that its recommendation regarding approved tenderers had been accepted, subject to the addition of ICC and Spie Capag to the list.

3.5.14 The addition of ICC and Spie Capag to the list of organisations invited to tender for the northern section occurred without any formal step having been taken by SECWA to amend its decision of 5 August 1981 to adopt the nine organisations recommended by Fluor Maunsell. It is not clear why SECWA directed that Spie Capag be added to the list, particularly having regard to the concerns previously expressed about its industrial relations record. The answer may, perhaps, lie in an approach to Mr Jones by Wesfarmers Limited, a Western Australian company which was associated with Spie Capag, that approach having been referred by Mr Jones to Mr Kirkwood.

3.5.15 Mr Kirkwood was obviously extremely enthusiastic in his pursuit of the goal of obtaining an aluminium smelter for the State of Western Australia. The risk of an adverse reaction from ICC, should it not have been invited to tender, would undoubtedly have caused him great concern, and the strong likelihood is that he decided to add ICC to the list, with the approval of Mr Jones, in order to avoid jeopardising the future prospects of securing the participation of ICC in the construction of an aluminium smelter and power plant in Western Australia. There was nothing improper associated

with that decision although, notwithstanding the approval of Mr Jones, there being an existing decision which excluded ICC, the matter should desirably have been referred back to a meeting of SECWA for formal approval of the change.

3.5.16 On 4 November 1981, tenders for the construction of the northern section of the pipeline were invited from those on the revised list of approved organisations.

### **3.6 Negotiations in Korea with respect to the smelter project**

3.6.1 Mr Jones, Mr Kirkwood and Mr Hohnen visited Seoul in the Republic of Korea on 6 and 7 December 1981 to meet representatives of ICC and the Korean Government. Mr Jones explained that he had become involved in the smelter proposal and, in particular, in travelling to Korea, at the invitation of Mr Kirkwood, following SECWA's advice to the Government in September 1981 that it perceived major difficulties in relation to surplus gas arising from the North West Shelf gas contracts. On 7 December 1981, Mr Jones, Mr Kirkwood and Mr Hohnen met the Korean Minister for Energy and Resources, Mr B Park, and Mr Chung, Mr D Y Kim and Mr Sungwon Yoon of ICC. According to notes of that meeting, the Korean Minister advised that his Government had a policy of actively supporting integrated trading companies, such as ICC, to achieve national development strategies and he provided a "categorical assurance that the Korean Government would support the initiatives within their capacity and competence". He added that ICC had reported to him in detail with respect to the pipeline, power plant and smelter projects.

3.6.2 Another meeting was held on the same day between Mr Jones, Mr Kirkwood and Mr Hohnen and representatives of ICC, including Mr Yang. At this meeting, Mr Yang referred to discussions with the Korean Government authorities in connection with the pipeline, power plant and smelter projects and said that he had gained a favourable reaction from the Government, which was prepared to support ICC's efforts in relation to the marketing of aluminium metal within Korea. He stressed to Mr Jones the extent of ICC's commitment to the power plant and the smelter and sought the Minister's assurance that his company would be seriously considered for the construction of the gas pipeline. Mr Yang indicated that ICC's price for this work would be just sufficient to cover its overheads, with minimum profit, and would therefore be very competitive. He accepted that it was not possible to introduce Korean labour into Australia, as ICC had done in other places, such as Saudi Arabia.

3.6.3 Mr Kirkwood replied to the effect that ICC would receive every consideration from SECWA and the Western Australian Government in connection with the pipeline; but he emphasised that SECWA had a 95% take or pay commitment with the JVP commencing on a certain date, and that the time of completion of the pipeline was critical. For this reason, SECWA was seeking to be assured that the selected contractor was capable of completing the project in the required time. Mr Kirkwood also stated that, in his view, ICC should attempt to build up its record in Australia with a less demanding project than the pipeline. Mr Yang informed them, however, that, in his discussions with the Korean Government, he had presented the three projects as a package, and it was on this basis that he had obtained the strong support of the Government. He saw the pipeline as important in order to retain the Government's confidence in ICC. In response, Mr Kirkwood said that the State was quite prepared to view the three projects as a group, as long as ICC could demonstrate a practical arrangement for their implementation. He suggested that ICC might consider working closely with a contractor with extensive Australian experience. Mr Kirkwood reiterated his view that experience in labour management in the Australian environment would be critical, and also that the power plant and smelter projects would be far less demanding from an industrial relations point of view. He referred to the experience of Spie Capag on the Sydney to Newcastle pipeline and the extremely poor industrial relations record of that project, which was using French contractors with French supervisory staff. He stated that, if ICC wanted to have a real opportunity in relation to the pipeline project, it would need to examine carefully a practical formula for the supervision of the project. The Koreans raised, finally, the possibility of their having a role in the supply of the pipes; but Mr Kirkwood told them that this would not be possible.

3.6.4 In a subsequent file note, Mr Jones recorded that he had been impressed by ICC's performance in arranging various meetings and in drawing together a prestigious guest list to a luncheon, at short notice, which, he concluded, indicated that it had considerable capacity and support within the Republic of Korea. He noted that the Ministerial visits had brought forward the Korean Government's commitment to the project, although no formal application had yet been made to the Government, either for an aluminium import franchise or for ICC to undertake the offshore project. The commitment of the Korean Government was required before taking things further, but, he said, this had now been obtained. The Republic of Korea's economy was centrally planned, and no major product could be imported without the approval of the Government. Mr Jones noted that, when a joint venture had been agreed in principle between ICC and Alcoa or some other partner in Australia, a request would be made to

the Korean Government. He suggested that its approval would be little more than a formality.

3.6.5 Mr Jones later reported, in a memorandum to the Premier dated 15 December 1981, that his Korean visit had been most successful and that various Korean Ministers had given undertakings, in the presence of the Commercial officer from the Australian Embassy. It was said that these undertakings were subsequently to be verified in writing and would provide the basis of discussions between ICC, Alcoa and SECWA.

3.6.6 Heads of agreement dated 31 December 1981 were signed on behalf of SECWA and Western Australia Power Company Pty Ltd ("WAPCO"). WAPCO had been established by ICC to own the contemplated electricity generating facilities. The heads of agreement provided that WAPCO would finance and construct a power station, consisting of two coal-fired generating units, on a site owned by SECWA adjacent to the existing Bunbury power plant. The power station was to be leased to SECWA, which would assume responsibility for its operation and maintenance, as had been contemplated in the earlier heads of agreement dated 20 October 1981.

3.6.7 Despite its earlier optimism with respect to the demand for gas within Western Australia, growing concerns on this issue were being expressed within SECWA. Mr Kirkwood wrote a briefing paper, dated 31 December 1981, dealing with the North West Shelf gas project, the Dampier to Perth pipeline and gas marketing. In the paper, he noted that, since the finalisation of the gas sales agreement, there had been a substantial reduction in the forecast demand for gas and that this could present significant problems to SECWA from 1985 onwards. At the same time, economic studies clearly indicated that the contracted quantities of gas were the minimum required to justify the construction of the Dampier to Perth pipeline. The reduction in the anticipated demand for gas was attributed to the shut down of the iron ore pellet plants in the Pilbara, the reduction in the projected demand for alumina, the slow down in the growth of demand for electricity and the general softening in new industrial growth. He indicated that the most promising prospect for large-scale mineral processing or other development which would permit the utilisation of gas for power generation, without disruption of the coal mining industry, was the construction of the aluminium smelter proposed by ICC. The avoidance of disruption of the coal mining industry was a recurrent theme. It was regarded by SECWA as a most important consideration. It was envisaged that substantial quantities of gas would be utilised in the early years for power

generating purposes to supply a smelter. In later years, as alternative markets for gas were developed, gas would be phased out of power generating applications and replaced by coal. Mr Kirkwood noted that consultants had been retained by SECWA and ICC to carry out detailed feasibility and costing studies to ensure that the construction of a power station with Korean generating plant would be feasible and the costs suitable for aluminium production.

3.6.8 Mr Kirkwood concluded his paper:

"The Korean smelter development would be consistent with Western Australia's overall ambitions for mineral processing. However, and perhaps much more importantly, in the short term it would provide a suitable market for the excess gas available from the North West Shelf which is committed to the West Australian Commission on a take or pay basis."

3.6.9 At this time, the three-spread tendering process, as set out in the Fluor Maunsell construction plan for the pipeline, was still in place. One of its advantages was that it was likely to encourage competition. It was explained in the following way:

"The timing of issuing of tenders and award of contracts has been selected to maintain an atmosphere of competition and enthusiasm amongst the tenderers. Progressive announcement of award of contracts will enable tenderers to assess their competitiveness prior to the closing of tenders for the next section. It is expected that as contracts are awarded, non-successful tenderers will maintain their confidence of achieving an award of a later section and this will result in realistic and competitive tenders for all sections."

3.6.10 Mr O'Connor became Premier of Western Australia on 26 January 1982. In that month, reports entitled "C-26 North West Shelf Gas Project" and "C-22B North West Shelf Gas Project, Dampier to Perth Pipeline and Gas Marketing" were prepared by SECWA for his benefit. The latter report noted that negotiations had been proceeding for some time with other prospective developers of an aluminium smelter in Western Australia, and in particular with Alcoa and Westal. The negotiations with those groups were, however, at a standstill as a consequence of the decision by the Loans Council not to provide borrowing authority for the construction of the Bunbury C power station, which was required to provide power for a smelter. Work was proceeding in an effort to develop a private financing mechanism to enable the power

station to proceed. The report then went on to detail the ICC proposals and pointed out that a smelter development would be important, as it would provide additional alumina sales for Alcoa, which in turn would accelerate the completion of the Wagerup refinery and would increase the demand for gas from the North West Shelf. The new power station would require some two million tonnes of coal per annum to supply the smelter. A massive displacement of coal for electricity generation in the State was anticipated in the first few years after supplies became available from the North West Shelf. This would result in a heavy cut back in coal requirements which the smelter development would counterbalance. A further important factor would be the opportunity to commence the supply to a new smelter based on gas before the coal fired station came into operation. That was considered very desirable in the period 1985 to 1987. The report detailed again the concern of SECWA about the anticipated decrease in the demand for North West Shelf gas and, accordingly, the importance of the proposed smelter and its wish to keep ICC in Western Australia and interested in the smelter proposal.

### **3.7 The ICC tender for the northern section of the pipeline and further negotiations in Korea**

3.7.1 The concern within SECWA about ICC's tender for the construction of the northern section of the pipeline was apparent in a memorandum dated 7 January 1982 from Mr D R Eiszele, the Manager, Energy Planning, to Mr Kingsmill. According to this memorandum, Mr Kirkwood had requested Mr Kingsmill, Mr Lowe and Mr Morrow to meet prior to tenders being received in order to ensure that appropriate action would be taken to obtain all necessary information with respect to ICC's capabilities. Mr Kirkwood had expressed his concern that they could reach a stage where, tenders having been received, and the ICC price being competitive, the only reason the consultants would have for rejecting ICC would be that they did not believe that it had the capacity to do the work. Fluor Maunsell was requested to research ICC's construction capabilities during the following few weeks and to be ready to present a carefully considered case to SECWA in support of its recommendation for the selected tenderer, "whoever that may be". Mr Kirkwood expressed the desire that the investigation be done "without fuss" in order not to provoke concern within ICC in view of SECWA's other negotiations with it.

3.7.2 Tenders for the northern section of the pipeline closed on 26 February 1982, following which SECWA requested Fluor Maunsell to undertake a

preliminary report on the tenders submitted by ICC and Saipem SpA. Fluor Maunsell responded on 9 March 1982 with a summary which recorded that ICC's tender was 32% above the average of all tenders, excluding the highest and lowest tenders, whereas that of Saipem SpA was 6% below that average.

3.7.3 Mr Jones, who was then overseas on visits to Japan and Korea, advised the Premier in a memorandum dated 12 March 1982 that, while the tenders for the first stage of the pipeline construction contract were still being assessed, ICC's bid was very high and was unlikely to be recommended. He told the Premier that at meetings between ICC and SECWA in Seoul on the previous day, ICC had indicated that it wished to be awarded the construction contract for the Dampier to Perth pipeline and that, should it not receive the contract, it would consider accepting the enticements to locate its smelter development in Queensland. He advised the Premier that "it will be necessary to re-assure the Koreans from a Government level that they will still be able to bid for the construction of the remaining two sections, and that the Government and the State Energy Commission would do all in their power to guide and assist ICC in forming a joint venture for the construction contract". Mr Jones expressed his concern that a failure to bring the power station and aluminium smelter project to fruition would have a very serious effect on the overall development program of SECWA as well as on the sales of North West Shelf gas, because the smelter project was a key part of the strategy for gas sales.

3.7.4 In order to reassure the Koreans that the Western Australian Government desired the smelter project to continue, and that ICC's failure to win the first construction contract for the pipeline would in no way represent a lessening of the Government's desire to be involved with Korean industry, Mr Jones arranged to travel to Seoul and meet the appropriate Government officials.

3.7.5 The negotiations conducted in Korea from 10 to 24 March 1982 were summarised in a SECWA Report, No C-28, dated 25 March 1982, which was intended to be an *aide memoire* for Mr Jones. At a meeting on 12 March 1982 between Mr Kirkwood, Dr Jae-ik Kim, who was the Korean Senior Secretary for Economic Affairs, and Mr Keith Holtsbaum, the Commercial officer with the Australian Embassy in Seoul, Dr Kim indicated that the establishment of an aluminium smelter with Korean participation so as to provide a strategic and economic supply of aluminium metal for Korean industry was an important objective of the Korean Government. It was also indicated by Dr Kim that Kukje/ICC was highly regarded by the Korean Government

and enjoyed the confidence and trust of the Government. ICC had kept Dr Kim and the Presidential Office fully informed of the progress of its initiatives in Western Australia, and they were well aware of the link between the three major projects being considered in the State. Dr Kim expressed the hope that ICC would be able to play a significant role in the construction of the natural gas pipeline. Mr Kirkwood summed up the position:

"Overall from the meetings and discussions in Korea it is clear that there continues to be strong Korean Government support for the ICC initiatives, and provided that an economical project can be developed which would be capable of producing metal at prices which will be competitive in the world market, then there will be strong Korean Government support for the initiatives now in hand."

3.7.6 A meeting also took place between Mr Chin-ho Keum, Vice Minister of Commerce and Industry, senior representatives of Alcoa, representatives of ICC, including its President, Mr Chung, and Mr Kirkwood, representing the Western Australian Government and SECWA. Alcoa still had an interest in being a possible participant in the smelter project. Mr Keum was aware of the smelter, power station and pipeline projects in Western Australia and he indicated his "hope and expectation" that the three would be seen as one entity by the Western Australian Government. He indicated his Government's readiness to provide support to ICC in achieving any necessary financing. The Managing Director of Alcoa also indicated his company's enthusiasm for the project. Mr Kirkwood advised the Vice Minister of Mr Jones' attitude as the responsible Western Australian Minister that "the three projects were seen as all of national importance, and it was seen as likely for the three projects to be linked under a Government to Government umbrella, as being a group of national projects with strong Government support on both sides". He conveyed to the Vice Minister Mr Jones' desire to make every effort to ensure that there was a speedy resolution of all matters relating to the three projects.

3.7.7 ICC now accepted that there was no prospect of its participation in the construction of the northern section of the pipeline, but the company, with Korean Government support, was pressing to secure the central and southern sections. Mr Kirkwood made it clear to the Koreans that such a proposal could be considered only within the framework of a Government to Government agreement between Korea and Western Australia and that it would require the establishment of an appropriate joint venture between ICC and an experienced Australian contractor. Any negotiation of

price, he said, "would need to be at a level which was consistent with the successful tender for the northern section of the pipeline which had been the subject of public tendering". Mr Kirkwood concluded:

"It is considered very likely that if the Government should make a decision to proceed in this way that agreement could be reached between the Korean and Western Australian Governments relating to all three projects and announcements made which would include both the northern section of the pipeline, which would be awarded on the basis of tenders already received, and the central and southern sections on a negotiated basis with ICC and an Australian contractor, before the end of May 1982."

This reflected an obvious change in attitude since the memorandum from Mr Jones to the Premier a few days before, in which Mr Jones had indicated it was necessary to reassure the Koreans that they would be able to bid for the remaining two sections.

3.7.8 During the discussions, Alcoa received the assurances it had been seeking regarding financial backing and the support of the Korean Government for its proposed joint venture with ICC in relation to the smelter.

3.7.9 A memorandum of understanding dated 22 March 1982 was entered into between ICC and SECWA, relating to the proposals for the development of a smelter in the State and for the building of an electricity generating plant to supply power for the proposed aluminium smelter, contingent on a firm commitment by Kukje/ICC and partners to the aluminium smelter project. It set out the general framework and the arrangements for ownership and operation of both gas turbine and coal fired generating plant for the provision of power to the smelter. It also recorded the negotiations currently in progress between ICC and Alcoa and the joint feasibility studies being undertaken.

3.7.10 Just before this time, Alcoa commenced a smelter feasibility study on behalf of itself and ICC. The study was made available to ICC at the beginning of May. Burns and Roe Inc, a utility consultant and engineer, had been retained jointly by ICC and SECWA to establish suitable preliminary power station arrangements and to develop cost estimates.

3.7.11 Mr Jones returned to Perth from Korea and reported to the Premier on the outcome of his meetings in a memorandum dated 22 March 1982. He said the

Koreans had been advised that it was unlikely they would win the contract for the northern section and "this has brought a very serious situation into being." He claimed that the Koreans had been, and still were, receiving attractive inducements to establish aluminium smelting operations in Queensland and he said he understood that the Premier of Queensland had indicated that he would assist in providing other construction work so as to form a "package" similar to that which ICC was seeking in Western Australia. Mr Jones reported that, although he had been able to get the smelter negotiations "back on the rails", it would take some very careful negotiations during the next three to four weeks, and that "considerable resources are being devoted to bring this to finality". He warned that the complete programme was still very delicately poised, and that the importance of its influence on the North West Shelf gas development could not be over-emphasised.

3.7.12 SECWA believed that substantial benefits would flow to the State from the construction of an aluminium smelter by ICC in this State. Six particular advantages were highlighted. First, the smelter's electricity requirements could be provided from gas fired generation from 1986 onwards. Secondly, the Korean Government would guarantee the aluminium metal market. Thirdly, Alcoa's involvement ensured the supply of alumina from gas fired alumina refineries. Fourthly, there would be Korean equity in the smelter. Fifthly, the economic viability of the North West Shelf gas project and pipeline would be improved. Sixthly, there would be the provision of funds from Korea for the construction of the associated Bunbury power station.

### **3.8 The proposed non-competitive tenders for the central and southern sections of the pipeline**

3.8.1 The minutes of the meeting of SECWA held on Thursday, 8 April 1982, recorded that the power station and smelter proposals were reaching a stage where decisions and commitments could be expected, but that the issue of ICC's participation in the construction of the gas pipeline remained to be resolved. It was reported once again that the Queensland Premier had, during the previous months, endeavoured to persuade Kukje/ICC that it should undertake a smelter development in Queensland, which had the advantages of cheaper coal being available and of there being no need to construct a power station. ICC had rejected the Queensland overtures, but at the same time it had made it clear to SECWA and to Mr Jones that the Western Australian proposals were conditional on ICC's securing a substantial role in the construction of the pipeline, a stand which the Korean Government strongly supported.

3.8.2 The minutes also recorded that, during discussions between Mr Yang and Mr Jones in Korea on 17 March 1982:

"[T]he Minister indicated that he would be prepared to consider an arrangement whereby the construction work for the central and southern sections of the pipeline was not the subject of competitive bidding. Rather, he was prepared to consider a negotiated contract provided that the unit rates were linked to the competitive figures which had been received in competitive bidding for the northern section. Also, provided that the State Energy Commission and the project consultant managers, Fluor/Maunsell, were prepared to endorse and approve any arrangements which ICC put forward to carry out the pipeline construction work. It was pointed out that ICC would need to enter into an arrangement or partnership with an experienced contracting group to ensure the success of the pipeline construction project."

3.8.3 In his evidence, Mr Jones denied that in his meetings in Korea he had been prepared to consider an arrangement whereby the central and southern sections would not be the subject of competitive bidding, and he claimed that the idea had been conveyed to him by Mr Kirkwood. He said it was not a matter into which he, as Minister, would have intruded. It was a matter for SECWA. He recalled that the possibility of a negotiated contract had arisen at this time, but in a different context, brought about by his intervention in the pipeline construction timetable. He had advised SECWA that he would not approve any tenders for construction work until there had been a resolution of the differences with the JVP and until the Alcoa gas contract had been concluded. In that context, he said, Mr Kirkwood had advised him that delays would involve difficulties in meeting the pipeline construction timetable and it might be necessary to consider other methods of construction. The suggestion of a negotiated contract had then been raised by Mr Kirkwood.

3.8.4 When given the opportunity to peruse the correspondence, Mr Jones conceded that his memory was inaccurate in this respect. His letters of 15 April 1982 to the Korean Minister of Commerce and Industry and to Mr Yang made it clear that, after the difficulties associated with ICC's tender for the northern section had been explained, and Mr Yang had been advised by Mr Jones that the Government intended to have SECWA award the contract for the northern section on the basis of the most competitive tender, Mr Yang had proposed that there should be a negotiated contract for the central and southern sections. In his letter to Mr Yang, Mr Jones wrote:

"However, I understand clearly your desire to participate in the central and southern sections of the pipe construction works and your proposal that there be a negotiated contract between Kukje/ICC and the State Energy Commission for these works, subject of course to satisfactory pricing and financing arrangements."

The letters record that Mr Jones had indicated that, subject to firm commitments to the smelter and power station projects, he would be prepared to consider and recommend to the Western Australian Government a proposal for the negotiation of the central and southern sections of the pipeline construction works, provided that the pricing arrangements were suitably based and that the organisation and arrangements proposed for the execution of the works were acceptable to Fluor Maunsell and to SECWA.

3.8.5 Unquestionably, the pipeline was being used as a strong bargaining tool. ICC left no room for doubt that its continued involvement in the smelter and power station projects was conditional on its gaining a substantial involvement in the construction of the pipeline. The Government and SECWA believed, with apparent justification, that ICC and the Korean Government were genuinely interested in furthering ICC's involvement in the smelter and power station projects. The emerging problems with the take or pay gas contract, and the interests of the State economy generally, provided powerful reasons for every effort to be made to secure the involvement of ICC in these projects.

3.8.6 Pressures to negotiate a contract for the central and southern sections of the pipeline also built up due to constraints of time. Delays had resulted from the desire to secure a firm commitment from the Koreans to the smelter project, which was not, in the end, to be forthcoming, and from the time taken to conclude the gas sales contracts with the JVP and with Alcoa. Mr Jones, as has been indicated, had decided that the pipeline construction contracts should not be let until a commitment had been obtained from Alcoa in relation to its contract to purchase gas from SECWA, because it was, in effect, being required to take on the responsibility for a significant portion of the cost of the pipeline. During March, SECWA advised Fluor Maunsell that it should not proceed with the calling of tenders for the central and southern sections of the pipeline and that SECWA would not proceed at that time with the award of the contract for the northern section. One of the reasons for the delay was the necessity to review the projected demand for gas and to research alternatives to make up shortfalls from earlier market forecasts. SECWA was then faced with a substantial deficit in respect

of gas sales from 1985/86 to 1989/90. As Fluor Maunsell expressed it in a subsequent report:

"In this respect the potential for the South Korean and Western Australian Governments to join in the development of an Aluminium Smelter and extensions to the Bunbury Power Station in order to provide a significant contribution to gas demand became an important consideration."

3.8.7 Mr Hayes explained that it had originally been intended to call tenders for the central and southern sections at or about the end of 1981, with the contract being awarded in May 1982. Under the construction plan, work was to commence in July 1982 on the southern section and in October 1982 on the central section. For the project to be completed in time to take gas as required under the contract with the JVP, substantial progress had to be made towards achieving firm contractual arrangements for the construction of the pipeline. Mr R M Miller, the Manager of Construction for Fluor Maunsell, stated that, by mid-July 1982, when negotiations for the central and southern sections were taking place, it would have been inadvisable to have gone back to a tendering process, by reason of the time taken to invite tenders, to evaluate them, to let them and to allow for mobilisation. Mr Jones said that SECWA was advising the Government of its concerns about the timing and of the need to keep up the momentum of the negotiations.

3.8.8 In these circumstances, we have concluded that it was reasonable for Mr Jones and SECWA to have indicated to ICC that they were prepared to consider a negotiated contract for the central and southern sections, rather than going to tender. Ultimately, a contract was negotiated and, while there was understandable concern that this Commission should investigate both the circumstances in which the decision was made to negotiate a contract and the negotiations themselves, no-one has suggested there is any evidence of impropriety associated with that decision or those negotiations, and we have not perceived any evidence of impropriety in the course of our inquiry. Further, subject to the question of cost, which is dealt with later in this chapter, the outcome of the negotiated contracts fully justified the decision.

3.8.9 It must be recognised, however, that, in the words of Mr Kingsmill, there was "no question a lot of people were very, very unhappy", although he added that his reservations were overcome by the hope that they would obtain a smelter for Western Australia. Mr Saunders, who was at the relevant time the Marketing Manager of

SECWA, said that there was a lot of nervousness within SECWA about the decision to negotiate the contracts rather than going to tender, because it was a major construction work and a tender process would have allowed it to be seen more clearly that everything was being done fairly; but, on the other hand, he said he could see the countervailing commercial arguments. The evidence clearly established that Mr Kirkwood was the chief protagonist of the smelter. Mr Saunders said that Mr Kirkwood was behind anything which would facilitate or smooth the way to securing a smelter, and this attitude pervaded much of what took place within SECWA at the time. He made it quite clear, however, that in saying this he was not suggesting there was any impropriety on the part of Mr Kirkwood. Mr Eiszele said that he was not aware of any concern within SECWA with respect to the proposal, although Fluor Maunsell was concerned, simply because it involved a change in its original schedule, and it saw a risk in an unknown factor coming into the project.

3.8.10 In a memorandum to Mr Jones, dated 14 April 1982, attached to SECWA Report No C-29 entitled "Status Report Easter 1982", Mr Kirkwood reported that the Kukje Group had indicated that its initiatives in relation to an aluminium smelter and power station were conditional on its securing a significant role in the construction of the gas pipeline. He continued:

"Specifically they require that a contract be negotiated with them for the construction of the central and southern portions of the pipeline project. However, the prices would be related to those secured by competitive bidding for the northern section. Also, they would be required to enter into an arrangement or partnership with an experienced contractor who has done previous work in Australia and to establish an arrangement which would be acceptable to the State Energy Commission and to the consultant managers, Fluor/Maunsell.

A decision to negotiate a contract with ICC Construction Company Ltd would, doubtless, result in serious criticism from other contracting groups. However, this must be weighed against the advantages in securing a smelter/power station development at this time in Western Australia and the very substantial contribution that it would make to overcoming the gas marketing problem."

Mr Kirkwood expressed the view that it was essential that there should be a Government to Government understanding between Korea and Western Australia in relation to the

three development projects, particularly by reason of ICC's proposal that a contract should be negotiated with it for portions of the pipeline, and the indications which had been given of Korean Government support for the consideration of the three projects as a single package.

3.8.11 Also attached to the report was a draft submission from Mr Jones to Cabinet regarding gas marketing, the aluminium smelter and power station and the pipeline project, in which the current position was reviewed. Cabinet approval in principle was sought for the negotiation of a contract with ICC for the central and southern sections of the pipeline. The draft submission had been approved by SECWA on 8 April 1982. It proposed that the contract should be negotiated on the basis that the unit rates would be substantially as secured under competitive bidding for the northern section, having regard to matters such as differing problems in the various sections. Furthermore, ICC would be required to take a suitable partner with experience in Australian construction contracting, with the precise form of any interrelationship being the subject of negotiation and of advice from Fluor Maunsell.

### **3.9 SECWA's pursuit of an aluminium smelter**

3.9.1 SECWA determined at its meeting on 8 April 1982 that steps should be taken to establish the necessary Government to Government arrangement. It proposed that there be an overall agreement between the Government of Korea and the Government of Western Australia linking the three projects together and indicating, subject to detailed engineering, environmental and economic studies, a commitment in principle to the smelter and power station proposals. ICC was to be committed contractually to contributing an agreed capital sum for the Bunbury power plant and to entering into power contracts with SECWA and Alcoa. As a further encouragement to the Korean Government, it was proposed that the coal-fired power station be partly manufactured in Korea, although to designs and subject to the overall guarantee of American power plant suppliers.

3.9.2 At the same meeting, SECWA approved a proposal that letters be sent by the Premier and by the Minister to the Kukje Group and by the Minister to the Minister of Commerce and Industry in Korea, outlining the current status of the several projects and indicating the nature of the agreements which were required. Drafts of the letters were approved by SECWA and were subsequently sent to Korea.

3.9.3 The first letter, from Mr Jones to Mr Suk-Joon Suh, Minister of Commerce and Industry, dated 15 April 1982, referred to the meetings in Korea in the previous month, involving Mr Kirkwood, Mr Keum and representatives of ICC and Alcoa, when Mr Keum had indicated that the Korean Government was prepared to support Kukje/ICC in financing a smelter and that the metal produced from the proposed smelter would receive preferential access to the Korean market. Mr Jones proposed, and sought agreement on, three points, in order that the several projects might succeed:

1. There be an overall agreement between the Government of Korea and Government of Western Australia, clearly setting out mutual support for the overall proposals, and giving necessary undertakings.
2. I would particularly seek your formal commitment that the metal produced by the smelter would have an assured market in Korea.
3. I ask for your assurance that the Korean Government would be prepared to issue the necessary guarantees to enable Kukje/ICC to finance the projects and to assure completion thereof."

3.9.4 The second letter, from Mr Jones to Mr Yang, dated 15 April 1982, referred to their discussions in Seoul on 16 March 1982 and advised Mr Yang that on Tuesday, 23 March 1982, Mr Kirkwood had visited Alcoa's headquarters in Melbourne, where he was told that Alcoa considered the prospects for success with the smelter project were good, provided an assurance could be secured from the Government of Korea that the production of aluminium from a Western Australian smelter would have access to the Korean market and provided that the electricity price which could be secured for the smelter power supplies would make the price of metal competitive. Mr Jones wrote:

"I made it clear at our meeting that subject to firm commitments to the smelter and power station projects, I would be prepared to consider and recommend to my Government, a proposal for negotiation of the central and southern portions of the pipeline construction works provided that the pricing arrangements were suitably based and that the organisation and arrangements proposed for execution of the works was acceptable to Fluor Maunsell and to the State Energy Commission.

...

You will appreciate that the overall arrangement will require to be the subject of an agreement between the Korean Government and the Government of Western Australia, and firm commitment that all three projects will proceed."

3.9.5 The letter from the Premier to Mr Yang, dated 16 April 1982, substantially reiterated the comments of Mr Jones with respect to the pipeline project and to the possibility of ICC's proceeding under a negotiated contract for the construction of the central and southern sections. It stressed that, "for such a major public work to be negotiated rather than awarded on the basis of competitive tendering it will be necessary to secure a commitment of the Korean Government to an overall agreement that the three major projects being undertaken are agreed as being of national importance and linked together and committed as a single package".

3.9.6 The memorandum from Mr Jones, which accompanied the letter for the Premier's signature, warned the Premier that, without a clear commitment on a Government to Government basis, it was quite clear there would be no project, because Alcoa would not be willing to enter into any arrangements with respect to a smelter.

3.9.7 Recorded in the minutes of the meeting of SECWA held on 8 April 1982 was a statement that SECWA was advised "today, 14th April, orally, that the Korean Government has agreed that it will give a firm commitment to take the metal from the smelter". It is not entirely clear how events of 14 April were recorded in minutes of 8 April.

3.9.8 The Korean Minister of Commerce and Industry replied to Mr Jones by letter dated 3 May 1982, which concluded with an expression of hope that the three projects would be "undertaken smoothly with good results", and a statement that he expected that both Governments would provide "support and encouragement toward that end". As Mr Jones acknowledged, the letter clearly fell far short of providing the commitment which was being sought and was not a sufficient commitment for Alcoa's purposes. Indeed, the Korean Minister appears to have made particular mention in his letter of the fact that the Kukje Group was "a private company". He gave no guarantee of a market in Korea for aluminium from the proposed smelter, but stated that, "given anticipated future increases in domestic demand, there will not be any special problems, assuming prices are competitive". So far as finance was concerned, he said it was

"primarily a matter to be resolved between the private companies themselves, but I will consider this matter in accordance with the proper procedures when necessary". On the face of it, the letter gave no encouragement for any belief that the Korean Government would be willing to commit itself in writing in the manner sought by the Western Australian Government.

3.9.9 Mr Jones and the Premier arranged to visit Korea at the end of May 1982 in order to pursue the matters raised in the correspondence. In the meantime, Mr Kirkwood had already been in Korea and, at a meeting with representatives of ICC on 10 May 1982, he had been informed that "President Chun [the President of the Republic of Korea] has reaffirmed orally his continued support and his understanding of the need for guarantees of assured market in Korea for metal produced from the proposed Western Australian smelter". According to Mr Jones, Mr Kirkwood understood from the meeting that the necessary approval to firm up the oral commitment would become available in due course.

3.9.10 On 10 May 1982, the Premier wrote to the Prime Minister of Australia, Mr Malcolm Fraser, who was to be in Korea at the same time as he and Mr Jones. The letter explained the situation with respect to the three projects and requested that, during his forthcoming discussions with the Korean President, Mr Fraser should raise the smelter project and assure the Koreans of Commonwealth Government support. He was also requested to seek positive assurances from the President that the Korean Government would commit itself to the project.

3.9.11 Mr Jones recalled that a meeting with President Doo-Hwan Chun took place in Korea, but that, while the President indicated orally the intention of his Government to support the smelter project, and in particular by way of a commitment to take the metal, he did not recall having received any such commitment in writing, and it is clear that he did not.

### **3.10 Negotiations with ICC on the pipeline contracts**

3.10.1 In a memorandum to Mr Jones, dated 13 May 1982, Mr Kirkwood summarised the current position. He noted several issues which, he said, had not progressed as quickly as might have been hoped, namely, the appointment by ICC of a financial adviser, the negotiation of a more favourable price for a power plant to be supplied by a Korean company and clarification of the availability of attractive export

finance for plant. He said that he was not then in a position to make firm proposals on the awarding of the contract for the northern section of the pipeline. He also referred to a meeting that morning between representatives of Fluor Maunsell, ICC and SECWA, reviewing ICC's tender for the northern section of the pipeline and advised Mr Jones that, over the next few days, these meetings would extend to the central and southern sections and "traverse the issue of the ICC offer".

3.10.2 A series of meetings were held in the middle of May between officers of SECWA and ICC to discuss ICC's tender for the northern section of the pipeline. According to notes taken by Mr Eiszele, they were held between 14 and 17 May 1982, although it may be, having regard to Mr Kirkwood's memorandum, that they commenced one day earlier. It is quite clear that the meetings were held as a prelude to negotiating a contract with ICC for the construction of the central section of the pipeline. SECWA informed ICC that there were four main areas in which its tender for the northern section did not compare favourably with other tenders received:

- (a) the tender price was too high, being at the top end of the 10 tenders received;
- (b) the consortium members did not possess the required experience in the construction of major pipelines;
- (c) the ICC consortium had limited experience in the successful completion of construction contracts in Australia; and
- (d) the personnel nominated for the project had limited experience in major pipeline construction.

The delicate industrial relations situation in Australia was once again explained to ICC, particularly with reference to overseas companies working in Australia for the first time. It was said to be essential that ICC work through special industrial relations staff who had a successful background in handling Australian labour on major remote projects.

3.10.3 The notes of the meetings recorded that ICC welcomed the opportunity to discuss its tender and to obtain guidance on those areas where improvements could have been made. It questioned, however, whether anyone would have the experience being sought by SECWA to build such a long pipeline, and it expressed the belief that

it could demonstrate that its project management capabilities would ensure that any industrial relations problems were overcome. Mr Eiszele said in his evidence that ICC reacted very positively to the post-tender review and welcomed the advice that working in Australia on pipelines was risky and expensive.

3.10.4 At the meetings, officers of SECWA emphasised the importance of ICC's joining with an experienced pipeline contractor with adequate Australian knowledge and expertise. They stressed the need for ICC to show that it had adequate back up staff resources to cover most of the important positions should they be unsuccessful in recruitment. It was explained, finally, that the next step would be to discuss with ICC the arrangements by which the company could form a joint venture with a pipeline contractor experienced in Australia. Those discussions were to take place as soon as the necessary Government agreements were in place.

3.10.5 A copy of the notes of the meetings was sent by Mr Eiszele to Mr T C Yoon, the Executive Vice President of ICC in Perth, with a covering letter dated 19 May 1982 under the heading "Aluminium smelter and power station developments. Natural gas pipeline project." Although the letter dealt only with the pipeline, Mr Eiszele explained that the heading was quite deliberate, the purpose being to maintain the momentum of the three projects, since SECWA was pursuing the negotiations with ICC only to link the three projects. As he put it, they were very conscious at that stage that, if the other two projects did not go ahead, but they had negotiated a substantial construction contract for the pipeline, they would not have achieved the real objective. Accordingly, the three projects were always referenced together in documents which went to the Government, to SECWA and to the Government of the Republic of Korea.

3.10.6 It is apparent that, by this time, SECWA had moved away from calling for tenders for the central and southern sections of the pipeline and that, instead, a contract was to be negotiated with a joint venture to be formed by ICC. ICC had been informed, however, that the Western Australian Government would be prepared to consider a negotiated contract only if there were a firm commitment by the Korean Government to the smelter and the power station projects and if its prices for the pipeline were related to those which had been offered by the successful tenderer for the northern section. It would seem that the negotiation process proved far more difficult than had originally been envisaged.

3.10.7 Notes on the proposed negotiations with ICC for the construction of the central and southern sections of the pipeline were prepared by Mr Eiszele on 25 May 1982. The notes recorded that SECWA's position in the negotiations with ICC should be that ICC would form a joint venture with the tenderer selected for the northern section, which was still not named, and that it would be preferable for the construction plan recommended by Fluor Maunsell to be continued, requiring a separate contractor for each section. That could be achieved by nominating major contractors as sub-contractors for each section, which would allow the use of locally-based civil contractors and would have the advantage of using contractors with experience in particular areas. The joint venture was to be organised so as not to allow ICC to participate in areas requiring direct supervision of labour, or in the specialised work associated with the project, such as welding. ICC was to be encouraged to accept a general role in the management of the joint venture and to view the project as an opportunity to gain valuable experience in working in Australia. SECWA and Fluor Maunsell would determine the work pattern, the major sub-contractors, the allocation of work to meet construction plan objectives and the extent of Western Australian participation. Fluor Maunsell would produce the tender documents for the central and southern sections and the joint venture would be requested to price documents in a competitive manner and within specified guidelines. Fluor Maunsell would produce a base estimate, backed up with the details required to support the estimates, which would include crew and production rates, material costs, equipment rates and the contractor's overheads and profit. Negotiations would proceed between the joint venture and Fluor Maunsell on a reasonable tender price for the work, based on the unit rates accepted for the northern section. Fluor Maunsell would submit its recommendation to SECWA in the normal way, and the contract would be awarded in accordance with established procedures. Finally, it was said:

"It should be noted that the acceptance of ICC's involvement in the Joint Venture is conditional on the associated smelter/power station projects proceeding. However, if these projects do not proceed, it may be necessary to still proceed with a negotiated contract to ensure that lost construction time is minimised."

3.10.8 Mr Miller gave evidence that SECWA had sought advice from Fluor Maunsell as to how ICC could be included in the construction contract, and that Fluor Maunsell had responded that they were convinced ICC could not do the work on a stand-alone basis. According to Mr Morrow, the idea that ICC should form a joint venture came from Mr Kirkwood, and it had arisen because it was apparent from its

rejection at the pre-qualification stage that ICC was not qualified to build a pipeline on its own. Mr Hayes said that the reason for the joint venture was that if ICC were to be involved, it would need to be associated closely with a very experienced pipeline construction company.

3.10.9 On 9 June 1982, ICC itself suggested that a satisfactory basis for a working arrangement would be the formation of a joint venture between ICC and the recommended tenderer for the northern section of the pipeline. This proposal by ICC was welcomed by SECWA as providing a good foundation for the negotiation of a contract price for the central and southern sections of the pipeline and being likely to result in a sound joint venture arrangement. Mr Jones agreed with the suggestion.

3.10.10 Although the contract for the northern section had not yet been let to the successful tenderer, it was apparent that Saipem SpA was the preferred tenderer, and it was approached regarding a joint venture with ICC in relation to the other two sections. Its initial reaction to a joint venture was not positive. In particular, it was concerned about its good reputation in Australia, especially in relation to industrial relations, and for obvious reasons it was not anxious to train a competitor in its special field. In the middle of June, Mr Eiszele and Mr Kirkwood flew to Italy with representatives of Fluor Maunsell and ICC to hold discussions with Saipem SpA at its headquarters in Milan. The purpose of the discussions was to advise Saipem SpA of the overall Government initiatives for the three development projects and to seek its co-operation in finding a way in which ICC could participate in the pipeline construction project.

3.10.11 The response from Saipem SpA was helpful and constructive. It offered to take a flexible approach to the formation of a joint venture with ICC and indicated that it would be prepared to assign its forthcoming contract with SECWA to a Saipem/ICC joint venture if suitable arrangements could be made. However, it was clearly stated that, for Saipem SpA to join such a joint venture, the following conditions would have to be met:

- (a) Saipem SpA would be the dominant partner in the joint venture and provide overall control of industrial relations and labour procurement;
- (b) Saipem SpA would be responsible for the construction of the northern and southern sections of the pipeline; and

- (c) ICC would be responsible for the construction of the central section of the pipeline.

3.10.12 The conditions proposed by Saipem SpA as the basis for a joint venture arrangement were acceptable to Fluor Maunsell and were supported by SECWA. SECWA regarded the suggested joint venture arrangements as providing it with substantial protection for the construction project being completed on schedule and within budget. It regarded the overall control by Saipem SpA of the joint venture as essential for enabling SECWA to be confident it could complete the project without substantial loss.

3.10.13 There was considerable resistance on the part of ICC to agreeing on the terms of the proposed joint venture with Saipem SpA. It saw its suggested role as being subordinate. Representatives of SECWA and ICC met in Perth on 29 June in an endeavour to overcome this resistance. SECWA was now in a difficult position. As Mr Kirkwood pointed out to ICC in a letter dated 7 July 1982, it faced substantial penalties of about \$20 million per month for late completion of the project and, accordingly, it had to maintain the position that a negotiated contract with ICC could be contemplated only under an arrangement by which an experienced contractor, such as Saipem SpA, had a major input. SECWA declined to agree to ICC's proposal that it should have sole responsibility for the construction of the central and southern sections, with Saipem SpA providing only technical assistance to ICC. Mr Kirkwood said that SECWA would not at that stage agree to any change in the termination points of the three sections; but he held out the possibility that detailed work by ICC and Saipem SpA might subsequently lead to a modification of the breakpoints between the sections if actual progress with construction showed this to be practical. In fact, SECWA subsequently conceded on the breakpoints, which increased the cost of the project.

3.10.14 While the final terms of the joint venture were being resolved between the parties, it became necessary to negotiate a price at which a joint venture would construct the central and southern sections of the pipeline. According to Mr Hayes, the negotiations with ICC for the construction of the central section were very difficult. SECWA was not in a position in which it was negotiating with an experienced pipeline construction organisation, and it did not particularly trust ICC's judgment. The fact that ICC's tender for the northern section was so high was regarded as a reflection of its inexperience. SECWA did, however, have quite firm views as to the pricing of the

central section, having available to it the estimates which had been prepared by Mr Miller of Fluor Maunsell.

3.10.15 SECWA was weakened in its negotiating position by reason of the initiatives which had been taken to achieve a commitment by the Koreans to the smelter package. From Mr Eiszele's perspective, there existed an agreement at Government level for the three projects to proceed together, and he believed it to be important to do everything possible to make sure that the projects came to fruition. He said it was important to fulfil the Western Australian part of the bargain and also to "guard very jealously our reputation of fair dealing". Mr Hayes explained that ICC's involvement in the pipeline was part of the total initiative with the smelter and power station, and it would have been very difficult for SECWA to have walked away at that time for the sake of driving a somewhat harder bargain and thereby endangering the smelter initiatives. The opportunity of establishing a smelter was perceived by just about every member of the management of SECWA as worth pursuing. As Mr Hayes explained, however, the construction program was becoming increasingly endangered, and the available time to complete the construction contracts was diminishing. He accepted that, by the middle of 1982, SECWA was proceeding effectively on the basis that it really had no alternative other than to reach agreement with ICC. He explained that SECWA found itself in this position primarily by reason of the desire to have the Alcoa gas purchase contract in place before it entered into any major contractual commitment for the construction of the pipeline, to the cost of which Alcoa was to make a substantial contribution.

3.10.16 Mr Andreas Van Kann was the contracts manager with Fluor Maunsell from 1980 until his replacement by a legal practitioner in August 1983. He held no formal qualifications, and his main tasks were to draft specifications and to deal with commercial matters, with the benefit of advice from solicitors. Mr Van Kann expressed the opinion that the negotiation process with ICC was not genuine. He claimed that it had commenced from a figure nominated by ICC, with allowances being adjusted to achieve that figure.

3.10.17 Mr Van Kann's opinion found no support from other witnesses. In particular, Mr Morrow and Mr Miller from Fluor Maunsell and Mr Hayes and Mr Treloar from SECWA all agreed that the negotiation process was genuine, being based on the rates tendered by Saipem SpA for the northern section, with appropriate allowances being made for the different characteristics of the central section.

Mr Morrow said that Fluor Maunsell tried its utmost to minimise any additional cost involved in negotiation. He could not recall any occasion on which SECWA had given an instruction to go easy. Mr Miller, who was a particularly impressive witness, refused to accept that ICC secured whatever it wanted, or that it had an easy ride in the negotiations. He could not recall any suggestion that ICC wanted a particular price or that the allowances were, or should be, adjusted to achieve that price. Mr Hayes did not accept that SECWA had capitulated to the prices proposed by ICC, and he maintained that SECWA had compromised no more than was reasonable in the circumstances. Nevertheless, he conceded that it would not have been possible at that time to have excluded ICC and to have proceeded with Saipem SpA alone, by reason of the lack of time and the fact that Saipem SpA was aware of the nature of the negotiations. Accordingly, SECWA was unlikely to have been any more successful with Saipem SpA than it was with ICC in achieving the best price.

3.10.18 The individual items which were allowed to ICC in the negotiations in relation to the contract price for the construction of the central section were explored with various witnesses. A major difference of opinion arose in relation to an allowance of \$2.28 million for the removal and replacement of topsoil. Mr Van Kann did not accept that there was such a difference in the treatment of topsoil between the northern section and the northern part of the central section as to require a greater allowance to be paid to ICC than that tendered by Saipem SpA for the northern section. Mr Treloar, on the other hand, said that there was a difference between the two sections and that any organisation tendering for the construction of the central section would have made an allowance in its price accordingly. He explained that, in the central section, six to ten inches of the topsoil had to be removed and stockpiled over the full width of the 30 metre right of way. Once the pipe had been laid, the ground had to be scarified to break up the underlying terrain which would have been compacted by the passage of vehicles, and the topsoil respread and reseeded. In the northern section, which passed mainly through pastoral leasehold land, as opposed to agricultural land, only a very narrow strip over the trenchline itself was required to be removed and replaced. His evidence was confirmed by reference to the specifications for the construction of the central section. Mr Miller agreed that the specifications for the central section required a greater treatment of the topsoil than that required in the northern section.

3.10.19 Areas of compromise which were identified by Mr Miller were the need to have someone supervise ICC, having regard to its inexperience, an allowance for new equipment and an allowance for the training of pipeline personnel. He considered that

costs for equipment and training should have been borne by the contractor; but ICC was very firm that SECWA should pay those expenses. In the context of the total contract price, they were relatively minor. Moreover, the extra equipment and personnel costs, he said, were justified to some extent because more tie-in crews were required on the central section by reason of the additional hydro-testing, topsoil and valving requirements, which in turn required more equipment. Mr Miller said that, in his opinion, any contractor would have allowed for employee training, having regard to the extra difficulties associated with the construction of the central section. An extra allowance was also made for hydro-testing; but, according to Mr Miller and Mr Treloar, this was justified having regard to the rolling terrain in the central section, in contrast to the flat terrain of the northern section, and the consequent differences in elevation between the high and low points of the line, which required more tests over shorter distances.

3.10.20 We accept the evidence of Mr Morrow, Mr Miller, Mr Hayes and Mr Treloar that the negotiations between Fluor Maunsell and ICC for the construction of the central section of the pipeline were genuine, and that, while there may have been some degree of compromise by SECWA, that compromise was reasonable in the circumstances. We do not accept Mr Van Kann's opinion that the negotiations commenced from a figure nominated by ICC. Mr Van Kann would not agree with the suggestion that there was anything improper in the negotiation process, but rather described his position as a difference of opinion with Mr Miller. Mr Miller was a highly qualified and experienced engineer and very much better qualified than Mr Van Kann. We have no hesitation in accepting his opinion in preference to that of Mr Van Kann.

### **3.11 The Saipem/ICC joint venture, the awarding of the pipeline contracts and continuing negotiations with respect to the smelter**

3.11.1 By a letter to SECWA, dated 8 June 1982, Fluor Maunsell had recommended the selection of Saipem SpA as the successful tenderer for the northern section of the pipeline, on a schedule of rates basis, for a nominal sum of \$84,713,439. That recommendation followed a very careful and detailed comparison of the competing tenders. Saipem SpA was described by Fluor Maunsell as having an enviable reputation as an international gas and oil pipeline contractor, with a history of completing many pipeline projects in Europe, Africa, and the Middle East, and having operated relatively

successfully in Australia and New Zealand over the past 15 years. Importantly, Saipem SpA had been able to meet the tight timing arrangements on the Moomba to Stony Point pipeline in South Australia. Fluor Maunsell reminded SECWA that the tenders were valid only until 26 June 1982 and that, if SECWA had not made a decision by that date, it would be necessary for the tender period to be extended.

3.11.2           The recommendation had been accepted by SECWA at its meeting on 16 June 1982, when a resolution was passed that it should be presented to the Minister, subject to his withholding his approval for the awarding of the contract until such time as negotiations with the JVP and Alcoa had been finalised. Mr Jones observed that the recording of the condition reflected the sensitivity of SECWA in its relationship with the Minister. It represented, he said, an acceptance by SECWA of the position which he had sought to establish, that any comments he made to SECWA should not be taken as orders. The delay in resolving the outstanding issues was creating a difficulty for SECWA in relation to the timing of the pipeline project; but it was a weapon to get the joint venturers back to the negotiating table.

3.11.3           An agreement between SECWA, ICC and WAPCO for the provision of power facilities for an aluminium smelter was executed on 28 June 1982. Clause 2.2(a) of the agreement provided that ICC and WAPCO could together withdraw from the agreement if ICC advised SECWA in writing that it did not intend to proceed with the smelter project on economic or other justifiable grounds, or if, "for financial or other justifiable reasons", it was unwilling to perform its obligations, or the obligations of WAPCO, under the agreement. That right had to be exercised during the period of six months after the completion of the engineering, environmental and financial studies which ICC and SECWA were required to undertake under clause 9 of the agreement. The execution of the agreement on its behalf was ratified by SECWA on 24 August 1982.

3.11.4           A protocol agreement had also been signed on 28 June by the Premier and the Chairman of the Kukje Group, Mr Yang. The agreement was executed "as evidence of mutual respect for the commercial intent of the agreement between the Kukje Group, through ICC Construction Co Ltd and the Commission". The protocol agreement recorded that the Kukje Group proposed to develop a smelter in the South West of Western Australia for the supply of aluminium metal to Korea and that, with Alcoa, it was engaged in a financial feasibility analysis.

3.11.5 On the same day, it was announced in a news release that preliminary agreement had been reached between Korean interests and the Western Australian Government on the building of a power station primarily to supply electricity for an aluminium smelter in the South West. It was said that this now cleared the way for separate negotiations to proceed further on the establishment of an aluminium smelter in the region. It was expressly recognised that there was no final commitment, and that the power station component was conditional on an agreement on the development of a smelter. The news release quoted the Premier as having said:

"I am pleased to say that the Korean Government has fully endorsed investment in the construction of the power station required for the total project, and has confirmed that the market for aluminium metal in Korea is more than enough to support the proposed smelter."

It was also said that the programme agreed by the Government and ICC called for a ratified agreement between a smelter company and the Western Australian Government to be signed by March 1983.

3.11.6 On 15 July 1982, Saipem Australia Pty Ltd ("Saipem"), a subsidiary of Saipem SpA, and ICC agreed to form a joint venture for construction of the pipeline. The agreement was acceptable to SECWA and to Fluor Maunsell. Copies of the draft agreement had been sent to Mr Jones, who was then in London, and to the Under Treasurer, Mr Les McCarrey, for approval. Mr McCarrey, in his advice to the Premier on 16 July 1982, apparently had no concern as to the proposed arrangements, since they had the approval of SECWA's consultants, and he assumed that they represented the least costly way of constructing the pipeline.

3.11.7 Mr Jones, on the other hand, had some reservations about the increasing Korean involvement in the pipeline construction contracts at that time. In a telex to Mr Kirkwood, dated 19 July 1982, following a telephone discussion with him earlier on that day, he expressed his concern as to the failure of the Korean Government to commit itself to the smelter project. He pointed out that he had indicated on several occasions his concern that, whatever pipeline contractual arrangements were agreed, the credibility and good name of SECWA and the State Government must not be jeopardised. Mr Jones stated that, where the pipeline negotiations were concerned, there had to be some commitment by ICC to the smelter and power station projects before there could be any agreement on any involvement by ICC in the pipeline. This was for the reason

that Korean involvement in the pipeline was of much less value to the State than the development of the smelter and power station. He wrote: "I have expressed some reservations about the apparently increasing Korean involvement with no guarantee from them regarding smelter/power station, and I continue to be reluctant to allowing ICC to have a dominant role in any part of the pipeline without some performance guarantee by Saipem, and without ICC commitment to the other projects".

3.11.8 Mr Kirkwood contacted Mr Jones by telephone to discuss his concerns and explained to him the need for the joint venture agreement, the main purpose of which was to enable the Government to consider the acceptability or otherwise of a Korean involvement in the pipeline. He advised Mr Jones that it did not seem possible to obtain a final commitment by the Koreans to the smelter prior to the placement of the pipeline construction contract. Mr Kirkwood was very clearly in favour of the joint venture agreement, notwithstanding the failure of the Korean Government to make the commitment which had been sought.

3.11.9 The agreement for the formation of a joint venture to construct the Dampier to Perth natural gas pipeline project was executed by SECWA, Saipem and ICC on 19 July 1982, although it was in fact dated 15 July 1982, the date on which, apparently, agreement had been reached between the parties. It recited that Saipem and ICC had held discussions on an arrangement for a joint venture to prepare a contract price and to construct the central and southern sections of the pipeline project. It was agreed that the arrangement therein set out would be adopted for the pipeline construction contract. In particular, a joint venture for the construction of the northern, central and southern sections was to be formed between ICC and Saipem, on conditions to be agreed between the parties. Under the agreement, Saipem was to be responsible for the construction of the northern and southern sections of the pipeline (approximately 840 kilometres) and ICC was to be responsible for the construction of the remaining section of the pipeline (approximately 620 kilometres). Saipem, through the joint venture project management team, was to provide overall co-ordination of the project and to make available to ICC its experience in industrial relations and labour acquisition and, as necessary and reasonable, technical expertise. Subject to the conclusion of the joint venture agreement, Saipem SpA was willing to assign its forthcoming contract with SECWA for the construction of the northern section to the Saipem/ICC joint venture. The basis of contract pricing for the central and southern sections was agreed to be the tendered rates of Saipem SpA for the northern section, as adjusted for technical and geographical variances. It was acknowledged that the current pipeline construction

schedule required finalisation of contract prices for the central and southern pipeline sections by 31 July 1982. It was contemplated that orders for the construction contracts would be placed during August.

3.11.10 By a letter dated 19 July 1982, SECWA gave an undertaking to Saipem that, in the event of a failure of the joint venture to conclude a workable contract with SECWA, ICC would not be invited to tender against Saipem for any part of the pipeline construction works. Saipem had sought this assurance by reason of the need to provide to ICC under the joint venture agreement commercially sensitive information which was critical to the tendering process. The undertaking was given on the understanding that Saipem would continue to use its best endeavours towards the joint venturers' reaching a firm contractual arrangement with SECWA.

3.11.11 Mr Kirkwood responded further to Mr Jones' concerns by a telex dated 20 July 1982, informing Mr Jones that he had signed the joint venture agreement with Saipem and ICC. He went on to say:

"I have signed agreement with Saipem and ICC on 19th July on the understanding:

- (A) from our telephone conversations together that this was your wish and had your approval
- (B) that my action had been cleared by the Premier following my meeting with him at your request
- (C) was necessary if negotiations between Saipem and ICC are to proceed on schedule.

Please know that I am very mindful of all of the sensitive issues which you have raised and if the above statements are not consistent with your wishes and understanding I would be grateful if you would advise by telex as it would be essential to inform both companies immediately. Also, the members of the Commission supported my action on the basis that the above statements are correct."

3.11.12 Mr Kirkwood sent another telex on 22 July 1982, in which he referred to telexes from Mr Jones on 19 July and on 20 July. Attempts by the Commission to locate a telex from Mr Jones dated 20 July have not been successful. In his evidence,

Mr Jones said that he had become aware that the joint venture agreement with ICC and Saipem had been signed only on his return to Australia early in August. Despite Mr Kirkwood's telex of 20 July, and although he agreed that Mr Kirkwood had discussed the signing of the agreement with him, Mr Jones could not specifically recall having given permission for Mr Kirkwood to sign the agreement. He did, however, accede to a suggestion that, given he was overseas, had several matters to deal with, and was possibly under pressure from Mr Kirkwood, he may well have given his assent to the agreement. Mr Jones conceded that, while he could not exactly recall receiving the telex, he thought that it reflected his sentiments.

3.11.13 In his telex, Mr Kirkwood acknowledged the concerns expressed by Mr Jones on 19 July and stated that:

"I believe we have both been aware from the earliest days of these initiatives that we would have difficulty reaching the stage where there could be a final commitment to the smelter by the time it would be necessary to commit a contract for the pipeline. That position is unchanged. Again I believe that this will be an issue which needs to be addressed by Cabinet but it may well be considered sufficient depending upon the progress made with smelter negotiations between now and mid August for there to be a commitment to the pipeline with the Koreans in advance of the smelter."

Mr Jones accepted the accuracy of that statement, although he added that it did not prevent the continuation of efforts to achieve a final commitment by the Koreans. Mr Kirkwood also said in his telex:

"You will realise that in the various documents prepared here at the Commission on these initiatives that we have always put the matter of commitment to the smelter and power station as a condition for the pipeline involvement of the Koreans. The Korean involvement in the pipeline is only being considered because it seems to be a necessary part of the Korean conditions for mounting a smelter project."

In all the circumstances, we have reached the conclusion that Mr Jones approved the execution of the agreement dated 15 July, albeit with some reluctance. His approval is a further demonstration of the difficult position in which the Minister and SECWA were placed, being anxious to secure the construction of a smelter, but being unable to obtain a satisfactory commitment from ICC and the Government of the Republic of Korea that

the project would go ahead. The involvement of ICC in the pipeline, it is clear, was considered only because it was effectively a condition of ICC's mounting a smelter project.

3.11.14 On 22 July 1982, Mr Mensaros, as Acting Minister, signed a Cabinet submission which had been prepared by Mr Kirkwood and which, according to his telex of 22 July 1982, he had redrafted, endeavouring to take into account the concern of Mr Jones that the first draft "implied too much commitment by the Government to the ICC involvement and to the Saipem/ICC joint venture". The submission provided a fair summary of the situation which existed at the time. It stated, *inter alia*:

"In order that everything can proceed with minimum delay, it is necessary to proceed now, without waiting for a final decision on the smelter, to negotiations (but not to a final commitment) which are required to involve ICC in a joint venture for the pipeline construction, and so that the basis for negotiation of a contract price can be firmly established.

Consequently a decision in principle by the Government is required now on the involvement of the Korean Group in the pipeline construction contracts."

On the basis that no formal commitment would be given until its approval had been obtained, Cabinet noted progress in negotiations, endorsed in principle the action being taken to negotiate a joint venture between Saipem and ICC, and noted that final approval of the pipeline arrangement would be referred back to Cabinet with a report on progress as to the smelter and power station projects.

3.11.15 Mr Jones expressed his anxiety about the lack of commitment by the Koreans in a letter dated 26 July 1982 to Mr Mensaros. Mr Jones was still overseas at the time. The letter followed a telephone conversation with Mr Mensaros. In his letter, he gave two reasons for his "hesitation". They were the need to ensure that both the Government and SECWA were seen to be maintaining the credibility of the tender system, which had already been criticised within Western Australia in relation to the pipeline project, and the fact that the Government and SECWA would be making commitments to ICC without adequate guarantees of the Korean commitment to the smelter and power station projects, which were the principal considerations for the Government. Mr Jones said his concerns were heightened following a meeting with Citibank, in which the bank indicated that it saw little chance of a smelter and power

station on the basis then envisaged, and that it was recommending a financing package involving 95% Korean equity and 5% Alcoa equity. This was quite different from the original understanding, and it was not something, Mr Jones wrote, which they would accept. It was certainly not acceptable to ICC, which later sought to interest the Reynolds Metals Company in the smelter project. Mr Jones said he would not like to see Cabinet give an unconditional approval until one or two other issues had been clarified. It is apparent from this letter, and from the other documentation, that Mr Kirkwood and not Mr Jones had been the main driving force behind the move to have the agreement executed, notwithstanding the desired commitment had not been forthcoming. Mr Jones was always reluctant to take this step, and had to be persuaded by Mr Kirkwood to do so.

3.11.16           The contract prices for the central and southern sections were agreed at a meeting between representatives of Fluor Maunsell, SECWA, ICC and Saipem on 29 July 1982. It seems that ICC initially offered to construct the central section for \$75.77 million, an offer which had been rejected by Fluor Maunsell. ICC then offered \$72 million, which had also been rejected. Fluor Maunsell suggested \$71.15 million as being a reasonable figure, based on the northern section rates. ICC sought to justify its price on the basis of extra costs for employee training, depreciation on new equipment and lower production rates. The parties eventually agreed on a price of \$71.5 million for the central section. Agreement was reached on a price of \$38,496,500 for the southern section. Fluor Maunsell had been closely involved in the negotiation of prices and also in the joint venturers' planning and estimating. On the same day, SECWA formally notified Saipem that the Commission had approved the placing of the contract for the northern section of the pipeline with it, subject to the approval of the Government. Pending final Government approval of the contract, SECWA requested that Saipem confirm the extension of the validity of its tender to 31 August 1982. SECWA requested Saipem to explore the prospect of a joint venture with ICC for the construction of the entire pipeline "and make its best endeavours to establish an arrangement satisfactory to the Joint Venture Partners, the Commission and the Government". The assistance of Fluor Maunsell was proffered to provide any assistance which it might require. Reference was also made to a letter which SECWA proposed to send to unsuccessful tenderers, for the purpose of clearing the way for contact between the Saipem/ICC joint venture and prospective sub-contractors within the pipeline industry, with a view to obtaining the most competitive pricing and a maximum involvement of Western Australian based sub-contractors.

3.11.17 A letter was sent to each of the unsuccessful tenderers for the northern section on 3 August 1982, advising it of the success of Saipem in obtaining the contract, that company having offered the lowest conforming tender by an experienced contractor. The letter then advised that the Government had accepted a recommendation by SECWA that Saipem should proceed with negotiations on the possibility of a joint venture with ICC. If a satisfactory arrangement, acceptable to the Government, could be negotiated, the joint venture would be responsible for the construction of the entire pipeline, based on the successful offer for the northern section.

3.11.18 A formal joint venture agreement was executed by Saipem and ICC on 6 August 1982. Under that agreement, Saipem and ICC formed a joint venture for the construction of the central and southern sections of the pipeline, with ICC being responsible for the construction of the central section and Saipem being responsible for the construction of the southern section. If Saipem were to be awarded the northern section, it undertook, with the approval of SECWA, to assign that contract to the joint venture. The agreement provided that both parties were to be jointly and severally liable to SECWA for the due and proper performance of the contract, although each party was to be considered an independent contractor in relation to the other, and was to be solely responsible for the complete, proper and timely performance of its portion of the project. A party incurring liability for a portion of the pipeline which was not its portion under the agreement was entitled to an indemnity from the other party. Saipem was required by the agreement to appoint the project director.

### **3.12 The adjustments to the northern and central sections of the pipeline and the cost implications of the joint venture arrangement**

3.12.1 At a meeting on 5 July 1982 between representatives of SECWA, ICC and Fluor Maunsell, SECWA requested Fluor Maunsell to examine whether it was possible to extend the central section by 100 kilometres either in a northerly or in a southerly direction. According to Mr Morrow, who was present at the meetings representing Fluor Maunsell, the suggestion had come from ICC because, as a matter of honour, it desired to secure a contract for one half of the total length of the pipeline, not wishing to be seen as the junior partner in the joint venture. ICC appeared to be unrelenting in its demands in this regard. Pressure to agree to such an arrangement was also applied to SECWA by the Korean Government. Initially, Fluor Maunsell was opposed to any adjustment to the three sections, having a particular concern as to time

and a continuing doubt as to ICC's ability to perform. It was, however, later decided to excise the southernmost 100 kilometres of the northern section and to add them to the central section. ICC would then commence work at the former junction of the central and northern sections and complete the original central section, before moving back to complete the added portion. This arrangement had the advantage that, if ICC did not perform according to schedule, then the transferred portion could be reassigned to Saipem under the umbrella of the joint venture. The arrangement had the disadvantage of increasing the overall cost of the pipeline.

3.12.2 Mr Miller explained that Saipem was paid compensation as a consequence of the northern section having been reduced after its tender had been lodged with SECWA. The tender had been for a 761 kilometre length of pipeline at a designated rate per linear metre. There were certain fixed costs in setting up a construction spread, including the cost of the mobilisation of equipment and setting up camp, which had to be incurred irrespective of the length of pipeline to be constructed. Furthermore, it was accepted that the final 100 kilometres of the original northern section was where maximum profit would be achieved by the contractor, because its construction crew would then be working at their greatest efficiency, and the ground was very good for constructing the pipeline.

3.12.3 SECWA and Fluor Maunsell recognised that, under the joint venture arrangements, Saipem was contributing heavily to the success of the pipeline as a whole. Within SECWA, ICC's demonstrable lack of experience in major pipeline construction remained a serious concern. A management services agreement was therefore negotiated, under which key personnel from Saipem SpA's Australian and Italian offices would commit their time and efforts as required to ensure the successful completion of the pipeline.

3.12.4 Although considerable efforts had been, and were being, made to secure ICC participation in the gas pipeline project, there was no concession forthcoming from the Korean Government. On 24 August 1982, Mr Kirkwood wrote to Dr Jae-Ik Kim, referring to the current position with each of the three projects. The letter stated:

"The Energy Commission and the Western Australian Government have shown their resolve to succeed with the overall Korea-Western Australian initiatives by keeping maximum effort behind all three projects.

Prior to making a firm commitment with the ICC/Saipem Joint Venture for the pipeline project in September, 1982 the Western Australian Government would seek some assurances from the Korean Government, that the Kukje/ICC smelter and power plant initiatives continue to have your strong support and that the next phase of the smelter project which is the detailed engineering and environmental studies would proceed.

All those involved in the three development projects have shown considerable application and dedication to achieving early resolution of the complex matters to allow these important projects to be committed. It is important that the Korean and Western Australian Governments indicate their mutual support for the work in progress if the common objective of both Governments is to be achieved."

3.12.5 Mr Jones wrote in similar terms to Mr Joon-Sung Kim, the Deputy Prime Minister of the Republic of Korea, and to Mr Suk-Joon Suh, Minister of Commerce and Industry. He emphasised the importance of securing an indication of continuing commitment to the smelter and power station projects by reason of the imminent decision regarding the gas pipeline project. He also wrote to Mr Yang on the same day, enclosing copies of his letters to the Deputy Prime Minister and Minister of Commerce and Industry. He emphasised his Government's concern that it should have further assurances from the Korean Minister.

3.12.6 There is no evidence of any response from the Korean Ministers. Mr Yang, however, responded to Mr Jones by letter dated 23 September 1982, in which he said that Alcoa's pre-feasibility study for the proposed smelter had been received and reviewed, and that it had been the intention of Kukje/ICC to complete the preliminary commercial, engineering and financial feasibility studies of the power station and smelter initiatives before the Western Australian Government made a firm commitment to the Saipem/ICC joint venture. But, he said, those studies had proven to be complex and this had led to unavoidable delays in finalising its concept of these projects. He gave his personal assurance "of the firm commitment of Kukje/ICC to our aluminium smelter project with significant Korean equity located in Western Australia and supplied by electricity at competitive power prices from the proposed Bunbury power plant". As to the Korean Government's position, Mr Yang wrote:

"I believe also that, although the Government of the Republic of Korea has yet to see the formal ICC proposal for the smelter

project, the Korean Government has indicated its support for the work in progress and maintains a firm commitment to the projects."

Mr Yang assured Mr Jones that Kukje/ICC intended to proceed with a full engineering, environmental and financial feasibility study for the smelter as soon as favourable Korean Government market guidelines were established. The Government and SECWA appeared to be no closer to receiving the written assurances which they had long been seeking from the Korean Government, and time was running out to let the pipeline contracts for the central and southern sections.

3.12.7 On 20 September 1982, Mr Jones made a submission to Cabinet for its approval to seek the Executive Council's approval to the award of the contract for the construction of the northern section of the pipeline to Saipem SpA, through its Australian subsidiary, Saipem. Cabinet was reminded that a prerequisite to commencing the construction of the pipeline had been an agreement between SECWA and Alcoa on their gas sales contract. The stage had, however, then been reached, it was said, where the draft Alcoa gas sales contract could have been executed by SECWA. It was accordingly necessary to proceed with the pipeline construction contracts as quickly as possible to achieve the earliest possible completion of the pipeline, and hence to facilitate the sales of the early gas prior to the JVP's take or pay conditions coming into force. The awarding of the contract had previously been withheld until agreement in principle between Saipem SpA and ICC on a suitable joint venture for the balance of the project could be achieved. The pipeline was already behind programme to secure early gas in the second half of 1984, and further delays would reduce the significant benefits of early gas sales to both SECWA and the JVP. Mr Jones said that "Cabinet is assured that the placement of an order with the Saipem/ICC joint venture for the balance of the pipeline construction is conditional on the Government being satisfied that satisfactory progress has been made with the Korean Government negotiations for the aluminium smelter and power station projects". Cabinet gave its approval as sought, and noted the progress made in the negotiations for the joint venture.

3.12.8 By a memorandum dated 12 October 1982, the Premier reminded Mr Jones that, in his minute to Cabinet, he had stated that the contract for the northern section was not to be awarded until the contract for the supply of gas to Alcoa had been finalised. As it was his understanding that the contract had not been finalised, he sought advice on the current state of negotiations before submitting the papers to Executive Council. Mr Jones responded by a memorandum dated 19 October 1982, informing the

Premier that he had held discussions with the Managing Director of Alcoa, who had confirmed Alcoa's original position and commitment.

3.12.9 Mr Jones made a further submission to Cabinet, dated 22 October 1982, seeking its endorsement of SECWA's recommendation that Executive Council approval be sought for:

- (a) the novation of the contract for the northern section in favour of the joint venture, the value of the contract being \$84.7 million;
- (b) the awarding of a contract to the Saipem/ICC Joint Venture for the central and southern sections, at an estimated value in May 1982 dollars of \$122,900,499; and
- (c) the management services agreement between SECWA and Saipem.

3.12.10 Cabinet was informed of the essential terms of the joint venture agreement and of the management services agreement. It was pointed out that the fee of \$6 million payable to Saipem under the management services agreement represented approximately 3% of the total cost of construction of the pipeline, and less than 1% of the estimated actual cost of the pipeline project. SECWA considered this to be a sound investment by way of insurance for the timely completion of the project.

3.12.11 It was also pointed out to Cabinet that, in order to achieve a division of work and responsibility acceptable to both Saipem and ICC, it had been necessary to reallocate 100 kilometres of the pipeline construction from the northern section to the central section, so that it became the responsibility of ICC. This reallocation resulted in an adjustment in the costs which had previously been determined for the former northern and central sections. To suit the construction plan in respect of stockpile logistics and weather, ICC had agreed to commence work at the 761 kilometre mark and to work south to the 1,281 kilometre mark. If ICC completed this part of the central section on schedule, SECWA would have to bear the actual cost of relocating the company's labour and equipment to the northern end of the central section in order to allow ICC to complete the first 100 kilometres of that section. Cabinet was informed that the cost of relocation, estimated at \$4 million, was not included in the price to be paid to ICC, but formed "part of the detailed overall cost estimates". Attention was drawn to a special condition in the construction contract allowing SECWA to review the

performance of ICC against the construction programme and to reallocate the first 100 kilometres of the central section to Saipem if ICC's progress was deficient. The submission also stated that Fluor Maunsell was satisfied that the proposal submitted by the joint venturers for the construction of the central and southern sections was at rates consistent with those tendered by Saipem SpA on a competitive basis for the northern section, taking into account differing characteristics between the sections. The joint venture proposal was also in accordance with the original budget estimates prepared by Fluor Maunsell.

3.12.12 Attached to the submission was a progress report on the smelter and power station project prepared by Mr Kirkwood. The submission summarised the report by stating that the commitment by the Korean Government and by the Kukje/ICC Group was very strong and that there were good prospects that the group would press ahead with a full engineering, environmental and financial feasibility study for the aluminium smelter in the near future, as soon as market guidelines for the product from the smelter had been established by the Korean Government. The submission continued:

"The stage has now been reached when contracts for the pipeline must be awarded if there is to be a reasonable prospect of completion on schedule and of taking 'early gas' prior to the commencement date for gas supply under the North West Shelf Joint Venture project gas contract ... I consider that sufficient progress has been made with the negotiations for the proposed aluminium smelter and power station that Cabinet may consider it appropriate to proceed with the awarding of the contracts to the Saipem Australia Pty Ltd/ICC Construction Co Ltd Joint Venture."

3.12.13 Mr Kirkwood's report noted that Mr Yang and Mr Kim, the Senior Executive Vice President of ICC, had met the Korean Minister for Industry and Commerce on 28 September 1982. The Minister, it was asserted, had assured Mr Yang of the support of the Korean Government for the Western Australian proposal and had said that the Government of the Republic of Korea would consider no other smelter proposal unless or until ICC formally withdrew its smelter/power station proposal from Government consideration. Mr Kirkwood also reported that, on 18 October 1982, the Ministry of Industry and Commerce had formally invited Kukje/ICC to submit its proposal for the Western Australian smelter. This invitation was, he said, interpreted by ICC as a significant step towards the firm acceptance by the Ministry of the proposal, and ICC expected a favourable response on guidelines for the marketing of aluminium

metal in Korea and on Government support for the financing of the project around mid-November. In the circumstances, notwithstanding all their efforts, it would appear that SECWA and the Government had made little progress towards securing the written commitment which they had been seeking before committing themselves to ICC's participation in the pipeline construction. The responses to their requests were, on their face, always comforting, but, in the end, they had little substance. At the same time, they certainly were not such as to suggest that the Koreans were not acting in good faith or that construction of an aluminium smelter was unlikely to proceed.

3.12.14 Fluor Maunsell presented a report to SECWA on 22 October 1982 regarding the negotiations for the construction of the central and southern sections of the pipeline. It concluded that the arrangements which had been made should protect SECWA and ensure that the pipeline was completed on time, although it recommended parent company guarantees from the joint venturers. It also recommended acceptance of the joint venture proposals on or before 15 November 1982.

3.12.15 SECWA, at its meeting on 25 October 1982, accepted the Saipem/ICC joint venture tender for the construction of the central and southern sections, to be constructed by ICC and Saipem respectively, at a price of \$80,321,480 for the central section and \$42,658,519 for the southern section. The difference between those amounts and the prices previously agreed and recorded in the notes of the negotiations on 29 July and in the joint venture agreement of 6 August was explained by Mr Miller as being due to escalations of prices and rates, and adjustments to the scope of work in the northern section, on the tender for which the other prices had been based. SECWA also approved the management services agreement with Saipem, and authorised its execution. The meeting noted both the draft variation order reducing the northern section by 100 kilometres and the draft novation agreement transferring the contract for the northern section to the joint venture.

3.12.16 Formal approval for the awarding of the contract for the northern section of the pipeline to Saipem SpA (through Saipem) was granted by Executive Council on 26 October 1982.

3.12.17 Without exception, all of the witnesses were positive that the process of calling for, and assessing, the tenders for the northern section of the pipeline had been conducted in a most proper and professional manner. The documentation fully bears this out.

3.12.18 On 8 November 1982, a memorandum was sent by the Under Treasurer, Mr McCarrey, to the Treasurer (and Premier) regarding Mr Jones' submission to Cabinet seeking approval for the letting of the construction contracts for the central and southern sections of the pipeline. Mr McCarrey questioned an apparent discrepancy of \$10 million in relation to the proposed transfer of 100 kilometres of the northern section from Saipem to ICC and to its possible reallocation back to Saipem if ICC did not perform. He referred to his understanding that the matter was to be raised with Saipem with a view to renegotiating the price adjustments on the transfer. Subject to that issue being resolved, he saw no objection to the contracts being let as proposed. As the Government had announced that the contract for construction of the pipeline was to be let, and as approval had been given to the contract for the northern section, he said he could not see that anything was to be gained by delaying the letting of the remaining contracts, notwithstanding the problems being experienced with the Alcoa gas contract. He noted his understanding that the Minister was hopeful that the issues in the proposed gas contract with Alcoa could be resolved satisfactorily during that week.

3.12.19 The suggested discrepancy of \$10 million raised by Mr McCarrey appears to have been arrived at on the basis that if the 100 kilometres previously transferred from the northern section were reassigned to Saipem in consequence of ICC's default, then under the contract Saipem was entitled to payment of \$13.1 million for that work. Saipem's contract price for the reduced northern section was \$81.5 million. Accordingly, if Saipem constructed the whole of the original northern section, it would be entitled to a total of \$94.6 million, in comparison with its original tender price of \$84.7 million for that length of pipeline. It was therefore reasoned that, under the new arrangement, in the event of default by ICC, Saipem would receive nearly \$10 million more than if it had performed the work in accordance with its original tender. Mr McCarrey was also concerned at the possibility of a conflict of interest, in that Saipem was being given \$6 million as a management fee to supervise ICC and stood to gain a further \$10 million if ICC defaulted. He believed that this should be recognised.

3.12.20 On 8 November 1982, Cabinet approved the seeking of Executive Council approval for the novation of the contract for the northern section of the pipeline, for the awarding of the central and southern sections of the pipeline to the Saipem/ICC Joint Venture and for the management services agreement between Saipem and SECWA, as sought in the Cabinet submission, subject, however, to the renegotiation of

the price adjustments on the transfer of the 100 kilometres of pipeline at the southern end of the northern section.

3.12.21 In the submission of 22 October 1982, Cabinet had been advised that, if ICC completed the initial 520 kilometres of the central section on schedule, it would have to relocate, at an estimated cost of \$4 million, from the southern end of that section north to complete the 100 kilometres at the top of that section. In addition, Cabinet had been informed of the management services agreement with Saipem, which provided for the use of Saipem's personnel, at a cost of \$6 million, to ensure the successful completion of construction of the pipeline. Accordingly, Cabinet had been advised of two items of cost totalling \$10 million. Furthermore, the memorandum from the Under Treasurer which was also before Cabinet referred to the cost of the reallocation of the 100 kilometre length of the pipeline as being approximately \$10 million. This sum did not include the payment to Saipem under the management services agreement amounting to \$6 million.

3.12.22 Mr Jones was given extensive information on costing in a memorandum from Mr Hayes dated 17 November 1982. He was advised that agreement had been reached on the cost of the central and southern sections, for which the joint venture had submitted a formal tender, quoting the agreed prices. Mr Hayes explained that the basis of the tendered prices was Saipem SpA's competitively tendered price for the northern section, adjusted for particular variations. A number of other details were explained. Of particular importance to Mr Jones, however, was the conclusion that the total cost of construction of the three sections had been estimated by Fluor Maunsell at \$222,378,273, but that the total of the tender for the northern section, plus the tender by the joint venture for the central and southern sections, was \$204,478,068, which was approximately \$18 million under the budget.

3.12.23 Mr Jones said in evidence that, having received the report from Mr Hayes, it seemed to him that, under the negotiated contract with the joint venture, the project was coming in \$18 million under budget. He did not address the issue of whether it might have come in further under budget had it gone to competitive tender. It is to be noted that the \$4 million relocation fee and the \$6 million management fee were not included in the calculations showing the negotiated contract coming in \$18 million under budget, since that figure represented only the amounts tendered for construction costs.

3.12.24 On 17 November 1982, Mr Kingsmill forwarded a memorandum to Mr Jones stating that officers of SECWA had met the Under Treasurer on 15 November 1982 to discuss the concern raised in his memorandum and he believed that the explanations were to the Under Treasurer's satisfaction. The details discussed with the Under Treasurer were provided in an attachment, which explained that an additional \$8.111 million would be incurred if ICC completed the contract, including the extra 100 kilometres, that cost comprising the estimated \$4 million relocation allowance to ICC and a recoupment of overhead expenses to Saipem amounting to \$4.111 million. Mr Kingsmill noted that SECWA considered that, as the construction of the pipeline progressed, there would be opportunities to negotiate to obtain the best result possible in terms of the cost of the construction and the time for completion. In the end, it should be noted, the relocation cost amounted to \$1.524 million, substantially less than the estimated \$4 million. In view of what he described as the urgent need to obtain Executive Council approval to the letting of the contract, Mr Kingsmill prepared a minute to the Premier, seeking his approval for the contract to be referred to a special meeting of Executive Council. At that time, both the Premier and Mr Jones were about to leave for Korea and it is likely that Mr Jones did not see the memorandum and the Premier did not see the minute.

3.12.25 Mr Jones' private secretary, in a memorandum dated 22 November 1982, informed him that, in the absence of the Under Treasurer, he had discussed the question of Executive Council's approval of the contract for the central and southern sections of the pipeline with the Acting Under Treasurer. The Acting Under Treasurer had told him that Treasury was not prepared to support the Executive Council minute, as there was an extra \$10 million "for the inclusion of the Koreans in the pipeline". He felt that Cabinet should be made fully aware of the circumstances surrounding this amount. The suggestion was that a Cabinet minute should be drafted to go to Cabinet which was meeting that day. The Minister's private secretary, in the absence of Mr Jones, and after consultation with Mr Kingsmill, decided that it was preferable to defer the matter.

3.12.26 It appears that at this time both the Premier and Mr Jones were in Tokyo. At the Premier's request, Mr Mensaros, as Acting Minister for Fuel and Energy, initialled the Executive Council minute, and on 24 November 1982, Executive Council gave approval to SECWA to enter into a contract with the Saipem/ICC joint venture for the construction of the central and southern sections of the pipeline for a nominal sum of \$122,979,999.

3.12.27 There may well have been misunderstandings between SECWA and Treasury in relation to the position. Mr Kingsmill, in a memorandum dated 26 November 1982, originated by Mr W C Heron, set out Mr Heron's conviction that Mr McCarrey had expressed a clear understanding of the interrelationship between the costing of the various sections and the overall effect of ICC being introduced into the joint venture. The memorandum noted that if Saipem, and not ICC, should complete the 100 kilometre section, SECWA would avoid the relocation cost of \$4 million and it would not need to reimburse Saipem for unrecovered overheads totalling approximately \$4.11 million. The amount to be paid to Saipem for this section would be the same as would have been paid to ICC, but would be approximately \$4 million higher than if the work had been done at the rates for the original northern section. The latter amount was not put before Cabinet because, at the relevant time, no variation had been concluded. The memorandum pointed out that Treasury was in error in believing that the arrangements with ICC involved an additional cost of \$10 million, since the price negotiated with ICC had always been based on a 621 kilometre spread, comprising the central section and 100 kilometres of the original northern section and "it was not possible to do a simple mathematical derivation of the effect of the cost of the additional 100 kilometres transferred from the northern section to the central section". Mr Kingsmill explained that he had tried to contact the Under Treasurer before the matter went to Executive Council to obtain his assurance that he had in fact agreed with the proposal, but he had been unable to contact him. The fact that both Mr Jones and the Under Treasurer were absent at the critical time appears to have been productive of difficulties.

3.12.28 In the circumstances, it appears that when, on 8 November 1982, Cabinet gave its conditional approval to the transaction, it was aware of the management services fee of \$6 million and it was aware of the issue raised by the Under Treasurer regarding what he saw as an additional cost of approximately \$10 million which would be incurred in the event of ICC's completing the additional 100 kilometres. The net difference between the estimated cost of ICC's completing this portion of the pipeline and the cost if Saipem did so would, in fact, have been \$8.111 million. As it turned out, of course, ICC did complete the 100 kilometre section, and the relocation cost was \$2.476 million less than estimated.

3.12.29 A number of witnesses provided estimates of the additional cost of proceeding by way of negotiated contract rather than going to competitive tender. By far the highest was Mr Van Kann's "gut feeling" of \$40 million. He was unable,

however, to offer any justification for that figure, and having regard to his lack of expertise in this area in comparison with the experience of other witnesses, whose estimates were less than half his estimate, we are quite unable to attach any significance to his evidence on this issue. His responsibility was essentially to deal with contractual documents. He was not a qualified engineer and he was not an estimator.

3.12.30 Mr G F Brayshaw, a chartered accountant, produced an estimate of \$18.486 million, based principally on records made by Fluor Maunsell at the relevant time. That figure included the \$4 million relocation expense, the \$6 million management fee, \$5.704 million as allowances made to ICC in the negotiation process which, in Mr Brayshaw's opinion, would not have appeared in a competitive tender, and \$2.782 million, being the difference between the negotiated price for the central and northern sections on the one hand and, on the other, the tendered price for the northern section plus Fluor Maunsell's estimated price for the central section. The \$5.704 million comprised allowances for a slower production rate, increased equipment costs and employee training. Mr Brayshaw rightly observed that any estimate to be made of the cost of including ICC at a negotiated price, rather than as a result of competitive tendering, without the benefit of testing the tendering process, is speculative and hypothetical. There was a difference of \$1.4 million between Mr Brayshaw's estimate and that of Mr Miller relating to allowances for equipment cost and employee training, Mr Miller attributing less of these costs to ICC's involvement. To the extent to which there is a difference between the amounts allowed by Mr Brayshaw and those allowed by Mr Miller, having regard to Mr Miller's knowledge and experience in the field, we prefer his evidence. Furthermore, as already noted, the relocation cost actually reimbursed was \$1.524 million, being \$2.476 million less than the original estimate.

3.12.31 Mr Treloar concluded that the additional cost of including ICC was \$16 million, comprising the \$6 million management fee, \$1.52 million, being the actual relocation costs, \$2.78 million representing an assessment of the cost of transferring 100 kilometres of pipeline from the northern section to the central section, and \$5.7 million representing allowances in the price for the central section due to ICC's lesser experience in pipeline construction than that of Saipem, such as allowances for a lower production rate, new equipment and employee training. Mr Treloar also stressed that any such figure was speculative, due to the fact that it was not known what price would have been tendered in a competitive tender.

3.12.32 While recognising that it is not possible to estimate precisely the cost as it would have appeared when the negotiated prices were agreed to, we accept the range of \$12.5 million to \$15.5 million suggested by Mr Miller. Mr Miller has very extensive experience in the pipeline industry, having worked in it since 1955. As the manager of construction for the pipeline project, he had a clear understanding of the costing issues involved. His estimate included the cost of relocation, the \$6 million management fee and the difference between the negotiated price sections (including the \$4.111 million recoupment of overhead expenses) and the Fluor Maunsell estimates. He estimated that the additional equipment cost and the cost of employee training resulting from ICC's involvement had amounted to \$2.7 million. It is to be noted that no one giving evidence on the matter made any allowance for the saving effected by not going to tender. Such saving was not insignificant.

3.12.33 In response to a question whether it would have made any difference to the Government's decision if it had known that the cost was about \$16 million to \$20 million, the question having assumed that Cabinet would have understood that the cost was only \$10 million, Mr Jones replied that the Government would have been more concerned as to whether SECWA was satisfied that Fluor Maunsell had recommended this course of action and as to how the additional cost stood in relation to budget estimates, rather than with the actual additional dollar cost. He said:

"Provided Cabinet was satisfied that the recommendation came to Cabinet or to the Government from SECWA and that it was supported by its own Commission, which had private citizens on it, and was adequately supported in a billion dollar project, no, Cabinet would have accepted the recommendation which came from SECWA."

We have no reason to doubt that this would have been so, and that it would have been a reasonable view.

3.12.34 It is apparent that detailed consideration was not given to the likely additional cost of the negotiated contract when compared with the competitive tendering process, but certainly Mr Jones was informed that the ultimate cost was less than the budget, which had been based on estimates of future tenders. The evidence before us established a likely additional cost of \$12.5 million to \$16 million. The issue of whether to proceed by tender or negotiated contract was effectively foreclosed from a

relatively early stage in the negotiations, and accordingly it seems that no one perceived the need to engage in a balancing exercise between the two options which would have brought into focus the likely additional cost of proceeding by way of a negotiated contract. It is highly unlikely that Cabinet would have declined to proceed if it had been clearly advised that an additional cost of \$16 million was involved, having regard to the cost of the total project and to the benefits which an aluminium smelter was capable of bringing to the State. There had been placed before it over the preceding months a very considerable amount of information regarding the importance for the State of securing the smelter project and also with respect to the negotiations which were taking place concerning the pipeline. No doubt the details of the cost of ICC's participation could have been placed before Cabinet in a far more comprehensible form; but it was made quite clear that there was a substantial cost associated with the proposal, which could have been up to \$16 million. In the circumstances, we are satisfied that Cabinet had before it sufficient information to enable it to make a proper decision on ICC's participation in the pipeline contract.

### **3.13 The completion of the contractual arrangements with the Saipem/ICC joint venture and the completion of the pipeline**

3.13.1 The management services agreement was executed by SECWA, Saipem and Saipem SpA on 10 December 1982. Under the agreement, Saipem was to provide services for the construction of the pipeline in the areas of overall project management, industrial relations, labour acquisition, equipment selection and expertise relating to all technical aspects of the pipeline construction. In return, Saipem was to receive \$6 million, inclusive of all costs associated with the provision of the services. In consideration of this fee, Saipem SpA undertook to provide various resources to its subsidiary, Saipem. The operation of the agreement was subject to the award of the contract for the central and southern sections of the pipeline to the Saipem/ICC joint venture.

3.13.2 SECWA awarded the construction contracts for the central and southern sections of the pipeline to the Saipem/ICC joint venture by letter dated 15 December 1982. The contract sum was \$80,321,480 for the central section and \$42,658,519 for the southern section, making a total of \$122,979,999.

3.13.3 The contract awarded to Saipem SpA for the construction of the northern section was varied in accordance with the arrangements which had been made. The

variation order, dated 15 December 1982, provided that, if the 100 kilometre stretch were constructed by another contractor, SECWA would increase the price per linear metre payable to Saipem SpA for the remaining 661.2 kilometres. If Saipem SpA were to construct the additional 100 kilometres by reason of the reallocation provision, it was to be paid at differing rates per linear metre for the first 661.2 kilometres and for the southern 100 kilometres. Notice of the reallocation of the 100 kilometres to Saipem SpA had to be given no later than 30 June 1983.

3.13.4 On 29 December 1982, the Saipem/ICC joint venture agreement was varied to accommodate the reallocation of the 100 kilometres section and to meet certain additional requirements of SECWA.

3.13.5 The novation of the contract for the northern section in favour of the Saipem/ICC joint venture was effected by an agreement dated 31 December 1982. The result was to create one indivisible contract between the joint venture and SECWA for the construction of the entire pipeline, although, under the joint venture agreement, each of ICC and Saipem was primarily concerned with its own separate section. On the same day, Saipem SpA executed in favour of SECWA a parent company guarantee, guaranteeing the performance, observation and discharge by its subsidiary, Saipem, of each and every obligation and liability to SECWA under the pipeline contract.

3.13.6 The pipeline contract was completed successfully within time and within budget. In the process, a world welding record was established for the number of welds per day without any reduction in quality. The result was a complete justification of the precautionary steps taken by SECWA with the assistance of Fluor Maunsell.

### **3.14 Subsequent developments**

3.14.1 Negotiations on the smelter and power station projects continued after the election of the Burke Government in February 1983. Indeed, in March 1983, the Deputy Premier, Mr Mal Bryce, and the Minister for Fuel and Energy, Mr Peter Dowding, visited Korea to further those projects. An aluminium smelter taskforce, consisting of personnel from a number of government departments, was established in March to handle future negotiations. It was chaired by Mr Kirkwood and was responsible directly to the Minister. On 20 May 1983, Mr Burke wrote to Mr Sang-chul Suh, the Korean Minister of Energy and Resources, reminding him of the change of Government in Western Australia and reaffirming the continued strong support of the

Western Australian Government for the ICC initiatives in this State. A similar letter was sent on the same day to Mr Dong-whie Kim, Minister for Commerce and Industry. There is nothing to suggest that the Korean Government was not acting in good faith, having gained a share in the pipeline contract.

3.14.2 In a letter from Mr Burke to the Prime Minister, Mr R J L Hawke, dated 3 May 1983, Mr Burke reported that the State Government was confident of the good intentions of the Korean Government and the Kukje/ICC group towards pursuing the smelter development in Western Australia, and that there had been assurances from the Korean Government that the aluminium produced from a soundly based smelter in Western Australia would have preferred access to the Korean metal market. In a brief for the Premier, the taskforce also continued to be optimistic, while at the same time pointing out that it considered the Korean involvement critical if there were to be a smelter project in the State by 1987.

3.14.3 While the smelter and power station negotiations were pursued with vigour throughout 1983 and into 1984, the projects foundered towards the end of 1984 due to financial difficulties suffered by Kukje and the withdrawal of the Korean Government's support. The assassination attempt at Rangoon Airport in October 1983 on the President of the Republic of Korea, when he was on his way to Perth for discussions with the Government regarding the smelter, resulting in his immediate return to Korea, was unquestionably a major setback.

### **3.15 The Kingsmill and Miller incidents**

3.15.1 The Commission has heard evidence of two instances of what could be characterised as improper conduct.

3.15.2 Mr Kingsmill, who was responsible at the time for the funding of the pipeline project, gave evidence that, as he expressed it, "just about every bank in the world made a call". One of the approaches made to him was improper. He described it in the following terms:

"The man, in very veiled terms, made it very clear to me that if I was able to give them any business that there would be considerable advantages coming to me. I immediately asked him to leave my office ..."

3.15.3 Mr Kingsmill spoke with Mr Bob Boylen in Treasury, in the absence of the Under Treasurer, and they agreed that no further business would be done with the bank or the person concerned. It is unnecessary to identify them. It was an isolated incident and the person in question is not a resident of Australia. It was clearly an improper approach which met the immediate rebuff it deserved.

3.15.4 In addition, Mr Miller gave evidence of an occasion late in 1983 when an envelope containing money was offered to him by a senior member of Kukje/ICC. Mr Miller rejected the offer and did not take offence. No favour was sought from him, and although construction work was continuing at the time, there were no decisions expected of him which might reasonably account for any desire to secure his favour by this means. Mr Miller thought that the offer might have been associated with Christmas or the forthcoming wedding of his son. He was somewhat inured to this type of situation, because he had previously worked in countries where he believed such conduct was an accepted way of doing business.

3.15.5 Mr Miller reported the matter to Mr Morrow; but it was not an issue about which either of them was particularly concerned and it was not taken any further. Until reminded of it recently, Mr Morrow claimed to have forgotten the incident and there is no evidence to suggest that any similar incident occurred or that the important processes of the assessment of tenders and the negotiation of contracts were in any way compromised by any such conduct. In these circumstances, it was unnecessary for us to pursue the matter any further.

### **3.16 Conclusion**

3.16.1 There was no evidence of impropriety in relation to the contracts for the construction of the pipeline, apart from isolated incidents involving Mr Kingsmill and Mr Miller. With these exceptions, no witness professed knowledge of any impropriety. The concerns expressed by Mr Van Kann as to the additional cost incurred in engaging ICC have been more than adequately answered by the evidence of a number of witnesses, and, in particular, the evidence of Mr Treloar and Mr Miller. There was no evidence of any corruption or of any illegal conduct.

3.16.2 **ICC's involvement.** The additional cost incurred in introducing ICC to the pipeline project was always seen as the price of attracting Korean participation in the construction of an aluminium smelter in Western Australia, with the substantial

benefits which it was capable of conferring, the consumption of surplus gas, the generation of substantial export income and the provision of employment.

3.16.3 The perceived risk of ICC's withdrawing from the project if it were not a participant in the construction of the pipeline was entirely reasonable. In the end, the smelter project came to nothing; but there was no evidence of bad faith by ICC and nothing to indicate that it did not have a genuine desire, at all material times, to establish the smelter and the associated power station. Indeed, it spent substantial money in pursuing this purpose.

3.16.4 **Pipeline tenders.** It is likely that the late Mr Bruce Kirkwood made the decision to include ICC in the list of approved tenderers for the first section of the pipeline in order not to prejudice negotiations between SECWA and ICC over the proposed smelter and power station. While certainly not an improper decision, he should have referred the matter back to SECWA for formal approval.

3.16.5 The tender process for the first section of the pipeline was carried out in a proper and professional manner, and the negotiations in relation to the contracts for the second and third sections were reasonable in the circumstances.

3.16.6 The then Minister for Fuel and Energy, Mr Peter Jones, and SECWA acted reasonably in deciding to negotiate a contract with ICC for the last two sections of the pipeline.

3.16.7 Despite the extra cost of the pipeline because two stages of the three-stage project did not go to tender, the contract came in under budget and on time. The extra cost arising from the participation of ICC was assessed as being between \$12.5 million and \$15.5 million.

3.16.8 **The Kingsmill and Miller incidents.** We have found it unnecessary to pursue two minor cases of impropriety. The first involved an improper approach by an international banking representative who offered money to the Assistant Commissioner at SECWA, Mr Marwood Kingsmill. The offer was rejected and immediately reported to Treasury. The bank and the individual involved were excluded from future dealings with the State.

3.16.9 The second incident involved an offer of money to the construction manager for consulting engineers Fluor Maunsell, Mr R M Miller, during pipeline construction. The offer was refused and reported at the time and did not compromise the assessment of tenders or the negotiation of contracts.

3.16.10 **Further matters.** Finally, reverting to the terms of reference, the Commission reports:

- (a) There are no matters addressed in this chapter which should be referred to an appropriate authority with a view to the institution of criminal proceedings; and
- (b) There are no matters addressed in this chapter which render changes in the law of the State or in administrative or decision-making procedures necessary or desirable in the public interest.

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## **2.1 The term of reference**

2.1.1 The Commissioners are required by their Commission, as affected by the *Royal Commission into Commercial Activities of Government Act 1992*, to inquire and report whether there has been —

- (a) corruption;
- (b) illegal conduct; or
- (c) improper conduct,

by any person or corporation in the affairs, investment decisions and business dealings of the Government of Western Australia or its agencies, instrumentalities and corporations in respect of the natural gas sales agreements entered into by the State Energy Commission of Western Australia for the purchase of natural gas from the North West Shelf Joint and the contracts relating to the Dampier to Perth natural gas pipeline project, and further to report whether —

- (d) any matter should be referred to an appropriate authority with a view to the institution of criminal proceedings; or
- (e) changes in the law of the State, or in administrative or decision making procedures, are necessary or desirable in the public interest.

2.1.2 Separate hearings into this term of reference were heard, one being in relation to the natural gas sales agreements, and the other, the contracts relating to the natural gas pipeline project.

## **2.2 Short history of early exploration of North West Shelf**

2.2.1 In 1963, exploration permits on the North West Shelf were granted to Woodside (Lakes Entrance) Oil NL ("Woodside") and Mid-Eastern Oil NL ("Mid-Eastern"). The permits covered an area of 37 million hectares (367,000 square kilometres), totally sea-covered except for a few coral islands and reefs. By reason of the depth of water over most of the ground covered by the permits, exploration was considered adventurous. Aero-magnetic surveys in 1963 suggested further exploration

was warranted. In 1964, Shell Development (Australia) Pty Ltd ("Shell") and Burmah Oil Co Ltd ("Burmah") were invited by Woodside to form the North West Shelf Joint Venture Participants ("JVP"), and each then acquired a third share of the operator of the project, Bocal Pty Ltd ("Bocal").

2.2.2 In 1967, exploration drilling began on the North West Shelf. In 1971, major gas accumulations were discovered on the North Rankin field which formed part of the permits which Woodside had been granted, indicating large reserves of gas. Bocal caused a feasibility study into the potential production and use of the gas. The studies were concentrated on an export liquid natural gas ("LNG") facility.

2.2.3 Exploration in the area and feasibility studies continued during 1972. In October 1972, the Minister for Fuel, Mr D May, provided preliminary advice to the Cabinet of the Tonkin Labor Government about the importance and implications of the North West Shelf gas discoveries. In a minute to Cabinet dated 27 October 1972, he urged Cabinet to adopt a uniform and united posture against any suggestion that North West Shelf gas be put to any use before the requirements of Western Australia had been fully considered. He emphasised that the future gas needs of the State would be substantial by world standards and that the State's long-term future depended largely on achieving the optimum level of processing mineral resources. That goal could not be reached unless the State had assured supplies of fuel.

2.2.4 The proposed Pilbara Industrial Complex was thought likely to be an enormous gas consumer. In addition, it was noted that the State Electricity Commission of Western Australia ("SECWA") was likely to require large quantities of fuel at the lowest possible cost. Natural gas was seen by the Minister as an important means of sustaining the State in the long term in circumstances where the State was otherwise severely fuel-deficient because, apart from Collie coal, there were no alternative fuel resources of significant size except gas. Mr May, in his advice to Cabinet, also noted that "some appropriate level of gas exports will be necessary to get the project into production as soon as possible".

2.2.5 The alternative he suggested would be to wait for years until the local market grew to a size which would justify the very expensive offshore production facilities. He recommended that Cabinet adopt a cautious attitude to any suggestion of gas exports or sales to other States until the Fuel & Power Commission had completed

a thorough assessment of the State's needs. Cabinet noted this advice on 30 October 1972.

2.2.6 A further minute to Cabinet from the Acting Minister for Fuel, Mr C J Jamieson, dated 15 November 1972, suggested that current estimates of North West Shelf gas reserves were not considered sufficient to meet all State demands as well as LNG export requirements. The minute suggested that export, hopefully, could be kept to a minimum, but appeared necessary in order to develop the gasfields as early as possible. The desirability for the supply of gas to the Pilbara iron-ore producers and processors, and to the populated south-west region of the State, were also noted as issues. Further study by the Fuel & Power Commission was noted as being necessary before any binding commitments relating to the Pilbara development concept were made by or on behalf of Government. It was too early for firm decisions to be taken on these issues. Cabinet noted this advice on 20 November 1972.

2.2.7 Much of the history of the development of the North West Shelf is taken from a document entitled "A Brief for Premier, Hon Brian Burke MLA", prepared apparently by a body known as the Aluminium Smelter Task Force and dated August 1984. The circumstances in which and by whom this document was prepared did not clearly emerge in evidence. Although the history of the document is unclear, the contents of it as to the history of the North West Shelf Project do not appear to be an issue.

2.2.8 Major gas accumulations were discovered at Scott Reef, North Rankin, and Goodwin Fields, in 1971. The latter two fields were in 130 metres of water and at that time no company in the world was producing gas or oil from water of that depth. After the first exploration well on North Rankin indicated large reserves of gas, Bocal appointed Fluor Australia Pty Limited ("Fluor") to conduct a feasibility study into its potential production and use. Bocal concentrated the study on an export LNG facility and the Fluor study showed a project was feasible depending on reserves. Bocal proceeded to appraisal wells in the North Rankin reservoir. Exploration in the area and feasibility studies continued during 1972 and the Angel field was located during that year.

2.2.9 Bocal spent \$3.5 million in 1972/73 on more detailed studies while appraisal wells were being drilled. Several sites for an LNG plant were evaluated. Withnell Bay was favoured. Drilling had indicated sufficient reserves of recoverable gas in three fields in the Dampier sub-basin to supply the estimated Western Australian

market and also to support an LNG plant for exporting LNG to Japan and/or the United States. Bocal was considered virtually ready to begin an LNG project. In that year BP Petroleum Development Australia Pty Ltd ("BP") and California Asiatic Oil Co. ("Cal Asiatic") took up interests in the project.

2.2.10 On 2 December 1972, a Federal Labor Government was elected with Mr E G Whitlam as Prime Minister and Mr R F X Connor as Minister for Minerals and Energy.

2.2.11 In 1973, the new Federal Labor Government declared a policy of purchasing all natural gas production at the wellhead and directly planning and controlling all downstream development activities. That announcement caused the JVP to completely reappraise the project. In conformity with its avowed policy of maximising Australian ownership and control of indigenous resources, the Commonwealth Government established a pipeline authority. Its first meeting was held on 10 October 1973 and it came within the portfolio of Mr Connor. The Authority's basic responsibility was the establishment of a national integrated pipeline to carry petroleum, natural gas, and other hydrocarbons. The concept provided for the eventual linking of all natural gasfields with cities and towns throughout Australia by an interconnected pipeline system.

2.2.12 Sir Charles Court had been Minister for Industrial Development and the North West in the Brand/Court Government from 2 April 1959 until 3 March 1971 when the Labor Government assumed power. Sir Charles became Leader of the Opposition on 5 June 1972 when Sir David Brand retired. Sir Charles said in evidence that, while in Opposition, he kept himself well informed about the political and economic scene in Australia and abroad by having regular contacts with the main developers in Western Australia, their overseas customers and sources of finance. He did this expecting to be returned to office in 1974.

## **2.3 Statutory background**

2.3.1 In 1973, the Federal Government passed the *Seas and Submerged Lands Act 1973* to establish Commonwealth sovereignty over the seabed beyond a baseline roughly corresponding with the low watermark. Previously it had been generally assumed that the Commonwealth's exclusive authority only operated beyond the three-mile limit. The question of sovereignty over offshore waters was debated and the matter

taken to the High Court of Australia to determine whether the Commonwealth or a State had sovereignty in offshore areas: *New South Wales v The Commonwealth* (1976) 135 CLR 337. The Court held that the Commonwealth legislation was valid. Both the Commonwealth and the State of Western Australia had passed Acts entitled *Petroleum (Submerged Lands) Act 1967*. The State Act was eventually repealed by the *Petroleum (Submerged Lands) Act 1982*. Until the passing of the *Seas and Submerged Lands Act 1973*, the administration of the two 1967 Acts had been jointly shared by the State and the Commonwealth in respect of territorial waters beyond the three-mile limit. Under that arrangement, the JVP's exploration permits would normally have been renewed by the signatures of both the State and the Commonwealth Governments.

2.3.2 In 1974, Woodside, in association with its joint venture partners, continued exploration of the North West Shelf permits. The main objectives were to test major drilling targets that had been explored and to ensure that the few outstanding expenditure obligations on individual permits had been met by the time the permits became due for relinquishment and renewal. But having regard to the policy of the Commonwealth Government and the issue of sovereignty, implementation of the project may be considered to have been "on hold" at that time. In April 1974, the Court Liberal Government took office with Sir Charles Court as Premier and the late Mr Andrew Mensaros, Minister for Mines and Energy.

2.3.3 Differences between the State and Commonwealth Governments over the North West Shelf were marked during this period. The offshore permits held by the JVP expired between March and September 1974 and the question arose as to who had the power to review and renew them. Mr Mensaros unilaterally renewed the exploration permits for a period of five years, despite the Commonwealth Government withholding consent.

2.3.4 In July 1975, the State Electricity Commission and the Fuel & Power Commission were amalgamated to form the State Energy Commission of Western Australia and amendments for that purpose were made to the *State Electricity Commission Act 1945* and other relevant legislation.

2.3.5 By the *Acts Amendment (State Energy Commission) Act 1975*, SECWA was set up and consisted of a Commissioner who was to be the Chief Executive Officer, an Associate Commissioner, who was to be appointed Chairman of the Energy Advisory Council established under the same Act, another Associate Commissioner, and two

Assistant Commissioners who were full-time employees of the Commission. The late Mr Bruce Kirkwood was at all material times the Commissioner, Mr Marwood Kingsmill an Assistant Commissioner, and Dr Robert Booth the other Assistant Commissioner.

2.3.6 In 1979, a new *State Energy Commission Act* repealed all earlier legislation. By section 7 the State Energy Commission was preserved and continued in existence under the name "the State Energy Commission of Western Australia". By section 11 it was then composed of a Commissioner, who was Chief Executive Officer, two Associate Commissioners and two Assistant Commissioners. Section 27 set out various functions and powers of the Commission. They included, by sub-section (8), the duty of assisting and advising and making recommendations to the Minister on its own motion or on reference by the Minister, as to matters relevant to the Act, and including questions of policy and ways of implementing policy. By section 28 the Commission had power, *inter alia*, to do all acts and things bodies corporate could do or suffer by law and it also had power to enter into contracts relating to the acquisition of energy and any source of energy. By section 32(1) the Commission needed Ministerial approval in writing to enter into contracts where the consideration was more than \$200,000 but less than \$1 million. Contracts where the consideration was more than \$1 million required ratification by the Governor as well. Under the 1979 Act there was a limited power of direction in respect of the provision, supply or distribution of energy, contained in section 27(4). Not until the amendments to the Act in 1986 did the Minister have a more general power of direction in respect of the Commission.

## **2.4 Relevant events from 1975**

2.4.1 The Premier, during 1975, engaged in a major effort to get the North West Shelf project underway by visiting all joint venture participants at their overseas headquarters. An Action Working Group comprising SECWA, the Department of Industrial Development and representatives of the JVP was formed to determine the market for natural gas in Western Australia and to examine the economics of producing gas from the North West Shelf gasfields to satisfy that market. The group, in November 1975, concluded that in the Perth region firm commitments amounted to only 112 mm cfd (million cubic feet per day). Pilbara demand was assessed at 60 mm cfd. The loads were much smaller than had previously been envisaged. The group also concluded that a pipeline to Perth to convey the gas to the metropolitan region would

need to be financed by the Government to make gas available in Perth at reasonable prices.

2.4.2 In November 1975, the Federal Liberal Government of Mr Malcolm Fraser took office. Commonwealth Government policy then changed to support private sector development of the North West Shelf. Serious discussions were then pursued about the development of the gasfields. During 1976, by reason of financial difficulties, Burmah sold its shareholding. North West Shelf Development Pty Ltd ("North West"), jointly owned by Broken Hill Proprietary Company Ltd ("BHP") and Shell Development (Australia) Pty Ltd ("Shell"), became the major shareholder and operator for the JVP. However, before Shell and BHP acquired the interest of Burmah, they sought assurances from the Commonwealth and State Governments that they would support the project. In particular, Mr James McNeill, as he then was, of BHP, requested the assurance of the Commonwealth Government that export of LNG at commercial prices would not be restricted.

2.4.3 Mr J D Anthony, the Acting Prime Minister, by letter dated 4 August 1976, said that 50% of proven and probable resources could be exported as LNG and gas liquids to ensure the project's viability. He indicated that the Government would be prepared to discuss a greater percentage of exports if required. The pricing for the domestic market was basically a matter for agreement with the Western Australian Government.

## **2.5 Proposed heads of agreement**

2.5.1 In August 1976, the JVP presented proposed heads of agreement to the State Government and SECWA. At a meeting of the Commissioners of SECWA on 20 September 1976, the draft heads of agreement submitted by the JVP were discussed. The three main areas requiring consideration by SECWA were:

- (a) reservation of sufficient gas reserves to satisfy the onshore market;
- (b) price of gas delivered to Perth and the Pilbara; and
- (c) finance and ownership of the onshore gas pipelines to Perth and the Pilbara.

2.5.2 In a Cabinet minute from Mr Mensaros to the Premier, dated 30 September 1976 and prepared by an officer of SECWA, it was noted that the draft heads of agreement did not provide any commitment by the JVP to supply gas to the local market or even proceed to the production stage, and otherwise sought to impose some unrealistic conditions on the State and sought unrealistic concessions from the Commonwealth. The minute recommended that the JVP should be required to commit production capacity in excess of their export requirements (with a minimum of 250 mm cfd) to the local market. The agreement, it was suggested, should also stipulate that 50% of the proven and probable reserves should be allocated for use in Western Australia. An internal memorandum from Mr D W Saunders, Manager, Resources and Planning, to the Commissioner, spoke of the Minister, Mr Mensaros, agreeing with the principle of SECWA marketing all onshore, gas consisting initially of a firm 250 mm cfd with the State having the right of first refusal to an additional 50% of the reserves devoted to onshore use. On 4 October 1976, Cabinet approved a negotiating proposal that any agreement with the JVP should:

- (a) include a clear statement that 50% of proven and probable gas of North Rankin and other fields be reserved for use in Western Australia;
- (b) provide for onshore gas to be sold at prices determined by negotiation in lieu of oil parity and that the State be responsible for transporting and marketing all onshore gas; and
- (c) provide for the State to build, operate and fund the pipeline.

2.5.3 In a memorandum dated 10 February 1977 to the Premier, Mr Mensaros assessed the situation, *inter alia*, as indicating the JVP's confidence in their continued efforts relating to exploration and engineering costing them \$1 million a week and referred to the Premier's press statements that the Government would not be pushed into a premature final agreement just to meet the election deadline of 19 February 1977. It is evident from the memorandum that negotiations were then proceeding between JVP representatives and officers of SECWA and the Department of Industrial Development.

2.5.4 On 14 January 1977, in Melbourne, Sir Charles Court and Mr Mensaros, representing the Western Australian Government, and Mr Kirkwood representing SECWA, as its Chief Executive Officer met representatives of the JVP. The meeting followed one held in Perth on 22 December 1976 when BHP and Shell had

responded directly to the Western Australian Government to clarify certain matters which had been discussed with the Government in 1976. Dr R R Booth, who was then the Assistant Commissioner-Engineering of SECWA, was aware of the proposed meeting and said: "It was regarded as quite a crucial meeting to see if some of these major points of principle could be settled". He was not at the meeting, but recalled Mr Kirkwood advising him later of "some good news and bad news". The "bad news", according to Dr Booth, was a concession by the Premier that the JVP could market gas to iron-ore producers in the Pilbara. Notes were taken of the meeting of 14 January by a representative of the Western Australian Government and a representative of the JVP, which appear to be basically similar. The good news was that the JVP were agreeable to some of the gas to be marketed offshore. The meeting agreed as follows:

- (a) Perth and the south-west of Western Australia would be available as a market to SECWA which would buy its gas at the inlet to the pipeline in the Pilbara.
- (b) The JVP would market gas in the Pilbara to all customers at competitive fuel prices.
- (c) The inlet gas price in the Pilbara paid by SECWA and the price to large industrial users in the Pilbara area were not to be related.
- (d) SECWA was to have access to sufficient gas to make the pipeline to Perth viable, namely, 250-275 mm cfd at 95% take or pay.

2.5.5 By 1977, the final form of the JVP had become as follows: Woodside, Woodside Petroleum Development Pty Ltd ("Woodside Petroleum"), Mid-Eastern, North West, BP and Cal Asiatic.

## **2.6 Memorandum of understanding with the JVP**

2.6.1 Negotiations between representatives of SECWA and the JVP followed the meeting in Melbourne on 14 January 1977. It appears, initially at least, to have been understood that the take or pay obligations of SECWA would involve paying for all of the gas it contracted to take, whether or not it actually took the gas, subject to unused gas remaining in "inventory", that is, in the ground until needed. During these negotiations, SECWA appreciated the need to conclude appropriate arrangements with

Alcoa of Australia Ltd ("Alcoa"). Alcoa would be by far the biggest user of the natural gas piped to Perth. Indeed, as a memorandum of understanding dated 12 September 1978 between SECWA and Alcoa reveals, the quantity of gas to be provided to Alcoa for 20 years was 150 mm cfd with an option for a further 40 mm cfd, such option to be exercised by Alcoa not later than 1 November 1978.

2.6.2 A memorandum of understanding was eventually signed on 11 November 1977 between SECWA and the JVP relating to the acquisition of gas from the North West Shelf ("the Memorandum of Understanding"). By clause 4, the allocation of reserves in order of priority for the delivery of gas was:

- (a) 250 mm cfd for 20 years for delivery to SECWA.
- (b) 70 mm cfd for 20 years for use by the JVP in satisfying existing Pilbara demands.
- (c) An additional 50 mm cfd for 20 years for delivery to SECWA on option that was to be exercised by 11 November 1978.
- (d) Sufficient gas to allow the export of up to 6.5 million tonnes of LNG per year by JVP for 20 years.
- (e) An additional 250 mm cfd for 20 years reserved for sale in Western Australia by SECWA and/or the JVP, as agreed between them.

2.6.3 While not undertaking to make the gas available at any specific time, the JVP expected that the gas would be available for sale about the middle of 1984. The Memorandum of Understanding included a take or pay provision to the effect that if SECWA took less than 95% of its annual contracted quantity, SECWA was obliged to pay for 95% of that contracted amount. Gas paid for but not taken, subject to the JVP maximum delivery obligations, might be taken at any time over the following four years or the remaining years of the contract term, whichever was the lesser figure.

## **2.7 Exercise of option**

2.7.1 1978 was a year of consolidation for all concerned. The JVP pressed on with detailed planning of the project, while SECWA was involved with similar detailed planning work for the pipeline project. As previously mentioned, on 12 September 1978 with Cabinet approval, a memorandum of understanding was signed between SECWA and Alcoa. A term of that memorandum of understanding provided that Alcoa would share with SECWA the interest, capital and related charges, and operating costs, of the pipeline.

2.7.2 Alcoa's option to take the additional 40 mm cfd had to be exercised not later than 1 November 1978 and SECWA's option to take an additional 50 mm cfd had to be exercised by 11 November 1978. Alcoa, however, decided not to exercise its option. SECWA prepared a Cabinet minute and submitted it to the Minister, Mr Mensaros, concerning whether it ought to exercise its option for a further 50 mm cfd. In a memorandum dated 5 November 1978, Mr Kirkwood told the Minister that he had no hesitation in advising that the joint recommendation to SECWA by him and Dr Booth to exercise the option would be endorsed by it.

2.7.3 The minute prepared by SECWA, which was later adopted by Cabinet, made the following points. Alcoa had advised SECWA it did not wish to exercise its option citing reduced expectation of development in the State as a result of the recent environmental enquiry into the Wagerup proposal. SECWA had been updating its forecasts of future gas requirements in anticipation of a decision on the optional quantity of gas. The firm market for Perth and the south-west area in 1984 was estimated to be about 230 mm cfd, including the gas supplied by West Australian Natural Gas ("WANG") from the Dongara field. It was expected that WANG would have difficulties maintaining its delivery rates during the final period of its contract between 1980 and 1986. The firm market of 230 mm cfd only included those industries that were known to require gas and had firmly stated their intention to use it. Many potential industries and gas customers could be identified which, when taken together, would lead to a potential demand for gas well above the 300 mm cfd supply available. While not able at that stage to be considered as firm, there would no doubt be an upsurge of industrial development as a result of the availability of North West Shelf gas. The minute went on:

"The consultants advising the Commission have conducted an extensive analysis of the development of gas markets in other parts of the world and even Australia, following the introduction

of natural gas. Their advice is that the demand for gas exceeds expectations in virtually every case and most purchasers of gas have had cause to regret that they did not secure larger quantities when they had the opportunity."

2.7.4 Further points were made favouring the exercise of the option. If the gas demand failed to eventuate as expected, it would be possible for SECWA to use some gas for power generation. Then there was the psychological effect on the JVP if the State opted for the lower quantity at that stage, since it might induce loss of confidence.

2.7.5 Before Cabinet approval, the minute was shown to Treasury. By a memorandum dated 7 November 1978, the Acting Under Treasurer said that Treasury agreed that the option be exercised. In Treasury's opinion, the principal safeguard in exercising the option was that an equivalent of 500 megawatts of power from the Kwinana power station, could be generated by gas rather than oil. Further, although Alcoa had not opted for the extra 40 mm cfd, it might take more than 150 mm cfd, although it was not prepared to make a commitment for the additional volumes at that time. The minute was approved by Cabinet on 7 November 1978.

2.7.6 On 8 November 1978, at a meeting of SECWA, it was resolved that SECWA approve the exercise of the option to bring the total contract quantity to 300 mm cfd over 20 years. The minutes of the meeting note that SECWA had been informed the exercise of the option had been discussed with the Minister and Cabinet who were in favour of the exercise.

2.7.7 The option was exercised by SECWA and approved by Cabinet.

## **2.8 Marketing of gas in the Pilbara by SECWA**

2.8.1 By early 1979, SECWA was seriously considering the establishment of a Pilbara area power pool to facilitate the energy requirements of industrial users in that district. The minutes of SECWA of 29 March 1979 disclosed that preliminary discussions had begun with the JVP regarding terms and conditions for supplying natural gas to the Pilbara, for which the JVP was responsible under the Memorandum of Understanding. Negotiations continued over time.

2.8.2 It is clear that by August 1979, from the minutes of a meeting held on 2 August 1979 between representatives of the JVP and SECWA, the JVP was having difficulty in getting firm commitments to take the gas destined for the Pilbara. It was stated that failure to reach agreement with the principal potential users, namely, Hamersley Iron Pty Ltd ("Hamersley") and Cliffs WA Mining Co Pty Ltd ("Cliffs"), might cause project delays. Further, the forecasted Pilbara area power pool tended to weaken the JVP's marketing position. During 1979, world crude oil prices increased dramatically. The base price escalation formula agreed in the Memorandum of Understanding meant that the gap between oil and gas prices increased significantly. This made it difficult to market gas to Pilbara users at oil price parity.

2.8.3 It also appears that Hamersley decided to close its pelletising plant in April 1979 because high oil prices made it uneconomical. Hamersley had been likely to use significant quantities of gas.

2.8.4 By August 1979, the JVP had suggested that SECWA should assume responsibility for selling 70 mm cfd gas in the Pilbara. A minute from Mr Mensaros dated 12 November 1979, to the Premier, refers to the oil price rise and its effect on the North West Shelf project by noting that the economics had changed quite favourably for the JVP. The JVP had recently said in public that the price it would obtain for the LNG portion of the gas stream would be higher than the onshore sale price, a situation the reverse of two years before.

2.8.5 In the two years since the signing of the Memorandum of Understanding, the JVP had sought to develop a market for Pilbara gas, but had failed, primarily because it had sought gas prices equated to oil parity prices. It was alleged that another factor was the imminent establishment of the Pilbara area power pool. The JVP therefore had recently opted to sell the 70 mm cfd to SECWA. The JVP, however, had sought to extract higher gas prices in the south-west of the State while being prepared to moderate somewhat its previous hardline stance with regard to Pilbara prices. The original Memorandum of Understanding had operated largely as expected and had led to a favourable position for gas prices delivered to Perth in relation to fuel oil prices. The JVP had however sought to gain a higher share of this favoured position than it would have been entitled to under the Memorandum of Understanding. As the minutes of the SECWA meeting of 4 October 1979 put it:

"... the Joint Venturers negotiating team had sought to depart significantly from the provisions of the original Memorandum of Understanding as well as seeking to obtain the best possible arrangement from their point of view for the sale of gas to the Pilbara."

2.8.6 The JVP appears by then to have been concerned about its obligations under the Memorandum of Understanding because the increased oil price, which had taken place since the Memorandum of Understanding had been concluded, threatened to make gas uncompetitive with alternative fuels, particularly coal. SECWA had responded to negotiations for higher gas prices requested by the JVP by developing three categories of gas sales with different pricing provisions: one set for the Pilbara; another set for one-third of the Perth market; and the other for approximately two-thirds of the Perth market. Cabinet endorsed the negotiating stance taken by SECWA.

## **2.9 The Swede Nelson principles**

2.9.1 In October 1979, Mr Swede Nelson, who appears to have worked for Cal Asiatic, visited the Premier. Mr Mensaros gave the Premier a briefing note dated 17 October 1979 before the meeting which alerted him to the JVP's desire to renegotiate the gas price for the south-west and to unburden itself of the obligation to market to the Pilbara. It also said that SECWA was concerned with the impact of the escalating oil price on the competitiveness of gas.

2.9.2 The resolution of this problem can be taken from the evidence of Dr Booth. He said that concern about assuming the obligation of marketing the Pilbara gas had changed for two reasons. First, the prospect of a power pool in the Pilbara coming into operation was real and SECWA would benefit in owning the gas that went into the power station that fed the pool. Second, and more importantly, the pricing principles introduced through Mr Swede Nelson significantly changed SECWA's attitude to the Pilbara and the south-west.

2.9.3 The pricing principles embodied in a letter from Mr Nelson to the Premier recognised that SECWA had to be able to market, under acceptable commercial terms, all the gas it took. It also had to market that gas into the energy market, in which the gas was being placed, as it was at the time of placement. The pricing principles became known as the Swede Nelson principles. If they could be put into an addendum to the Memorandum of Understanding and finally into the contract for the purchase of

the gas, that would give SECWA extra protection and assurance about the taking of the gas for the Pilbara. The incorporation of the Swede Nelson principles into an addendum to the Memorandum of Understanding and then the contract would give the Commission another means to negotiate itself out of trouble if the realities of the energy market turned out to be adverse. So far as taking up the extra 70 mm cfd, Dr Booth said:

"I would try and describe our state of mind as being a similar position as we were with the optional 50. I mean, there was a risk associated with it, but we believed after very extensive discussions with the iron ore companies and particularly with the Nelson Principles in mind, that the risk was acceptable and there could even be some advantages to it down the track. In the short term, we were concerned about the depressing effect of doubling of oil prices on the general economic activity — that was the essential risk — but in the long term there were some advantages coming out."

Eventually, the Swede Nelson principles were incorporated into an addendum to the Memorandum of Understanding and into the final agreements which were executed on 30 September 1980.

2.9.4 Dr Booth said that the implementation of the Swede Nelson principles led to greater optimism within SECWA that it could successfully market Pilbara gas and the south-west gas and, if the energy market turned "sour", SECWA had a solid basis upon which to renegotiate pricing provisions with the JVP.

## **2.10 Negotiations leading to the execution of the gas sales agreements**

2.10.1 There was considerable negotiation in 1979 and 1980 concerning the drafting of the final agreements. By the end of January 1980, draft no. 5 had been made available to the JVP. Woodside, since the negotiations commenced in late 1976, had been considered to be the weak partner in the project and one likely to have most difficulty in financing its obligations. It was also the Australian partner and therefore important to enable the JVP to meet Commonwealth foreign investment requirements in the project. At an early stage in the negotiations, the drafting had been done by representatives of the JVP, but SECWA perceived that it would be advantaged if the initiative in drafting were taken over from the JVP. Mr P Lowe, a London solicitor, much experienced in drafting gas supply contracts, was consulted along with Mr C Hardcastle, a technical consultant. They advised Dr Booth and his negotiating

team. Another adviser, particularly on financial matters, was the Royal Bank of Canada.

2.10.2           The *North West Gas Development (Woodside) Agreement Act 1979* was assented to on 21 December 1979. The Act ratified an agreement dated 27 November 1979 between Sir Charles Court on behalf of the State and Woodside Petroleum Development Pty Ltd, Woodside Oil Ltd, Mid-Eastern Oil Ltd, North West Shelf Development Pty Ltd, BP Petroleum Development Australia Pty Ltd and California Asiatic Oil Co, the then Joint Venturers. The agreement provided for the development of the North West Shelf project and the establishment of facilities associated with it. Clause 6 of the agreement was in the following terms:

"The Joint Venturers shall notify the Minister by 11 December 1979 (or such later date as the Minister and the Joint Venturers may agree) whether the Joint Venturers intend to proceed with the overall project and shall at the same time furnish to the Minister a summary of the results of their studies."

2.10.3           This clause was altered in 1980 to increase the time for notification to 30 June 1980 and, later, 30 September 1980.

2.10.4           In a telex from the Royal Bank to Mr Kingsmill dated 20 March 1980, the Bank said most of them would have no difficulty in funding their commitment to produce and deliver the required natural gas, but Woodside did not have the same financial strength. The Bank recommended that SECWA insist on obtaining an ultimate parent company guarantee from the JVP. It was recommended that SECWA should point out that it was being asked to build a pipeline without any concrete assurance that natural gas would be available for delivery, and that that was unusual. This advice will be discussed in more detail later.

2.10.5           On 5 March 1980, Mr Mensaros the State Minister for Fuel and Energy was replaced by Mr Peter Jones. The change followed the re-election of the Court Government at the March 1980 general election.

## **2.11           Expected demand for gas**

2.11.1           Negotiations in relation to the gas sales agreements between the JVP and SECWA proceeded during 1979 and 1980 on the basis that the contracted quantity was

now 370 mm cfd. In 1979, SECWA retained P A Consulting Services Pty Ltd ("PA Consulting") to study the market for natural gas for Perth and the south-west to determine, *inter alia*, the then non-transport fuel market, its characteristics, and that part which might be secured by gas. Additionally, PA Consulting was to determine the estimated total non-transport energy demand and the gas share "for each year between 1984/5 and 1989/90 and 2003/4" (*sic*).

2.11.2 The report dated September 1979 confirmed the demand. It observed that natural gas consumption in the Perth area was limited by supply constraints, not by demand. For that reason, any new gas source such as from the North West Shelf, given competitive prices, would experience a sizeable latent demand resulting in an abrupt increase in consumption. In practical terms, users would simply switch from oil products to gas since there were few long term oil supply contracts in force. It was also stated that the availability of North West Shelf gas could attract additional industries with energy-intensive processes or which used gas as a feedstock. Even one such industry could have an appreciable effect on the energy consumed within the study area. In detail, the study indicated that the demand for total energy (excluding fuel used for transport and power) should increase fivefold from 111 joules x 10<sup>15</sup> per annum in 1978/79 to 571 joules x 10<sup>15</sup> per annum in 2003/4. It was expected, assuming North West Shelf gas became available early in 1984, that natural gas would become the dominant industrial fuel amounting to 65% of energy use. The demand for natural gas in 1984 from the industrial, residential and commercial sectors, was forecast to be 6.5 million cubic metres per day, and by the year 2003/4 to have increased to 15.2 million cubic metres per day. If these figures were converted into cubic feet per day, the finding would be 229 mm cfd for 1984 and 537 mm cfd for 2003/4.

2.11.3 In February 1980, Cliffs announced that it would close the second of the only two pelletising plants in the Pilbara at the end of April 1980.

2.11.4 Meanwhile, negotiations to conclude the terms of the gas sales agreements were proceeding. By July 1980, the matters which apparently remained outstanding in relation to draft no. 5A included the need for parent company guarantees. The gas sales agreements were eventually signed on 30 September 1980 without parent company guarantees. This matter is discussed in more detail later. Upon the signing of the gas sales agreements, the JVP immediately gave formal notice pursuant to clause 6 of the *North West Gas Development (Woodside Agreement) Act* of its intention to proceed with the overall project.

2.11.5 The gas sales agreements executed on 30 September 1980 reflected SECWA's original commitment under the Memorandum of Understanding to take 250 mm cfd, together with added obligations arising from the option exercise in 1978, and the further agreement relating to the Pilbara gas in 1979, a total commitment of some 370 mm cfd. The take or pay provision of 95% remained the same. The gas pricing structure varied between the gas allocated to the south-west of the State at a price calculated pursuant to a formula which took into account the need to be competitive with either oil or coal, where appropriate, and thus incorporating the Swede Nelson principles. One-third of the total payment by SECWA to the JVP for this gas was to be paid for at oil-competitive prices which were then, and still are, substantially greater than coal-competitive prices. The Pilbara gas was to be purchased at a price which was to be linked to the oil-competitive price and the Consumer Price Index and was the highest price. The agreements also contained provision for gas which was paid for but not taken under the take or pay provision, and went into inventory. Gas could be withdrawn from the inventory within four years at no premium but after that period gas taken from the inventory would cost SECWA the difference between the original price and the then current price.

## **2.12 Depressed state of gas market**

2.12.1 The large quantities of gas which SECWA had contracted to take were predicated upon a significant industrial growth in the State. For example, by 1981 it had been proposed for some time that an aluminium smelter would be established in the south-west of the State. This, however, never happened. By June 1980, the two iron-ore pelletising plants, part of the original load estimates in the Pilbara, were no longer functioning. By June 1981, SECWA was in possession of an internal memorandum from Mr J E Hayes, Manager, Resources and Planning, to the Commissioner, dated 30 June 1981, outlining that the market for natural gas was likely to be depressed when gas from the North West Shelf flowed. The memorandum pointed out that the depressed world steel industry meant it was unlikely in the foreseeable future that the Pilbara pelletising plants would be reopened. If that proved to be the case, the Pilbara gas demand would be only about 20 mm cfd. The brick and cement industries had not been persuaded to convert from coal to natural gas because coal provided a more radiant flame for kiln firing and the ash was useful in the final product. SECWA's capacity to attract new large industries ran into the hurdle that the price at which gas could be offered was not attractive. The forecast stated that even if all doubtful customers decided to use gas, then SECWA would still be faced with about a surplus 95 mm cfd

of take or pay gas in 1985/86 at best. If the certain/probable customers signed on a 90% take or pay basis, the Commission's take or pay commitment would increase to about 120 mm cfd, excluding an additional possible Pilbara take or pay quantity of 46 mm cfd. Because of the limited total industrial market available, it appeared necessary for SECWA to use a considerable quantity of natural gas as power station fuel, probably at Kwinana.

2.12.2           The problem, however, in that course of action, was that to use up all the available unwanted gas by such a method would displace a further 800,000 tonnes of coal, having serious implications for the proposed 20 year Western Collieries coal contract with SECWA. In summary, the probable best position would be a surplus of 120 mm cfd and the worst position would be something like 145 mm cfd. Mr Hayes recommended renegotiation of the gas sales agreements to reduce both the take or pay commitment and gas prices and to burn take or pay gas in power stations.

2.12.3           In a letter dated 22 September 1981 Mr Kirkwood told Mr Jones that a current review of the Western Australian market for natural gas at prices set in the sales agreements indicated that a substantial gas surplus was likely in 1985 over the amount contracted to be taken. That applied both to the gas to be sold in the south-west and in the Pilbara. Unless new markets could be developed to use the surplus gas, some of it would have to be used for electricity generation. The use of surplus gas, however, for electricity generation would involve a severe fuel penalty in 1985 of the order of \$70 million per annum. If that occurred, it would be necessary to try to reduce coal consumption and to export the surplus coal. Many of the problems referred to by Mr Hayes were repeated in the letter. Mr Kirkwood also said the contract with Alcoa should be completed without major problems. Mr Jones, in his statement to this Commission, said that this memorandum was the trigger which started a more intense look at and reappraisal of the total situation. After its receipt, Mr Jones told Mr Kirkwood that he should talk to the JVP about the economic and marketing outlook. Over the next three months, Mr Kirkwood began discussions, which were confidential because Woodside had entered into financing arrangements which would have been jeopardised if SECWA had revised all options available to it under the gas sales agreements.

## **2.13 The side letters**

2.13.1 In Mr Jones' view, the JVP was not addressing the problems raised in Mr Kirkwood's letter of 22 September 1981 and he expressed those thoughts in a letter to Mr Kirkwood of 22 March 1982. In that letter he said the situation was becoming increasingly critical and he could see no alternative other than to tell the JVP that SECWA would publicly announce its intention to challenge certain aspects of the gas sales agreements and that no further work would be done on the pipeline until some resolution was reached. The construction of the pipeline was a major concern to the Government because negotiations were proceeding to commitment for the construction involving considerable expenditure. In March and April of 1982, Mr Jones had meetings with the JVP. The State's position in support of SECWA was made clear which was that unless some progress with discussions in relation to the gas sales agreements occurred, SECWA would not be in a position to commit to the pipeline construction. JVP responded vigorously. Woodside was defensive saying it was required to inform its bankers of the discussions and was concerned that its finance could be jeopardised. Over the next few months, negotiations between the JVP, the Minister and SECWA resulted in documents called "Side Letters" of 18 August 1982. The Minister obtained Cabinet's consent on 16 August 1982 to conclude negotiations on the basis of the Side Letters. It is not necessary to detail the precise provisions of the Side Letters, except to say that so far as the delivery of early gas was concerned, the arrangement had the effect of relieving SECWA from its obligation to pay for shortfalls in contract deliveries over the first two years of the gas sales agreements coming into force. A resume of the Side Letters is contained in an undated telex from Mr Kirkwood to Mr Jones in New York. Essential features described in the text of the telex were:

- (a) The Joint Venturers' acceptance of the concept of early gas as a trade-off against failure to meet the take-or-pay level in the early years of the agreements.
- (b) Agreement to a discount for gas burned in the power plant, this discount representing approximately 20% of the price of the coal-competitive classification under the agreements.
- (c) Clarification of pricing procedures and agreement to a three-year pause between price redetermination.

- (d) An agreement to work together to seek new Pilbara industries and a willingness to negotiate a price appropriate for such industries.

## **2.14 Mr R J O'Connor becomes Premier**

2.14.1 Mr R J O'Connor became Premier following the retirement of Sir Charles Court on 25 January 1982. SECWA, in a report dated January 1982, briefed Mr O'Connor on the North West Shelf Gas Project, including gas marketing. Mr O'Connor was specifically advised that on the basis of firm commitments to date "it is expected that there will be an oversupply of perhaps 100 mm cfd to 120 mm cfd". The report noted that since original negotiations with the JVP, forecast demand of gas for alumina production had dropped, the iron ore pelletising plants in the Pilbara had been shut down and a number of industries had chosen coal as the preferred fuel, for example, the Worsley Aluminium Refinery and Swan Portland Cement Works. It was also noted that there had been "less vigorous development of the energy market generally than in earlier years". The report further pointed out that based on market estimates, the Commission would have to "burn very substantial quantities of gas for electric power generation in the south-west during the first few years of the gas contract, if the take or pay commitment of the gas sales agreement is maintained stringently". Mr O'Connor was advised that the agreement with the JVP provided for price renegotiation on the basis that gas had to be priced competitively with other fuels in the respective markets, but that process could be activated only after the first gas supply date — 1984/1985. The report highlighted the differing prices for gas supplied in the Pilbara, Perth and the south-west and also the different escalation provisions.

2.14.2 In the memorandum to the Premier of 12 August 1982, Mr Jones said that while the Side Letters were "far from ideal from both the legal and commercial aspects, I believe it is the best arrangement which can be secured in the current circumstances without causing a complete restructuring of the North West Shelf Joint Venture, a process which would cause very considerable disruption, lead to extensive further delays and perhaps call into question the investment climate in Western Australia. It would also cause, in my opinion, a complete cessation of progress regarding the LNG negotiations in Japan. Indeed, the Japanese companies considering buying LNG have already drawn attention in their most recent discussions with the JVP to the Government's hold-up on the pipeline construction".

2.14.3 Cabinet had to decide whether to commence the Dampier/Wagerup pipeline construction on the basis of the Side Letters. Woodside had made it clear that

the Side Letters had to be approved by each of its 62 lending banks and that would take probably 12 weeks. In the circumstances, the Government could only make clear to the JVP that it would have SECWA commence the pipeline construction on the understanding that the Side Letters prevailed. The Side Letters did in fact prevail and the pipeline was built.

## **2.15                   The document "A Brief for Premier Hon Brian Burke MLA"**

2.15.1               On 19 February 1983, the Liberal Government of Mr R J O'Connor was defeated and the Burke Government came to power. The new Government was briefed shortly afterwards by SECWA and the Treasury on the current status of the North West Shelf Gas Project and the financing of both the pipeline and the gas purchases. The Burke Government decided to proceed with contracts for the construction of the pipeline. Mr Burke said on 10 March 1983, after having referred to detailed briefings and assessments which he had received on the project, that "we in office had been able to very quickly assure ourselves of the magnificence and of the benefit that would flow to the people of the State from the development of the North West Shelf and from involvement of your State Government in that development". Even looking at the worst possible debt profile resulting from the worst possible postulation, Mr Burke was of the opinion that from the State's point of view the project remained immensely attractive.

2.15.2               As previously mentioned, it has not been established who was responsible for the compilation of the document headed "A Brief for Premier The Hon Brian Burke MLA" and bearing the name "Aluminium Smelter Taskforce". That document is dated August 1984, but is unsigned. Mr D R Eiszele, who became General Manager, Electricity Supply, at SECWA and had been employed by that organisation since 1964 in several capacities, said that in mid-1983 Mr Kirkwood had moved out of SECWA to head the Aluminium Smelter Taskforce which was separately located from SECWA in Irwin Street, Perth. He was accompanied by a small staff of officers from SECWA. Additionally, a number of heads of department were appointed to serve on the Taskforce. Mr Saunders confirmed Mr Eiszele's evidence, but he was unable to help with the authorship of the document, except to say that in his view it would have been prepared by members of the Taskforce under Mr Kirkwood's responsibility. Some statements in the document require further investigation, though it will suffice for the most part at this stage of the report merely to state them. In Appendix I it is said:

"The Energy Commission always had an overriding responsibility under its Act to supply energy in the Pilbara, as indeed it has for all areas of the State. However, during the original negotiations in the 1970s and at the time of the original Memorandum of Understanding in 1977, the JVP insisted on reserving for itself the sole marketing rights for gas in the Pilbara. The Government of the day agreed to this proposal despite recommendations to the contrary by the Energy Commission."

2.15.3 This matter can be dealt with immediately. Evidence supports the proposition that no recommendation to the contrary was made by SECWA. An Appendix II, attached to the document, is in narrative form and purports to be a brief history of the North West Shelf Project. Under the heading "1977", reference is made to the meeting of 14 January 1977 in Melbourne. The text makes it clear that from early 1976, the JVP believed that SECWA should sell gas only into the traditional markets in Perth, while all other onshore marketing should be handled by the JVP. The JVP wanted the State to fund the onshore pipeline to Perth. The brief history then said:

"The Premier made it clear this was not acceptable. As a compromise, it was agreed that the State Energy Commission would sell into the entire Perth and South-West market while the Joint Venture Partners would have exclusive marketing rights in the Pilbara."

2.15.4 That statement shows clearly that the JVP's marketing rights in the Pilbara were reached as a compromise and not despite recommendations to the contrary by SECWA, remembering that SECWA was a negotiating party represented by its Commissioner, Mr Kirkwood.

2.15.5 More importantly, however, Appendix I stated:

"While most decisions were taken following close working discussions between the Commission and Government, and involved mutual concurrence, the Government overruled Commission recommendations on at least two material particulars:

- (a) The Commission did not want to execute the JVP-SECWA contracts until a back-to-back agreement had been made with Alcoa. The Government elected to proceed without the Alcoa contract.

- (b) The Commission sought performance guarantees from the parent companies whose subsidiaries made up the JVP, but the Government *instructed* the Commission to drop this requirement. [our emphasis]

The first has proved very damaging, as mentioned earlier, while the second has not affected the contracts thus far."

2.15.6 In Appendix II, reference is made to the parent company guarantees:

"In the last few days in September strenuous efforts were made to secure the desired Parent Company Guarantees. The Premier, Minister for Fuel and Energy, Board of Commissioners and senior Commission staff were involved. The JVP steadfastly refused to provide such guarantees. On the night of Sunday 28 September it was concluded that the required guarantees could not be obtained. The Premier *directed* that the Commission accept 'Letters of Comfort' instead." [our emphasis]

2.15.7 The above two contentions will be examined in more detail later.

## **2.16 Gas Strategy Committee**

2.16.1 In 1984, a committee was established under the Chairmanship of Mr L McCarrey, the then Under Treasurer. The other two members were Mr S Hohnen from the Department of Industrial Development and Mr Kirkwood of SECWA. This committee was known as the Gas Strategy Committee. The terms of reference included, *inter alia*, the need to consider alternative strategies for handling the gas surplus issue. In its report of September 1984, the Committee noted that the gas sales agreements allowed for annual redetermination of price if the gas price failed to reflect the price of competitive energy forms, having regard to the three pricing principles written into the agreements. However, no provision was made in the agreements for redetermination of contract volumes or take-or-pay levels. The Committee defined the primary objective as being to seek relief from the gas inventory problem by either reducing the take-or-pay commitments or reducing contract volume. The gas price issue was very relevant to that question because it affected the cost of gas in inventory and SECWA's capacity to meet the cost of financing inventory. It recommended a negotiating strategy which concentrated on pricing to force the JVP to address contract quantity and take-or-pay issues. The report then set out a recommended approach. The Committee stressed in its report that negotiating tools existed within the gas sales agreements. These tools included the "Lifeboat" clause (Article XI, 11.2):

"(1) The Buyer and the Seller agree that the provisions of this Article XI give effect to the following principles

- (a) South West Gas and Pilbara Gas will be on-sold by the Buyer into a mixed energy market where oil coal and gas are and/or will be used in significant quantities and compete with one another.
- (b) The Buyer acknowledges the Seller's rights to an equitable share of the increased values of natural gas used in the South West of the State of Western Australia which can be justified and supported by reason of increased fair market values for such natural gas which may occur from time to time and such sharing will be done separately for gas deemed to be directly competing with liquid petroleum products and gas deemed to be competing with coal.
- (c) The Seller acknowledges that separate prices for natural gas must be established in the respective markets so that the natural gas can be on-sold by the Buyer in the South West of the State of Western Australia and the Pilbara on a commercial basis."

2.16.2 The report also referred to legal advice which confirmed that the marketing principles in the gas sales agreements were considered to override the pricing formulae provisions. A good case could be made out for a review of the pricing mechanisms to achieve gas prices which more closely reflected market reality and economic circumstances.

2.16.3 The Gas Strategy Report was followed by a further report by the same Committee in 1985. In the same year the Western Australian Government and SECWA conveyed to the JVP their serious concerns about the viability of the Project. The Federal Government was approached by the JVP participants and resulting negotiations involving all parties produced the Agreed Statement of Principles ("ASOP"). The changes embodied in ASOP acknowledged the need for all parties to make concessions, or "share the pain", to ensure the project remained viable. It is not necessary to

enumerate the changes suggested. The ASOP modifications also involved the State and Commonwealth Governments foregoing royalties.

2.16.4 The setting up of an Aluminium Smelter Taskforce indicates the importance Government attached to a smelter. Had a smelter been constructed by 1985 or in the subsequent years, very likely the quantity of gas contracted for the south-west region could have been substantially absorbed. Unfortunately, it was not possible to persuade any company to build a smelter. Further reference to the attempts to obtain a smelter will be referred to in chapter 3.

## **2.17 Allegations of improper conduct**

2.17.1 As noted at the outset, the Commission had been required to inquire whether there has been corruption, illegal conduct or improper conduct in respect of "the natural gas sales agreements entered into by the State Energy Commission of Western Australia for the purchase of natural gas from the North West Shelf Joint Venturers". There is no justification for taking the view that this term of reference restricts the enquiry into the gas sales agreements signed on 30 September 1980. In the Commission's view, it is open to it to have regard to the Memorandum of Understanding and amendments leading up to the execution of the various agreements for the sale of natural gas and any amendments or variations of those agreements.

2.17.2 At the opening of this term of reference, we were informed by Commission staff that, despite invitations extended both publicly and privately, no allegation of impropriety, illegality or corruption in relation to the signing of the original gas sales agreements or subsequent amendments or variations had been received. The only allegations which appear to be worthy of investigation appear in the document attributed to the Aluminium Smelter Taskforce already referred to earlier in this report (see paragraphs 2.15.1 to 2.15.7 inclusive of this chapter), and in the document entitled "The Implications of the North West Shelf Gas Sales Agreements", a statement by the Minister for Minerals and Energy, Mr David Parker, of 23 August 1985.

2.17.3 In his statement to the Commission, Sir Charles Court suggested that there were matters arising from the handling of issues relating to the gas sales agreements between 1983 and 1992 which merited investigation. He suggested that the Burke Government went against the advice of the Gas Strategy Committee in concluding the ASOP agreement, and then failed to honour its side of the so-called "sharing of the

pain" aspect of that agreement by failing to refund the agreed amount of royalties and levies to SECWA.

2.17.4 We accept the submission of Counsel Assisting that it is unnecessary and inappropriate, having regard to the scope of this term of reference, for the Commission to inquire into the commercial judgment of those involved in the making of the gas sales agreements or their amendment or variation unless evidence suggests that a lack of judgment was sufficiently gross to amount to impropriety. We were advised that the Commission had no basis to further investigate the commercial basis of decisions made after the gas sales agreements were signed on 30 September 1980. Consequently, sections of Sir Charles Court's statement which dealt with his contention that issues relating to the gas sales agreements between 1983 and 1992 merited investigation were not admitted in evidence.

2.17.5 The principal allegations contained in Mr Parker's statement are dealt with in the following paragraphs.

2.17.6 Mr Parker said the prospects for SECWA would have been good if it had been obliged to take 250 mm cfd for sale in the south-west, and not additions of 50 mm cfd provided for by the option, and 70 mm cfd of Pilbara gas. In the document, he said that he proposed to examine the circumstances in which these two decisions were made and said:

"Although it was a period of diminishing projections of energy growth rates, it is submitted that this series of decisions represents inept management of the State's interests by a Government which campaigned on its ability to manage resource development programs."

2.17.7 Mr Parker was referring to the period 1977 to 1979. It is important, however, to appreciate the then circumstances in respect of the provision of energy for the State. Natural gas was supplied from the Dongara field, the life of which was known to SECWA as likely to terminate in the mid-1980s. Therefore, in Dr Booth's opinion, Dongara gas needed to be replaced urgently. That view was supported by Mr Ludlow (who was at that time employed by SECWA as Resources Engineer), Mr Kingsmill, and Mr Saunders. According to Dr Booth and Mr Kingsmill, Collie coal reserves were limited and represented a very high cost fuel. Dr Booth said the large North Rankin gasfields had to be developed in relatively deep water and therefore

needed a volume of production that exceeded the State's energy requirements by many times over and therefore a large component of export gas would be needed in the volume of production. Mr Saunders, referring to the Dongara gasfield, recalled that SECWA had debated at the time how much gas it should take from that field. In the end, it decided to take a modest quantity and within a year it had sold, apart from a small amount held back for reticulated supplies, all of the gas. Thereafter, it was heavily criticised for lack of foresight by a large number of unsatisfied gas customers who were suffering financially because of the rise in oil prices. Oil prices had increased fourfold in 1974 and doubled in 1979. Dr Booth pointed out that the whole world wanted an alternative to oil in 1974 because it was feared that the oil price per barrel might go as high as \$60. Mr Saunders agreed. Dr Booth referred to the State's dependency on oil during the 1970s and to the high priority given by SECWA to wean the State off that dependency. This thinking was behind the strategy embracing development of the North West Shelf gas supplies. In summary, oil prices did not fall from 1977 to 1979, and there was no indication that energy growth rates were diminishing.

2.17.8 We have already referred to the report of PA Consulting, produced in 1979, which supported progressively increasing energy projections. Dr Booth said the initiative to exercise the option to take an extra 50 mm cfd came from SECWA. It had "no hesitation" in advising that the option should be exercised, as expressed in a memorandum from Mr Kirkwood to Mr Mensaros dated 5 November 1978. SECWA was concerned to protect the State's energy interests by ensuring that the State had sufficient gas. SECWA appreciated the risk in exercising the option, but believed it was acceptable because the State might have been caught in a position where it would become short of gas, if energy needs turned out greater than forecast, if no extra gas were found and the gas covered by the option exported.

2.17.9 According to Dr Booth, the addendum to the Memorandum of Understanding, which was executed on 3 November 1979 and contained an assumption by SECWA of responsibility for marketing the 70 mm cfd of Pilbara gas and the price redetermination provisions, was entered into by SECWA of its own volition and free from political interference. He further said that the addendum to the memorandum was achieved with the assistance of the Government and especially the Premier, Sir Charles Court, when he obtained a letter embracing the Swede Nelson principles. Mr Saunders also agreed that SECWA entered into the addendum of its own free will. Dr Booth said the introduction of the Swede Nelson principles into the Memorandum of Understanding created a better deal for SECWA and that was the collective judgment of SECWA. It

believed that because of the change, it had entered into an arrangement which, though more complex, was a better one than had previously existed. The addendum was regarded as giving SECWA much greater flexibility and assurance in tough times than had previously existed.

#### 2.17.10

Mr Kingsmill believed the right to market the Pilbara gas was beneficial to SECWA rather than an obligation. He believed that incorporation of the price redetermination provisions was a major coup as it gave SECWA the assurance it could market gas commercially in a mixed energy economy, giving the opportunity for price redetermination on an annual basis if that was considered necessary having regard to the competitiveness of prevailing energy prices. The SECWA board was elated that its negotiators had arranged for the price redetermination provisions and Mr Kingsmill remembered the negotiators being commended for their efforts. He said that though the price redetermination provisions allowed the JVP an opportunity to exercise rights conferred on them under those provisions, it was in his opinion fair to say that there were more advantages to SECWA than to the JVP and that had been shown to be the case as history progressed. Dr Booth said he could never have envisaged circumstances in which the price redetermination provisions would have been surrendered.

#### 2.17.11

Referring specifically to the addendum of 3 November 1979 to the Memorandum of Understanding, Mr Parker, when speaking of Mr Mensaros's actions in relation to the addendum, said that even if he placed the kindest possible construction on his actions, then he was incompetent rather than irresponsible. In our view no evidence supports the proposition that the addendum was specifically the result of action on the part of Mr Mensaros: indeed, it is clear the addendum was willingly entered into on the initiative of SECWA. Nor is there any evidence to support the proposition that there was "inept management of the State's interests" by the Government. The evidence leads to only one conclusion and that is that SECWA entered into the Memorandum of Understanding and exercised the option contained in it of its own volition and free from political interference. In that action, of course, it had the support of the Government, as it had in entering into the addendum. The better view is that SECWA may have acted imprudently had it not exercised the option and accepted responsibility for marketing gas to the Pilbara. Information from consultants and from its own officers pointed to increasing energy requirements of the State and the need to secure further energy resources as cheaply as possible. SECWA was obliged to forecast energy requirements

for 20 years ahead and that necessarily involved the risk of an overstatement of requirements in the earlier years. Subsequent developments have established the wisdom of SECWA's actions.

#### 2.17.12

By the financial year 1987/88, gas placed in inventory represented only 7.5% of the total gas delivered to SECWA from the North West Shelf that year. In the financial year 1988/89, the corresponding percentage was 1.1%. In the 1989/90 year, no gas was accumulated in inventory and the cumulative inventory had been reduced to 3.2%. In 1989/90, SECWA committed itself to purchase gas from other suppliers. In that year, SECWA's demand for gas exceeded the take-or-pay volume specified in the gas sales agreements. On 28 March 1989, *The Australian* newspaper reported that the Western Australian Government had issued an urgent appeal for more gas exploration saying that the State's energy situation had changed dramatically. Mr J Carr, the then Minister for Fuel and Energy, was reported as stating that the State was looking for additional gas supplies to the equivalent of 1 million tonnes of coal a year. In 1987, SECWA had exercised an option to purchase additional supplies of gas from the Dongara field; in late 1989 it agreed to purchase gas from the Tubridgi Joint Venture over a 10 year period; and in late 1990 it had agreed to purchase gas from the Harriet gasfield over 10 years. By the end of the financial year 1990/91, the cumulative value of gas in inventory, valued at cost, was \$240.7 million. Over the period since 1985, under half a year's supply has accumulated in inventory. Sir Charles Court, in his statement, said that within reasonable limits, inventory reserves were not a liability. If the inventory were empty, the State would be in a weak negotiating position for new industry and economic growth.

#### 2.17.13

Although Mr Parker was prepared to forgive Mr Mensaros for what he conceded might be reasonable business decisions in 1978, he could not do the same, for Mr Jones' decision in 1980 to translate the earlier Memorandum of Understanding into the contractual commitments of 30 September 1980. By then, it was clearly apparent that the gas market was declining. According to Mr Parker, SECWA counselled the Government against entering into contractual relations with the JVP without a back-to-back contract with Alcoa. "Despite this advice [of SECWA], the then Government pressed on and forced the signing in September 1980 three weeks before the Federal Liberal-NCP Government...went to an election on the basis of a resource boom". Mr Jones' actions were said to have been motivated by political guile or business

ineptitude, the irrefutable fact being that they were contrary to the State's interests. "The contracts with their unsecured commitments by the SEC placed Alcoa in an ideal position to negotiate its contract with the SEC". Mr Jones had to have been irresponsible. This was so, it was said, because, by April 1980, both pelletising plants had closed and there was no prospect of them reopening. The potential market for gas was therefore substantially reduced from earlier optimistic projections. Thus, with the unfortunate decision, so-called, to take the extra 50 mm cfd for the south-west and the extra 70 mm cfd for the Pilbara, Mr Jones "was motivated by political considerations in the face of the then impending Federal elections".

#### 2.17.14

We propose to deal first with the allegation that it was clearly apparent by 1980 that the gas market was declining. From 1979 to March 1981, SECWA was confident and advised the Government that it would be able to sell the gas it was committed to take. Mr Ludlow (who at the time was employed by SECWA as Resources Engineer) said that at the time of the gas sales agreements, SECWA believed it could market 300 mm cfd, based on studies it had carried out. Indeed, some people in SECWA felt that the amount agreed to be taken might prove too small. The confident view in SECWA was that a market would be found for all the gas contracted to be bought, bearing in mind that the gas would not flow until 1984.

#### 2.17.15

According to Mr Kingsmill, based on submissions prepared by a number of able consultants, SECWA had good reason to believe that the gas contracted for would be sold within a reasonable time. And, of course, at that time, 1980, an aluminium smelter was expected to be built when the gas flow began. It was only in later years, when the economy went into recession and the smelter was not to be built, that it began to be appreciated that a serious problem existed with the magnitude of gas contracted for. Mr Kingsmill agreed with a SECWA report headed "Review of Future Prospects 1980-1990" produced in March 1981. It had been assumed that when North West Shelf gas became available, substantially all gas purchased by SECWA would be sold within the State to customers in the Pilbara and south-west. That view accorded with the thinking of SECWA in March 1981, and, according to Mr Kingsmill, with external organisations. He was also referred to a passage of the report which stated that it was anticipated gas could be sold at prices which would enable it to be competitive with both coal and fuel oil in the Pilbara region. It then said that with the expected increase in energy demand in the Pilbara, due to the expansion of the existing iron ore industry, the development

of a new project during the 1980s, and the possibility of electrifying the railway systems, the potential demand for natural gas exceeded that available under the gas sales agreements. Mr Kingsmill agreed that this passage of the SECWA report reflected the thinking current within SECWA during 1981.

#### 2.17.16

Dr Booth gave similar evidence to Mr Kingsmill. SECWA's position when the gas sales agreements were signed in September 1980 was perhaps best summed up by Dr Booth when he was asked, whether at that time, there was any portent of a downturn in economic conditions. He said:

"Yes; but not definitely and not to the extent that would worry us. I think one must keep in mind that we were signing a 20 year contract for delivery of gas that was not to begin until late 1984 or 1985. I mean, long-term contracts require one to take a long-term view. The fact that there may be imminent signs of economic problems in the first couple of years before the gas even came was reason to be worried, but one essentially needed to take a long-term view and as far as we were concerned . . . you might remember that this is the period of time when Australia was supposed to be in a mineral boom and all sorts of things were going to happen. The outlook was uniformly bullish and it took a lot of persuading and a lot of experience, harsh experience, before Australia sort of rid itself of that optimism. That optimism still remained, as I remember, in the '80/'81 period although it is undoubtedly true there were signs on the horizon of some troubles."

#### 2.17.17

There is no evidence to support Mr Parker's claim that it was apparent by 1980 that the gas market was declining. Indeed, the evidence is all the other way in affirming SECWA's view and those advising it, that the gas market was likely to increase significantly.

#### 2.17.18

We now have to deal with allegations that the Government forced SECWA into signing the gas sales agreements of 30 September 1980 and did so for political purposes which are said to be connected with the then pending Federal election. Dr Booth gave his view why the agreements were signed at the end of September 1980. He said the timing was determined by the three-month rest period that existed in the ratified agreement referred to in the *North West Gas Development (Woodside) Agreement Act*

1979. The JVP was keen to have all the documentation ready by 30 September, as that was the end of a three-monthly extension for compliance with the provisions of clause 6. The two essential things determining the timing were the three-monthly rest period and the JVP embarking on a programme to have all relevant matters required under the legislation completed by 30 September 1980. The gas sales agreements executed with SECWA on that date were part of that programme. Mr Kingsmill was asked whether the timing of the signing of the agreements was hastened by an impending Federal election. He said he did not see any evidence of that and felt the suggestion was a figment of the imagination of the media and some politicians. In any event, the political benefit would not have been major. Everybody knew the North West Shelf Gas Project was proceeding and that negotiations for the purchase of gas were continuing. Hastening the signing by three weeks would not have yielded any benefit. He could not remember any pressure being brought to bear to hasten the signing. Sir Charles Court denied any connection between the signing and the impending Federal election and so did Mr Jones. The only conclusion open on the evidence is that the timing of the signing on 30 September was not related to the impending Federal election, nor were the Government and Mr Jones motivated by any political guile or any desire to benefit the Federal Liberal Government of the day.

#### 2.17.19

It remains for the Commission to deal with the two issues raised by the report of the Aluminium Smelter Task Force to which we have referred. Those issues bear on the question whether the Government forced SECWA into signing the gas sales agreements. They are the allegation that SECWA counselled the Government against entering into the agreements without a back-to-back contract with Alcoa, and that SECWA, having sought performance guarantees from the parent companies, was instructed by the Government to drop that requirement.

#### 2.17.20

Dealing with the allegation about Alcoa, there was no evidence that SECWA advised the Government not to sign the gas sales agreements before there was a back-to-back contract with Alcoa. Both Sir Charles Court and Mr Jones said no such advice was given. The evidence was that it was impossible to sign the contract with Alcoa until the cost of the pipeline and the cost of transporting gas through it was known. Dr Booth said it was impossible for the Alcoa contract to be entered into before the gas sales agreements, though it would have been nice if that could have been done. First, the timespan did not allow the negotiation of a complex contract and, secondly, that the

Alcoa contract was not a back-to-back contract with the gas sales agreements. The reason for the complexity of the Alcoa contract was the cost of gas which was affected by the cost of the pipeline. In the ordinary sequence of events, it was inevitable that SECWA had to finalise the arrangements with the JVP, and progress had to be made on pipeline construction, so as to enable some costing definition of the transportation arrangements. Dr Booth said that he entirely disagreed with the proposition stated in the Aluminium Task Force brief that the Government proceeded without the Alcoa contract against the advice of SECWA. Mr Saunders said the two aspects of costing so far as Alcoa was concerned, were the cost of gas and the cost of transporting it and, with the latter, about half the capacity of the pipeline was reserved for Alcoa's gas. The capital charge could be calculated only when the final capital cost of the pipeline was known. It was not until well into 1982 that an updated estimate could be made of the final capital cost.

#### 2.17.21

If SECWA was under pressure from the Government to execute the gas sales agreements without obtaining a back-to-back agreement, we would have expected there to be some indication of that pressure in SECWA's minutes. The minutes of a meeting of SECWA, on 29 September 1980, contained nothing to indicate any such pressure. At p 7 of the minutes, the situation with Alcoa is referred to. The Commissioner informed SECWA that he had discussions with the General Manager of Alcoa and had sent him a telex on 26 September, a copy of which was apparently annexed to the minute. Mr Vann, Alcoa's Manager, had replied, confirming that Alcoa wished to purchase at least 150 mm cfd over a 20 year period on terms and conditions generally as set out in the 12 September 1978 memorandum of understanding between SECWA and Alcoa as modified on 19 September 1979. The Commissioner informed the members that the preparation of the agreement with Alcoa was well advanced and could proceed unhindered with the conclusion of the North West Shelf gas sales agreements. He confirmed that Alcoa had shown every indication of wishing to remain within the terms of the original memorandum of understanding and had been pressing SECWA regarding the availability of additional gas throughout the contract period. SECWA noted these developments and the added degree of assurance with the exchange of correspondence.

#### 2.17.22

There is no suggestion of any pressure or compulsion on SECWA to proceed without the contract with Alcoa having been first completed and executed. The letter

from Mr Vann fully confirms what Mr Kirkwood told the Commission. Without going to the other exhibits, which are copies of minutes of the Commission held after 30 September 1980, it is necessary to say only that those minutes also do not suggest any pressure from Government.

#### 2.17.23

Our conclusion is that the allegations that SECWA had counselled the Government against entering into actual arrangements with the JVP before a back-to-back contract with Alcoa had been concluded or, alternatively, that SECWA did not want to execute the gas sales agreements until the agreement with Alcoa had been completed, are not supported by the evidence. Nor is there any evidence that the Government pressed on and forced the signing of the agreements of 30 September 1980. It is true, however, that the Government approved the action of SECWA in entering into the agreements of 30 September 1980. Further, it may be noted that, for the contract to be enforceable, the Governor's ratification was required as outlined in paragraph 2.3.6 of this chapter. The ratification was given on 1 October 1980.

#### 2.17.24

The second issue raised by the task force is the allegation that SECWA sought performance guarantees from the parent companies whose subsidiaries made up the JVP, but the Government "instructed the Commission to drop this requirement". The history of the parent guarantees is set out in the minutes of the meeting of SECWA held on 29 September 1980, in a report Mr Kirkwood made to Commission members. A full credit assessment of the JVP companies was carried out by the Royal Bank of Canada and Orion Bank Ltd on behalf of SECWA. From the start of the negotiations, SECWA, acting on the advice of these banks, insisted that there should be satisfactory guarantees of performance of the signatories, none of whom, in the opinion of the financial advisers (with the possible exception of Hematite Petroleum Pty Ltd, a subsidiary of BHP), was considered to have the financial substance to carry through the obligations arising from its share of the first stage of the North West Shelf Project. The JVP negotiators indicated that the issue of the guarantees would be a matter for their senior executives to decide.

#### 2.17.25

On 22 August 1980, SECWA wrote to the parent companies indicating that parent company guarantees would be required. The companies refused, giving several detailed reasons. The Premier was advised of the refusal, as appears from a

memorandum from Mr Jones appended to the minutes of SECWA. The Premier agreed that SECWA should continue to insist on full parent company guarantees.

#### 2.17.26

After a further meeting with the Premier on Thursday night, 25 September, representatives of SECWA met representatives of the JVP in an endeavour to resolve the problem. The JVP were adamant that the respective parent companies would not give either guarantees or legally binding letters of assurance. That state of affairs was then referred to the Premier on 26 September. On the night of Friday, 26 September 1980, after meetings had taken place between the Premier, Mr Kirkwood, Mr Kingsmill, and Mr Hardcastle, the Premier decided he would accept letters of comfort from the companies concerned in a form similar to a precedent which had been presented to him.

#### 2.17.27

The Premier also had discussions with Sir James McNeill of BHP, telling him that SECWA would require the parent companies to give guarantees or appropriate letters of assurance should they find it necessary to give parent company guarantees or appropriate letters of assurance to the Japanese purchasers of gas. Sir James McNeill agreed on behalf of the JVP. The Premier insisted that SECWA not be in any worse position than the Japanese purchasers of LNG.

#### 2.17.28

On 28 September, Mr Jones met Mr Kirkwood, Mr Kingsmill and other officers. After telephone discussions between Mr Jones and the Premier, Mr Jones told the meeting that he and the Premier had concluded, from their discussions with the JVP and from their knowledge of the overall position, that neither parent company signatures to the gas sales agreements nor guarantees could be secured, nor could firm letters of assurance be obtainable. Hence, the Premier and Mr Jones decided that they would be prepared to accept letters of comfort. That ends the recital of developments by Mr Kirkwood. SECWA noted these developments and, while expressing some disappointment at the absence of formal parent company guarantees or legally binding letters of assurance, accepted the Government's position and noted that the nature of the companies involved and the powers given to the Government under the *Petroleum (Submerged Lands) Act* provided the Government with substantial legislative backing if the JVP failed to perform their obligations. SECWA also noted that Mr Jones intended to take the matter to Cabinet.

#### 2.17.29

The only matter that tends to support there having been an instruction to SECWA by the Premier or Government is a draft of a submission from Mr Jones to Sir Charles Court. The draft was clearly the type that would be likely to have been prepared by SECWA for submission to the Minister for his approval before he submitted it to the Premier to obtain Cabinet endorsement. The first page of the draft is unexceptional, since it merely sets out the history of the matter leading up to the signing of the gas sales agreements. The second page is significant. It states:

"In all negotiations, the Commission made it very clear to the Joint Venture Partners that full parent company guarantees of the performance and of the financial strength of the Companies entering into the agreement would be required. This requirement was endorsed by the Premier and the Minister and although the Commission made every effort to obtain the guarantees, and also attempted to arrange a compromise solution to the problem, the Companies refused to issue such guarantees. Instead, the Companies offered letters of assurance but without any legally binding commitment.

The Premier, after full consideration, *instructed* the Commission to proceed on the basis of the letters of assurance offered by the companies." [our emphasis]

#### 2.17.30

It is not known who drafted this document. It is possible that Mr Kingsmill did, but he could not recall doing so. The actual memorandum that passed between the Minister and the Premier, and which Cabinet noted and approved, is different. The first page is identical, but the second page varies considerably. While the first paragraph on the second page is very similar, it includes a paragraph which reads:

"After full consideration and discussions involving all parties, including the Premier and myself, the Gas Sales Agreement was finalised on the basis of the letters of assurance offered by the companies.

**Recommendation:** That Cabinet notes the completion of the Gas Sales Agreement, and endorses the actions taken."

#### 2.17.31

Mr Jones accepted that he would have seen the draft minute and he would have

altered it so that it conformed with his understanding of the matter. In any event, the draft would have required alteration since it spoke impersonally of the Premier and the Minister, instead of the Premier and "me". Sir Charles Court denied that any instruction had been given. As to obtaining the parental guarantees, Sir Charles said that after he spoke to the JVP at SECWA's request, he made up his mind that SECWA and the Government, in going beyond letters of comfort, were wasting their time, since the JVP was prepared only to give letters of assurance or parental guarantees if the Japanese insisted on similar legally binding documents. In Sir Charles' view, Mr Jones had interpreted the facts correctly when he submitted a minute stating that "after full consideration and discussions involving all parties, including the Premier and myself, the Gas Sales Agreement was finalised".

#### 2.17.32

Mr Kingsmill, Mr Booth and Mr Saunders agreed that no instruction or direction had been given. The views of SECWA, the Premier and Mr Jones were not diverse on this matter. Mr Kingsmill said he could not remember the Premier ever having given him an instruction. He believed that, after a full discussion, those present probably realised they were not going to get the guarantees and the Premier might have said: "Well, obviously we're not going to get them. We're just going to have to proceed without them and that's the way it is". Mr Kingsmill agreed with a leading question put to him that without parental guarantees — that being the only obstacle left before the matter of the North West Shelf could proceed — SECWA could have believed that a political decision had to be made as to whether or not SECWA should abandon the strong advice of its advisers to insist on parental guarantees. Mr Kingsmill said that was fair comment because SECWA might have been accused of not keeping the Government fully informed if it had said it did not need the guarantees and something had gone wrong. SECWA had kept the Government fully informed during the North West Shelf negotiations and the Government had actually been involved in the negotiations.

#### 2.17.33

It is also important to remember that, in 1980, not even the Minister had power to give SECWA binding instructions, except as to policy.

#### 2.17.34

In the minutes of the SECWA meeting held on 15 October 1980, reference is made to the Assistant Commissioner — Commerce (Mr Kingsmill), who said the Minister had advised him the minute approving the execution of the gas sales

agreements had been approved by Cabinet, but a copy had not yet been received by SECWA. At the meeting of the board of SECWA on 29 October 1980, the minutes record that the Commissioners noted with concern that the Commission had still not received a copy of the Cabinet resolution relating to the acceptance of letters of assurance rather than parent company guarantees. The explanation for that minute lies in SECWA's belief that it should have a record of Cabinet's endorsement of SECWA having signed the agreements without parental guarantees. We do not believe, however, that anything more should be read into it. In any event, to have a copy of the Cabinet approval was not necessary, since the agreements were unenforceable until ratified by the Governor as the consideration expressed therein would have been more than \$1 million. As the agreements were ratified by the Governor on 1 October 1980, he would not have done so without the advice of Executive Council, the members of which had been fully informed that the parental guarantees were not forthcoming.

#### 2.17.35

No credible evidence supports the view that the Government or the Premier, Sir Charles Court, instructed the Commission to proceed with the gas sales agreements without parental guarantees. The decision to proceed seems to have been a team decision. To have risked the opportunity presented by the North West Shelf project because of the absence of parental guarantees would have been insupportable. By 30 September 1980, the JVP had spent considerable money in exploration. It can be concluded, therefore, that there is no substance to the allegation that the Government instructed the Commission to drop the requirement of parental guarantees.

## **2.18 Conclusion**

2.18.1 The Commission has found no suggestion of corruption, illegality or impropriety in its inquiry into the North-West Shelf natural gas sales contracts.

2.18.2 In September 1980, SECWA concluded an agreement with the North West Shelf joint venture participants to take 370 million cubic feet of gas a day for 20 years under a take-or-pay provision.

2.18.3 The Commission inquired into allegations made by a former Labor Government Minister for Minerals and Energy, Mr David Parker. In short, the allegations were that SECWA had signed the contracts while energy growth rates were falling. He claimed that the contracts were the result of "inept management of the State's

interests" by the then Liberal Government and had left the State with more gas than it could use.

2.18.4 Energy growth rates were, in reality, projected by SECWA to rise, and rising oil prices, the State's dependency on oil, the high cost of Collie coal, and the need to replace the Dongara gasfield as a source of supply combined to justify SECWA's strategy to embrace development of the North-West Shelf gas reserves and the Government's encouragement that it do so.

2.18.5 There was no evidence to suggest that the commercial judgment of those involved in making the contracts was so flawed, if at all, as to be improper.

2.18.6 **SECWA.** In particular, we have found that:

- (a) SECWA, at all material times, negotiated the terms of the Memorandum of Understanding which was concluded in November 1977 free of any political direction.
- (b) SECWA exercised the option under the Memorandum of Understanding to take a further 50 mm cfd of gas of its own motion as a result of its assessment of future needs.
- (c) SECWA negotiated the addendum to the Memorandum of Understanding in November 1979 of its own motion after assessing its future needs.
- (d) SECWA, at all material times, maintained an appropriate relationship with the relevant Minister.
- (e) SECWA did not counsel the Government against entering into the contractual arrangements with the joint venture partners without a back-to-back contract with Alcoa having been first concluded.

2.18.7 **Sir Charles Court and Mr Peter Jones.** The Commission has found that neither the then Premier, Sir Charles Court, nor Mr Peter Jones, the responsible Minister, required SECWA to sign the gas sales agreements of 30 September 1980. The Premier did not instruct or direct SECWA to abandon the requirement from the JVP of

parental guarantees. The timing of the execution of the gas sales agreements on 30 September 1980 was not related to the impending Federal election.

2.18.8 **Further matters.** Finally, reverting to the terms of reference, the Commission reports:

- (a) There are no matters addressed in this chapter which should be referred to an appropriate authority with a view to the institution of criminal proceedings; and
- (b) There are no matters addressed in this chapter which render changes in the law of the State or in administrative or decision-making procedures necessary or desirable in the public interest.

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