REPORT

STORM FINANCIAL LIMITED, COLONIAL GEARED INVESTMENTS ("CGI" – COLONIAL FIRST STATE) AND THE COMMONWEALTH BANK OF AUSTRALIA

22 FACTS POINTING TO EXISTENCE OF NON-EXCLUSIVE JOINT VENTURE BETWEEN CBA / CGI (COLONIAL FIRST STATE) AND STORM FINANCIAL LIMITED

1. CBA/CGI "developed and administered Storm investment products".

2. Storm-branded index investment products were developed in conjunction with Colonial First State (CBA) and Challenger.

3. Development in tandem of mutual Client support arrangements/system, by which CBA customers remained, first and foremost, Storm Clients on the premise that Storm Clients would also become CBA Customers.

4. CBA left all Client contact to Storm ARs (Authorised Representatives) and ERs (Employee Representatives).

5. CBA delegated Client loan serviceability assessment to Storm.

6. CBA extended special lending concessions, including especially generous (but also riskier) buffers, LSRs and LVRs to Storm Clients ,on proviso that Clients followed Storm advice.

7. CBA specifically approved in writing of Storm advisory model.

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8. CBA licensed by Storm to issue Storm branded products in Australia and New Zealand, for which Colonial to pay licence fee to Storm.

9. CBA principal banker to Storm Financial Limited ,Storm directors and Storm Financial Limited shareholders and held registered fixed and floating charge over assets of Storm Financial Limited , placing it in actual or potential conflict of interest with Storm Clients(i.e. if it was not good for Storm it was not good for the CBA).

10. CBA and Storm developed incentives for Storm Clients based on conversion of trail commissions to Client incentives *vis-á-vis* interest discounts, higher buffers, more generous/elastic LSRs and LVRs and treating Storm Clients as "off limits" for direct CBA contact/competition (e.g. no competition from Comsec).

11. CBA and Storm co-benefited from Client incentives, because what was good for Storm Clients was *ipso facto* good for Storm and good for the CBA, i.e. more CBA /CGI loans written.

12. CBA bypassed Client and paid Client fees payable by Storm Client to Storm directly and debited to Client's CBA account.

13. CBA and Storm worked collaboratively to maximise borrowings by Storm Clients by proposing opportunities for further margin loans and leverage against Storm Clients' real estate to invest in Storm index funds, including through VAS revaluations generated by CBA, sometimes "off the CBA's own bat ".

14. CBA set -up dedicated Storm Team just to service Storm Clients at CBA Townsville.

15. CBA purported to reserve "the right ", which it in fact exercised, to bypass Storm Clients and to deal directly with Storm about Storm Clients.

16. Storm, through associated/related entity, Ignite Financial Systems and Research Pty Limited, provided Colonial (and Challenger) with product development, research and marketing services.

17. CBA/CGI sponsored or co-sponsored

(a) Alaska trip;

(b) Italian Gala Concert/Dinner; and

(c) Golf Day for Storm ARs, ERs and Storm Clients.

18. CBA lent its name to promoting Storm IPO Prospectus and sponsored and funded concessional unsecured Storm "Staff loans" to facilitate subscription to Storm scrip.

19. Former CBA staffers moved to senior roles in Storm, with effect of optimising co-operation and collaboration between CBA and Storm.

20. CBA reserved the right to approve, veto or remove Storm ARs and ERs under Dealer Agreement with Storm.

21. CBA referred to "partnership" with Storm in dealing with margin calls in 18th May, 2007 letter from CGI to Storm.

22. CBA neglected adequately to establish and support reliable margin-monitoring systems, evidently placing excessive reliance on CGI's expectation that Storm would responsibly monitor the market and keep Storm Clients informed, in dereliction of CBA's separate duty to CBA Customers who were also Storm Clients: This was symptomatic of CBA's reliance on the arrangement with Storm, whereby the CBA would take a "hands-off" role with Storm Clients, leaving the running to Storm. Apparently, the CBA failed in its own responsibilities towards its customers (who were also Storm Clients) to keep them reliably and fully informed of market movements affecting customers' investments/margin loans.

INDEX

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STORM FINANCIAL LIMITED, COLONIAL GEARED INVESTMENTS ("CGI" - COLONIAL FIRST STATE) AND THE COMMONWEALTH BANK OF AUSTRALIA

1. The following material is derived from a number of sources, including my personal interviews conducted in May and June, 2009.

CGI'S APPROACH TO MARGIN CALLS

2. Ron Jelich was the principal of the largest Storm office in Australia, at Redcliffe, near Brisbane, which was originally a private financial planning consultancy and investment business which managed funds for a range of clients predominantly placed with Storm. Jelich's business was then acquired by Storm Financial Limited (Emmanuel Cassimatis) – in 2007, with the funding for the acquisition to come from the float of Storm Financial Limited, which was never achieved.

3. Ron Jelich has experienced margin calls in his capacity as a financial planner dealing with Colonial Geared Investments ("**CGI**")/Colonial First State, including as set out in para. 7 of **Doc. 24**.

CGI's practice through to the end of 2008 was to make a phone call to the client and to the planner during the buffer period and then if the buffer were exceeded, a letter to each would be automatically generated by the CGI system (see below).

THE STORM FINANCIAL PROSPECTUS

4. Storm Financial Limited, ACN 064 804 691 – Chairman's Letter of 14 November, 2007 (**Doc. 1**) – (Prospectus, page 2) - representation that Storm used custom-developed processes and training systems to deliver investment, debt management and risk management advice – "a proven system which continues to underpin the Company's growth as it further expands its network across Australia."

   Emmanuel Cassimatis advised that the promoters had retained UBS and Macquarie Bank for the Storm float and Mallesons in Brisbane had done due diligence.

   Everything in the Prospectus had been cleared with the financial institutions who are expressly linked to Storm.

5. On page 17, identifying the advisers to the offer, it is recorded that Mallesons Stephen Jacques were the legal advisers and Price Waterhouse Cooper Securities Limited, were the financial advisers and prepared the investigating Accountant's Report on historical financial information and Forecast Financial Information, (see page 23).

6. At Clause 2.13, "Institutional Offer", on page 23, it is noted that certain institutional investors would bid for shares. According to Cassimatis, on 19 May, 2009, although there was not strong institutional support, the CBA was one of the institutions which had supported the Storm IPO and subscribed for shares.

CO-DEVELOPMENT AND LICENSING OF STORM FINANCIAL PRODUCTS

7. At page 32, under: "4. The Storm Overview" (at 4.2), the Storm history includes:

   > "2001 – 2007, Storm-branded index investment products developed in conjunction with Colonial First State and Challenger".

8. At page 35, Clause 4.3.3, under "Index-Based Approach to Investment", it is recorded:

"Storm offers a range of Storm-branded, sector-specific index funds that have been developed exclusively for Storm by Ignite and are managed by some of Australia's leading fund managers, including Challenger Managed Investments Limited ("**Challenger**") and Colonial First State Investments Limited ("**Colonial**").

"Storm and Challenger have entered into a Product Maintenance and Development Deed under which Storm agrees to provide Challenger with the first right to develop any Storm funds management product until 11 January 2012.

"Further details of this Deed are set out in Section 9.7.6: "***Storm has granted Colonial a Licence to use the Storm trademarks in connection with Storm's financial products. Further details on the Colonial Trade Mark Licence are set out in Section 9.7.5***."

9. And then at page 35, second column, third paragraph:

"Ignite provides both Challenger and Colonial with product development, research and marketing services, in relation to the index funds. In respect of such services, Ignite receives a fee of no more than 0.33% per annum, inclusive of GST, of all investments in the index funds."

10. At page 13, it was recorded:

"Reliance on Ignite Financial Systems and Research Pty Limited ("**Ignite**") and other service providers: Storm relies on Ignite and other third parties to carry out some core business operations. Ignite is separately owned by the Founders. Storm is, therefore, susceptible to a risk of default or termination by these service providers. (See Section 5.2.6)."

11. See page 44, Clause 5.2.6, "Reliance on Ignite and Other Service Providers: Storm's business and its ability to continue to service its clients, relies heavily on services provided by Ignite, including...."

> "In addition, the investment products that Storm offers are developed and administered by third parties, including Ignite, Challenger and Colonial. This leaves Storm susceptible to a risk of default or termination by these service providers."

12. Page 41, "Fees that Ignite currently receives from Colonial and Challenger:

> "Ignite receives: 0.33% per annum from Colonial on the funds invested in Storm-branded Index Funds issued by Colonial ($752 million as at 30 September, 2007); and
>
> "0.165% per annum from Challenger on funds invested in Storm-branded Index Funds, issued by Challenger ($1.298 million, as at 30 September, 2007)."

13. As to the relationship between Storm and Ignite, see page 79, under "Licence Fees", whereby considerable funds stand to be transferred by Storm to Ignite as licence fees.

14. At page 82, under Clause 9.7.5, "Colonial Trade Mark Licence", it is recorded that:

> "Storm has granted Colonial a licence to use a number of the Storm trademarks. This licence permits Colonial to issue certain financial products (being Index Funds), under the 'Storm Financial' brand...
>
> "The licence is limited to Australia and New Zealand and it is non-exclusive."
>
> "Colonial agrees to pay fees set out in its product disclosure statements for the 'Storm Financial'-branded funds, issued by Colonial from time to time."

15. At Clause 9.7.6, it is recorded that Storm agrees "not to develop a product with another person on terms more favourable than previously offered to Challenger." (*Vide* "First right to develop new products") on page 82.

16. On page 89, "Founders" are defined as meaning "Julie and Emmanuel Cassimatis" "Ignite" is defined as meaning "Ignite Financial Systems & Research Pty Limited, ACN 091 752 920".

17. In the glossary to the prospectus at page 88, "AR" or "Authorised Representative", is defined to mean, "a person who is not an employee of the Group, authorised to provide financial services on behalf of Storm". "Company" is defined as meaning "Storm Financial Limited (ABN 11 064 804 691) and "the Group" is defined to mean "Storm and its subsidiaries".

TRAIL COMMISSIONS – HOW TREATED

18. At Clause 7.13, in Section 3 of Part 7, "Financial Information" on page 65 of the Prospectus, the following appears, under "Trail Commissions", with the terms from the Glossary, substituted into the passage quoted, to render the excerpt readily comprehensible:

> "Trail Commissions
>
> "(Storm Financial Limited) receives Trail Commissions from institutions on investments which were originated by (Storm and its subsidiaries) and its (authorised representatives). Trail Commissions are received over the life of the investment, based on its market value. Storm Financial Limited also makes Trail Commission payments to authorised representatives, based on the investments lodged.
>
> "On initial recognition, Trail Commission revenue and receivables are recognised at fair value, being the expected future Trail Commission receivables, discounted to

their net present value. In addition, an associated payable and expense to the (authorised representatives) are also recognised, initially measured at fair value, being the future trail commission payable to (authorised representatives), discounted to their net present value.

"Also recognised are client servicing costs, initially measured at fair value being the future servicing 'Sots' discounted to their net present value.

"Subsequent to initial recognition of measurement, the trail commission asset, trail commission payable and servicing costs are measured at amortised cost. The carrying amount of the trail commission asset and trail commission payable and servicing costs are adjusted to reflect actual and revised estimated cash flows by recalculating the carrying amount through computing the present value of estimated future cash flows at the original effective interest rate. The resulting adjustment is recognised as income or expense in the profit and loss account."

19. And then, under "5. Accounting Estimates and Judgments" (on page 65 – second column):

"Trail Commissions

"(Storm Financial Limited) receives trail commissions from institutions on the market value of investments outstanding, to which (Storm and its subsidiaries) are entitled without having to perform further services. (Storm Financial Limited) also makes Trail Commission payments to (authorised representatives), based on the investments."

20. At point 4 of page 5 of the Storm Prospectus: "Five Key Components of Storm's Differentiated Business Model", are outlined as including:

"Commoditised advice and centralised administration and processes that improve the quality and consistency of advice and allows for more effective risk management and control."

21. **Attached** (**Doc. 11**) is a search of Ignite Financial Systems and Research Pty Limited, conducted 29 May, 2009, showing that the Company was incorporated on 25 February, 2000 and its name was changed from Storm Financial Research Pty Limited to Ignite Financial Systems and Research Pty Limited on 23 March, 2007.

There are two (2) directors, Emmanuel George Cassimatis and Julie Gladys Cassimatis, both appointed on 25 February, 2000.

Emmanuel Cassimatis is also the Company Secretary.

There are only two shareholders, who each hold their shares beneficially in equal allotments, namely Emmanuel George Cassimatis and his wife, Julie Gladys Cassimatis. They appear to be the original shareholders.

In the Prospectus, "the Founders" are defined as being Julie and Emmanuel Cassimatis who hold shares through Cassimatis & Associates Limited as Trustee for The Emmanuel Cassimatis & Associates Unit Trust.

22. See "Statement of Advice – Fee Comparison", given to "D.J. and J.E. S." on 17 May, 2007 (**Doc. 4**): On page 54 of 109, Storm has acknowledged receiving a benefit from Colonial Geared Investments ("**CGI**"), which gave it a competitive advantage in the marketplace but by implication denied and continues to deny that this was for commissions or trailers.

At point 3 on page 54 of 109, the Storm Financial Disclosure Statement to DJS and JES (**Doc. 4**) declared:

> "The interest rate on the margin loan borrowings has been increased by 0.6% to allow for a trial commission of 0.6% per annum to be paid to Storm."

However, on page 58 of 109 in the same document, it was recorded:

"Please note, Storm does not receive commission for Margin Loans but prefer to pass the benefit on to our clients in the form of reduced interests rates. The standard variable rate usually offered by Colonial Margin Lending is 9.05%, however, the rate you will receive after the Storm discount of 1.15% will be 7.90%, based on proposed total Margin Loan borrowings of $500,000.00. This discount increases in tiers as your margin loan balances increase."

THE 18TH MAY, 2007 "PARTNERSHIP" LETTER

23. Letter from Craig Keary, General Manager, Geared Investments, written on Colonial Geared Investments letterhead, dated 18 May, 2007 (**Doc. 2**), addressed to Mr Emmanuel Cassimatis of Storm Financial Pty Limited.

The letter refers to the margin offered for lending facilities extended to Storm Financial clients and allocates "a global LVR of 80%" for Storm clients who invest in listed index trust funds with Challenger, Colonial First State, MLC and Barclays. The letter sets out the parameters for Storm to place investments and on page 2, stipulates that CGI will maintain the 80% LVR and 10% buffer for existing business retained or newly written business for "specific clients" of Storm, "provided that the client 'adheres to Storm's advised strategy', expectations are met and Colonial's assessment of the appropriateness of the loan conditions persists."

It is also specifically written that, "Despite our allocation of a global LVR of 80% to your clients on the basis of our expectations being met as set out above, nothing in this letter modifies or varies the obligation of any client borrower under Clause 3.2 of the margin loan to pay us the amount owing under the margin loan if that client borrower is ***either in default or we send that client borrower a five (5) day notice requiring payment of the amount owing***." (Penultimate paragraph of page 2 of letter).

In the final paragraph on page 2, Keary wrote: "Storm Financial will not gear a client above 65%. Should a client find themselves (sic) at LVR of 65% or above, then any additional gearing will only occur if the client's buffer increases."

Finally, Keary records: "In the unlikely event of a margin call, CGI and Storm Financial ***will work in partnership to clear the margin call***. Note, however, that CGI reserves its rights under its Margin Lending Terms and Conditions." (See the importance attached to this passage by Greenwood J. in para. 49 (at page 16) of his judgment in Storm v CBA [2008] FCA, 1991 (**Doc. 12**) (discussed at pages 17 and 18 of this Report (below)).

THE 'VAS' – VALUATION ASSESSMENT SYSTEM

The significance of the "in tandem" operations of CGI and Storm grew as the VAS, computer-based valuations generated from the CBA's Atikenvale branch – described by the CBA as "an automated decisioning tool", enhancing the client LVRs became more significant. According to the Duncan Hughes article in the Australian Financial Review ("**AFR**").

> "How CBA stepped up to Storm Financial" (**Doc. 10**), published 11 June, 2009,....
>
> "the VAS worked overtime in Townsville where its turbocharged valuations were estimated to have helped generate more than $100,000,000 of loan applications in the 2008 financial year – at a time when real property prices were falling."

According to the report, a "specialist cell" was established in the Bank's Aitkenvale, North Queensland Branch, during 2008, to deal with increased workload with specialist lending staff, seconded from branches across Northern Queensland – (See Hughes' article, *Ibid*).

In the same article it was reported that through 2006/2007 Storm encouraged clients to increase their holdings and make the most of their "lazy assets" by cashing in their superannuation, investing their inheritances or using the increased equity from their rising house prices – or all of the above.

Storm called it "stepping" an investment, thereby increasing its revenue stream. During 2008, CBA's VAS system was allegedly used to trawl through the accounts of Storm

customers and provide valuations that were used to top up their investments in Storm index-linked products.

In the same article, a former CBA executive, based in Townsville, recalled:

> "The system was used to 'deliver customers up to Storm for them to pick them off.' The CBA proactively delivered their customers to Storm to invest in a falling market...by offering Storm the opportunity to increase clients' borrowings without first seeking the client's approval, it gave tacit approval to the Storm model. The Bank was clearly okay with the Storm model because it was saying, there is more equity in the property, we can lend them more money and you can invest more money. If it had a problem with it, why were they offering their customers to Storm?"

24. It appears that Storm and the Commonwealth Bank made use of valuations generated by the internal valuation system of the Commonwealth Bank's, known as VAS. The **attached** Statement of "Yvette Daniel", a Senior Storm Adviser from MacKay, made 21 April, 2009 (**Doc. 14**), demonstrates that between October, 2007 and March, 2008, the Fs' property at Charters Towers, was revalued by VAS from a purchase price of around $50,000.00 to $350,000.00, ie. in a period of just five (5) months.

Another Storm customer, referred to another remarkable CBA VAS-based re-valuation whereby her property at Heritage Court was revalued over a period of ten (10) months, from $790,000.00 in May, 2007 to $1,000,000 (one million dollars) in March, 2008.

On 9 May, 2008, a Storm Financial operative wrote to PH & CH, by letter dated 9 May, 2008, advising that since the CBA had introduced a new computerised VAS (Valuation Assessment System), the valuation of their home had been increased for the purpose of permitting them to become their "own banker", turning their home from being an illiquid asset to drawing as much liquidity as they could from the house, in order to invest in the Australian Stock Market, which had experienced substantial market volatility over the past six (6) months, down fourteen percent (14%) from its November, 2007 peak. This kind of

advice is on all fours (4s) with the May 18, 2007 CGI letter to Storm, whereby CGI required Storm to convey the individual LVR to the client and ensure that the client followed and did not deviate from "Storm's advised strategy".

See copy letter from Storm Adviser to the Hs, dated 9 May, 2008, showing how CBA and Storm worked systematically together to generate shared business: CBA provided an unsolicited home valuation to Storm of a Storm Client's (and CBA customer's) property and Storm urged the Client to gear it further to buy shares.

CBA INSISTS ON TOEING THE STORM LINE

25. As to the symbiotic relationship between Storm and CGI/CBA, see page 2 of the letter of 18 May, 2007 from Craig Keary, General Manager of Geared Investments (**Doc. 2**), requiring Storm financial to advise the client that they "must" follow "Storm's advised strategy": (4th paragraph on page 2):

> "Each fund may attract a different LVR on a stand alone basis from Colonial Geared Investments. Storm Financial ***must*** convey these individual LVRs to the client and advise the client that departure from Storm's advised strategy will lead to a re-balancing of their facilities with Colonial Geared Investments..."

CONTROL & AGENCY

26. Then on 14 July, 2008, there is a letter from John Clothier, Head of Investment Lending, CGI, to Storm Financial Pty Limited (sic), marked to the attention of the Commissions and Operations Manager of Storm (**Doc. 3**):

> "Re: Dealer Group Agreements and the AML/CTF Reforms".

The letter refers to the new anti-laundering legislative framework and defines the CGI's new resultant obligations as requiring that "CGI must have systems and processes in place to carry out:

" * due diligence screening on its employees, agents and contractors; and

* customer identification checks."

The letter continues:

> "CGI has updated its Dealer Group Agreement (DGA) to include the additional requirements and new procedures...."

The letter refers to "a new DGA (Dealer Group Agreement)" incorporating "the existing terms and conditions of the current DGA".

CGT recognises albeit on a limited basis, an agency relationship between itself and the dealer.

At the foot of page 1, Clothier wrote, "As part of these changes, application forms and terms & conditions documents distributed by CGI, have also been reviewed and updated. From 31 August, 2008, advisers will be required to use new documents for the Colonial Margin Loan.

The letter also incorporated the following passage:

> "To ensure that all stakeholders – dealer groups, advisers and CGI – are compliant with the new laws, it is important that the signed DGA is returned to us by 31 August, 2008."

Then there is the "Australian Financial Services Licensee – Dealer Group Agreement Colonial Geared Investments", attached to the letter, citing the parties as being the Commonwealth Bank of Australia and Storm Financial Limited.

Under Annexure "B" thereto, headed "Colonial Margin Loan Services and Commission", the following appears:

"Clause 1(b):

"(Storm agrees) to act as our (the CBA's) agent and in accordance with our procedures, to ensure clients are properly identified in accordance with the Anti-Money Laundering and Counter-Terrorism Financing Act...."

Clause 1(b) continues:

"Except as specifically provided, you are not our agent for any other purpose under this Agreement."

However, the obligations imposed on Storm *vis-à-vis* "the client" in Clause 1(a), (c), (d), (h) and (i), in particular, would seem at least to set up a "tri-partite" relationship as identified and described by Greenwood J. in Storm v CBA *op. cit.* at para. 49, page 16 of Report (see page 18 below).

In Clause 1(h) of Annexure "B", Storm agrees to "perform the Colonial Margin Loan Services in such a manner as to promote our (the CBA's) reputation and our (the CBA's) Loans and not to engage in any conduct which may adversely affect our (the CBA's) reputation."

At Clause 1(i), a conflict of interest is created whereby Storm is required, to the extent permitted by law and its "duties to the Client", to cooperate with the CBA:

"in the event of a dispute or claim between us (the CBA) and the Client, in connection with the Loan or Colonial Margin Loan Services."

There is also a covenant by the CBA to pay commission in Clause 3(b) of the proposed Dealer Group Agreement, in accordance with Attachment 1 to Annexure "B" but Attachment 1 to Annexure B provides for zero Trail Commission to be paid. The

implication here is that the Bank had a direct relationship with the Client – Storm or no Storm.

Notably, "The Client" is defined in Clause 1 of the Dealer Group Agreement as being "an existing client of yours (Storm's)."

Under the Dealer Group Agreement in Clause 2, Storm is required to inform the CBA of the identity of its authorised representatives – and to provide a list of them, on request from the CBA. The CBA can require that an authorised representative no longer provide the services defined in Annexure "B" (Clause 2(c)) and pursuant to Clause 3, Storm is required to provide the CBA with the services referred to in Annexure "B", in consideration of the payment of commission, although no commission is actually specified.

PAUL JOHNSTON:- THE CBA/CGI "SYSTEM"

27. Paul Johnston, was Senior Manager of Margin Lending for Colonial State Bank until June, 2000 and for the Commonwealth Bank until 2003. He then became Senior Manager, Margin Lending at Challenger Financial Services Group Limited, until October, 2004. He told the writer on 5 June, 2009, that Storm Clients typically followed and did not deviate from Storm's advised strategy and he did not accept the notions that the CBA had no obligation to the Borrower or direct dealings with the Borrower and that the Borrower was solely reliant upon the intermediation of the dealer. If that were the case, Johnston argued, then the Bank would have had to have done extensive due diligence on the financial planner/dealer, eg. Storm.

According to Paul Johnston, it was not easy for a Client to access information on the performance of the index investment trusts in which Storm invested Client monies. The CBA only updated the information available online every couple of days, whereas there could be movements in the prices on a moment to moment basis.

See also former (unnamed) CBA Branch Manager, Observations by email dated 18 April, 2009 (**Doc. 6**), concerning the difficulty of accessing information from the CBA, particularly after the 2008 margin calls were made by CGI.

With respect to loan applications from Storm, the CBA had to rely upon Storm administering a serviceability test to clients because the Bank did not itself apply a serviceability test with respect to Storm Client borrowings.

Paul Johnston was concerned that the mass redemptions undertaken pursuant to the margin call may have depressed the price of the index investment trust funds. The price of the index investment trust funds fell faster than the stock market as a whole. Johnston speculated, since the CBA started its own index fund close on the heels of the redemptions having occurred, as to the ultimate principal buyer of the off-loaded stock, who might have benefited from the forced sales. It is a matter to be investigated.

As to Paul Johnston's view of the nature of the contract and the identity of the contracting parties, see paragraph 24 of his Statement attached to his Professional Profile (**Docs. 20 and 21**).

A copy of Ron Jelich's email setting out the content of his discussions with Paul Johnston in conference on 27 April, 2009 (**Doc. 22**), is **attached**. Notably, Ron Jelich recorded the fact that there appeared to have been a practical departure from the 18 May, 2007, written compact between CGI and Storm in that the buffer from 70% to 80% and the margin call threshold, from 80% to 90%, were not adhered to and rather, the buffers were in the low 80% range and the margin call trigger rates set in the early to mid-90% range.

Mr Johnston was of the view that the buffer and margin call levels were set dangerously high from a risk management perspective and also, that the CBA/ CGI was inadequately resourced from a staffing systems and procedural standpoint, routinely to fulfil its obligations towards Storm Clients.

Referring to the fact that Storm did not take trail commissions on Margin Call Loans, Johnston considered this as being evidence that there was a direct relationship between the Bank and the lender, rather than through Storm.

28. As to the approach being taken by the CBA to settlement of liabilities by Storm customers, I **attach** a serious of email correspondence as follows, involving:

(i) JC (**Doc. 19**);

(ii) RT and GT (**Doc. 15(a)**); and

(iii) DF and RF (**Doc. 15(b)**).

OTHER MATTERS AND DOCUMENTS OF INTEREST

29. **Attached:** Invitation to a Gala Evening to be held featuring Tina Arena at Castle Bracciano in Italy, promoted by Storm Financial, Colonial First State, Macquarie Margin Lending and Colonial Margin Lending.

RE: STATEMENT ISSUED BY COMMONWEALTH BANK ON 17 JUNE, 2009, THROUGH ITS CEO, RALPH NORRIS:

30. The Bank has made some key concessions. Broadly, Mr Norris has made the following acknowledgment and qualifications.

(i) The CBA was involved, to some degree, in the chain of circumstances which led to some Storm Financial clients finding themselves in a parlous financial position.

(ii) CBA has identified shortcomings on how money was lent to customers involved with Storm Financial.

(iii) CBA is "not proud" of its involvement in some issues involving substantial losses being suffered by Storm's and the Bank's clients/customers and claims to be working towards a fair and equitable outcome for affected customers.

(iv) CBA has only focussed on its "lending practices", as an area where shortcomings may be identified by the Bank.

(v) CBA divorced itself from financial advice provided "independently by Storm Financial" to the Bank's customers, saying "That was clearly the responsibility of Storm Financial, a licensed financial advisory company" – (per CBA Chief Executive Officer, Ralph Norris).

[*This does not sit will with the Bank's position adopted in the letter to Storm of 18 May, 2007 from the General Manager of Geared Investments, insisting to Emmanuel Cassimatis that "Storm Financial must convey these individual LVR's to the client and advise the client that a departure from Storm's advised strategy will lead to a rebalancing of their facilities with Colonial Geared Investments."*]

In February, 2009, CBA established a Hardship Team on the ground in Townsville. As a sign of the Bank's commitment, it announced that it would immediately suspend repayment obligations until 31 August, 2009 for all loans made to customers in relation to Storm Financial.

ASIC will come to a preliminary conclusion in its investigation into Storm on 31 August, 2009, which is the cut-off date for CBA's interest payment moratorium for Storm clients.

Arguably, Storm has exposed the Bank's inadequate risk management policies, practices and procedures, relevant to its margin lending portfolio.

FURTHER BACKGROUND

31. **Attached** as **Doc. 6** is a Report by a retired CBA Branch Manager, who resigned in 2006 with forty (40) years' experience with the CBA, at various levels, from conveyancing, senior loans officer, supervisor and up to branch manager.

He has expounded on his understanding of the usual banking practices of CBA (see **Doc. 6**). By the time of his retirement from the CBA in 2006, Mr Anderson was unaware of any "VAS" computer system for valuations (page 2). Under "Branch Network Area Manager" on page 3, he notes that Storm-initiated loan applications "all went through the Townsville office and were farmed out to North Queensland branches, attached to CBA Townsville Area Office, for domicile, adding to the new business written to several branches rather than all via Aitkenvale. It is no wonder that this area was the best of the best in Australia for CBA..."

At page 4, under "Brokers & Referral Agents", he remarks:

> "The Bank/Storm relationship was extremely close, given the number of ex-CBA people working for Storm, their continued contact with former work colleagues at CBA and evidenced by a constant stream of CBA staff, visiting the Storm Townsville office daily. The suspected payback was the automatic approval of all Storm applications which gave Storm their up-front commissions, rather than broker payments and commission trail.
>
> "Ample evidence exists of inflated property values, incomes etc, to suggest some degree of complicity between Storm and the Bank in ensuring approvals. Income from share dividends included but interest only on Margin loans not taken into consideration in the assessment of loan servicing. The actual value of security offered appears to be the only consideration given to decision process to ensure a sale occurred."

In the first paragraph on page 4, he wrote:

"The fact that Storm clients did not approach a Bank and all dealings were via Storm, this would imply that Storm acted as an agent of the Bank (sic)."

He concludes that:

"The volumes of new Home Loan business written via Storm in Townsville would be known to all Management levels, right up to the Chairman of the Board of CBA."

"CHURNING" BORROWINGS AGAINST REAL ESTATE EQUITY

32. Article "How CBA Stepped up for Storm Financial" (**Doc. 10**) by Duncan Hughes, Australian Financial Review, 11 June, 2009:

"The (the CBA-generated VAS valuations, to promote lending to Storm Clients, which) loans were used to invest in storm-badged products and additional margin loans for more investments that earned huge commissions and fees for Storm, CBA and other major banks that provided additional loans."

It was suggested that the use of VAS "evolved into a seamless relationship with the CBA providing valuations to Storm."

FORMER STAFFERS ENGAGED

Storm employed several former CBA employees, including David McCullough, an ex-CBA Townsville Business Banking Manager who worked at a very high level in Storm, Camella Richards, who ran back office systems and processes and Kirsty Devney, who was involved in day-to-day liaison between CBA and Storm.

During 2008, CBA's VAS system was allegedly used to trawl through the accounts of Storm customers to provide valuations used to top-up their investment in Storm index-linked products, according to the AFR report.

33. Storm obtained hundreds of valuations undertaken by CBA and then wrote to the investors with advice on what to do with the increased equity in their properties – according to the article.

Storm employee representative, Karen McTier, wrote on 9 May, 2008, to some Rockhampton clients of Storm:

> *"By drawing as much liquidity as we can from your house, while we want to and while the Bank is happy to do so, means you are setting yourselves up as your own banker."*
>
> *"Again, if at any time in the future you need the money, we have already borrowed it and it is sitting in high quality liquid shares that we can access very quickly..."*
>
> *"Taking money out of your home reduces liquidity risk and more importantly, provides the opportunity to 'buy now'."*

According to real estate industry statistics and opinion quoted in the article, as CBA's computer program was boosting property valuations, property prices were actually falling. Evidently in the North Queensland region, in calendar year 2008, "prices fell by more than 15%, the worst for a generation."

> "For CBA, a client following Storm's advice could generate earnings for the Bank's Aitkenvale branch, its margin lending offshoot, Colonial Geared Investments and Colonial First State, the Funds Manager who provided Storm's branded products."
>
> "For Colonial there was the initial fee and ongoing management charges. In addition, clients were often advised to take out personal insurance and income protection, which would be handled by Comminsure, the insurance division of the CBA." (**Doc. 16**)

34. As evidence of the Commonwealth Bank's consciousness of guilt after the December, 08 margin calls, telephone communications by CBA staff to Storm clients were pre-scripted, with potential answers to disgruntled Storm investors' anticipated complaints and recriminations. See **attached** Scripts for Calls to Storm Financial Clients – Monday 8 December, 2008 and Thursday, 11 December, 2008 – the latter: "Script for follow-up Call to Storm Financial Clients". The contents of the Scripts were slanted to disclaiming responsibility on the part of the Bank for the financial calamity and blaming Storm for the customers' woes.

35. Greenwood, J., in the Federal Court at Brisbane delivered an interlocutory judgment on 24 December, 2008, in Storm Financial Limited v Commonwealth Bank of Australia [2008] FCA 1991 at page 14, paragraph 43 (**Doc. 12**):

> "For present purposes, I am satisfied by the weight of the Applicant's (Storm's) material that had the financial adviser assumed a management responsibility for the margin loan transaction in each case and more particularly, a 'sole' responsibility for the management of the margin loan account through the period, the documents as between the Bank and Storm and in particular, the letter of 18 May, 2008, (copy letter **attached**) would have said so in clear and transparent terms.

36. Then at paragraph 49, Greenwood J. commented:

> "The Bank's position on the application for interlocutory relief is that this has nothing to do with the Bank, it is entirely a matter for Storm. That seems unlikely as the letter of 18 May, 2007 talked about working in partnership to clear margin calls and the Bank's letter of 17 December, 2008, seems to acknowledge that the position is that Storm had primary responsibility for the loan. It seems unlikely as a matter of prudential bank management that the Commonwealth Bank of Australia would have displaced all responsibility for its loan portfolio with these borrowers and investors, entirely to a third party, Storm. However, it should be noted that the protocol surrounding, or at least reasons for the Bank sending daily data sheets to Storm,

containing all the relevant ratios and information, is not explained by Storm in its material, in support of the Application.

"The much more likely inference is that both Storm and the Bank assumed a degree of responsibility for managing in a tri-partite way, the relationship between the Bank/the borrower/customer/investor and Storm as adviser overall. The boundaries of that relationship are the core matter in issue in these proceedings."

37. **Attached** is the signed Statement of Radomir (Ron) Jelich (pages 1 to 14) (**Doc. 25**), who was the Principal of Storm's largest office – in Redcliffe, near Brisbane, Queensland – and the supplementary Statement which he made on 20 April, 2009, with regard to the CBA's practice prior to the 2008 financial crisis which, in Jelich's understanding, had involved a CBA/CGI officer calling him to let him know that an account was in buffer, which was also then accompanied by a written notification.

38. When a loan was in margin call, there were follow-up discussions held to discuss options to address the position.

39. Even for Storm-authorised representatives and employee representatives, the amount of latitude given to Storm clients by the CBA/CGI and the closeness of the relationship which was akin to a joint venture, induced expectations and reliance, not only by the Storm representatives themselves but also by their clients. They were led by the CBA and Storm to believe that they would receive special treatment from the CBA and indeed, be treated with "kid gloves", in contradistinction to the treatment meted out to clients and customers of other margin lenders. eg. Macquarie Margin Lending ("**MML**"), which had lower buffers and could make earlier margin calls.

40. This was given practical expression in a number of forms, including in relation to the CBA's approach to real estate valuation, which became more aggressive from about March, 2008 onwards, when the VAS system of real property valuation was introduced by the CBA.

41. On 30 June, 2008, which was a gazetted holiday in Townsville: "Townsville Show Day", the CBA staged a "loan fest" when it signed up $25 million in loans secured against real estate, to be invested in Storm-branded Index Investment products.

42. With respect to revaluations obtained on real estate, in order to facilitate increased borrowings to invest in Storm-branded Index Investment products through margin lending, the process primarily involved Storm contacting the CBA and requesting a revaluation. The request for a revaluation was not a matter which would normally be imparted to a client or even concerning which the client's instructions would be sought.

This practice became more common because of the introduction of the CBA's VAS System.

43. In order to generate business, the CBA would "do VAS valuation runs on particular areas". For example, the CBA might perceive that property values had increased in Mackay in Queensland. The CBA would generate a VAS spreadsheet for the CBA's Mackay office, so that the Bank could notify Storm of the Bank's revaluations of Storm clients' real property in the Mackay area and the Storm employee representative at Mackay could, in turn, notify the client that more money could be drawn down secured against the client's residence, to invest in Storm Index Funds.

44. According to Jelich, in the months immediately following the 18 May, 2007 letter from Craig Keary, the General Manager of CGI, Emmanuel Cassimatis, at a series of meetings, boasted to Storm employee representatives and advisers that:

> "I've done the deal of the century for Storm with the CBA."

Between about March and November, 2007, there were frequent meetings between Jelich and Cassimatis.

THE CASE OF THE McARDLES

45. Sergeant Sean McArdle of the Queensland Police Service who, with his wife, Paula, invested heavily through Storm in Storm-branded Index Investment Trust Funds was ultimately refinanced entirely by the CBA at the beginning of September, 2008. He initially attended three Storm seminars, commencing in 2006, at each of which, the strong relationship between Storm and various banks, particularly the CBA, was emphasised by the Storm presenter.

Sean's wife was and remains on an invalid pension (related to residual injuries from a motor vehicle accident) of approximately $23,000.00 per annum and Sean continues to receive a policeman's salary of between $60,000.00 and $70,000.00 gross (which was his salary range at all material times). Sean had been told, after he approached Commonwealth Bank branches at Turnbull and Virginia near Brisbane, in 2006,that the maximum that he would be able to borrow from the CBA as an investment loan would be $350,000.00, based upon his own earnings and his and his wife's capacity to repay.

However, when they signed on with Storm, they were offered a million dollars ($1,000,000.00) as an Investment Home Loan by the CBA, notwithstanding that his available security was unchanged (apart from the Storm investment for which he intended to use the funds to be borrowed) and his income (absent the dividends which were in prospect from his intended investment in Storm-branded investment index investment products) had not altered either.

He had lodged the same payslips, tax return and group certificate to support $1 million in borrowings against his and his wife, Paula's, real estate holding, as he had presented to receive an offer of just $350,000.00 from James Lowe, the Manager of the Turnbull branch of the CBA, very shortly prior.

A margin loan granted by Macquarie Margin Lending ("**MML**") on Storm's application, had escalated to $2.5 million by July/August, 2008. When the McArdles were notified by MML that they had gone into 'buffer' in c.August, 2008, Emmanuel Cassimatis responded by

organising for CGI to refinance the MML debt, with a drawdown of up to $3 million. This was when the global financial crisis was entering a critical phase. (Lehman Bros. collapsed on 15 September, 2008).

So not only had Cassimatis of Storm organised for the McArdles to discharge their $2.5 million indebtedness to MML to take advantage of CGI's bigger buffer offered to Storm customers, by having the CBA refinance the McArdles' MML debt – for so Emmanuel Cassimatis' argument went – but Cassimatis led them into $500,000.00 more debt, by telling Sean McArdle:

> "All the planets are in alignment."

and that the McArdles could make 'a killing' on the stock exchange by buying more stock, at the bottom of the market.

The CBA facilitated Cassimatis' astrological approach to investment lending even after the Lehman Bros. meltdown. See copy letter to E.G. Cassimatis approving funding to other Storm clients, dated 17 September, 2008 and particularly, the opening paragraph on page 2 (**Doc. 35**):

> "The CBA is pleased to offer Storm Financial clients significant discounts on selected home loans and investment home loans, as well as great savings on everyday banking, investment and insurance products, under our Employee Plus package."

However, the very fact that the McArdles were in buffer with MML meant that they were at between 75% and 85% of LSV (Loan to Stock Value) when the refinance took place. (The reference in document No. **35** to the requirement that the Bank interview the Storm Client was not in practice or as a rule, implemented by the CBA). By itself, this represented a significant departure from Storm Financial's concept of "best practice". In their Advice to DJS and JES, (page 42/109, being part of document No. **4**), Storm wrote:

> "Liabilities that exceed 70% of the value of assets are very difficult to manage... The optimal liability to asset ratio is between 40% and 60%. These levels give sufficient leverage....while maintaining safety and guarding against volatility in asset prices."

Since the CBA was insisting that Storm Clients follow the Storm advice model to receive special benefits from the CBA, the CBA should be deemed to have been "on notice" of this advice (see page 2 of document No. **2**).

In terms of the McArdles' income, independent of dividends from the index trusts, it was still pegged at the salary/pension levels which were relatively similar to what they had been when their involvement with Storm had been initiated.

According to Sean McArdle, there has not been a single occasion since he and his wife, Paula, signed up to Storm in circa February, 2007, when he has met a representative of the Commonwealth Bank (other than a Storm-authorised or employee representative, if as Storm representatives they could be regarded, *ipso facto*, as CBA/CGI representatives.)

46. **Attached** is a Loan Application, stamped "Received 2 September, 2008" (**Doc. 31**), which led to the refinance of the McArdles' Macquarie Margin Lending facility. The credit limit shown in panel 4 of $3,000,000.00 (apparently altered), is not in either of the McArdles' handwriting. The Risk Disclosure Statement, appearing at Panel 9, is entitled, **"Risk Disclosure Statement"** and reads:

> "This Statement must be read by each person considering borrowing from the Commonwealth Bank of Australia, under Colonial Margin Lending Facilities. By signing this Application, you confirm that you have read and confirmed this Risk Disclosure Statement. In the case of a company, the person signing for the Company must also have signed."

> "2. Margin Calls

> "If the Margin Loan equals or exceeds a certain percentage of the overall security value, you will receive a margin call. You cannot just, 'wait out' any downturns in the market. You will have limited time to deal with any margin call, either by repaying us enough of your facility or giving us more securities on your list. If you fail to act within the time period specified in the Terms and Conditions, then some of your securities may be sold, so as to reduce the amount owing to an amount that does not exceed the base security value."

The "Margin Calls" passage (above) in the Risk Disclosure Statement, clearly envisaged that there would be some reasonable notice and an opportunity afforded to the Bank's customer to deal with the margin call and that some securities might be sold to reduce the amount owing to an amount that does not exceed the base security value. It should be noted that the time when this right to refinance occurred, the McArdles were already in buffer and on the verge of facing a margin call from MML. MML's buffer cut in between 75% and 85% of LSV.

Under the Colonial Geared Investments Margin Loan Terms and Conditions, July 2008 version (**Doc. 30**), current at the time when the further advances were made, in Clause 1.2(f), there is a representation that CGI would only lend a client money if:

> "(f) we are satisfied that immediately after we make the loan to you, the current loan-to-security ratio, will not exceed the margin call loan-to-security ratio..."

At that time, the McArdles, on a combined income made up of Police wages and an invalid pension of about $100,000.00 gross, were paying-off a $1 million Investment Home Loan and granted a Margin Loan, with a credit limit of $3 million, even though they were already in buffer with the MML.

INCONSISTENCY BETWEEN CGI "MARGIN LOAN TERMS AND CONDITIONS" AND LOAN APPLICATION

The terms of Part 9, Risk Disclosure Statement, Section 2, Margin Calls, "in the Loan Application Form (**Doc. 31**), should override the qualification on the giving of notice in the Margin Loans Terms and Conditions documents, because the "Margin Loan Terms and Conditions" (07/08 edition) were earlier in time, there was no definition of "Terms and Conditions" in the Loan Application document and, there were direct representations in the Risk Disclosure Statement that the Borrower himself would receive a margin call and notice to a "Client Adviser" was not advanced as an alternative.

Further, there is the principle of contractual construction known as the "*contra preferentum* rule", which would require that any ambiguity be interpreted against the CBA who prepared both documents.

47. Stephen Wilson on 28 June, 2009, made a submission to the Inquiry into Financial Products and Services in Australia – Parliamentary Joint Committee. According to Wilson, CGI had conceded in an email to his adviser/financial planner, that the CBA's figures on the CGI website were inaccurate between 25 September, 2008 and 20 October, 2008. A copy of Mr Wilson's Submissions are **attached** (**Doc. 27**). Similarly, Sean McArdle made a submission to the Inquiry which is also **attached** (**Doc. 28**), noting a concession which he avers having received from Angus Cameron of Colonial Margin Lending on 23 December, 2008, to the effect that:

> "If the clients had been COMSEC clients, they would have been called and protected from Margin Calls. Because we were with Storm, no such calls were made. Colonial only ever dealt with the Storm advisers and never contacted Storm clients directly. This is a standard feature of the product."

Mr Brian Phelps, Executive Manager of Colonial Margin Lending, made a similar concession, according to Sergeant McArdle:

> "The relationship between Storm and the CBA is that you are a Storm client and we are not allowed to contact you. This has been the arrangement for many years and

has worked well. When we realised that Storm was not responding in the appropriate manner, we stepped in and took over."

48. Clause 4.3 in the Margin Loan Terms and Conditions document of July, 2008 (**Doc. 30**) is, in any event, ambiguous. A reasonable construction of Clause 4.3(a), is that it simply sets out three (3) optional ways, one or more of which must be followed by CGI, by which the Bank will provide notice of Margin Call.

This is the only reasonable inference available by which the conflicting representations in the Loan Application document, (current in September, 2008 and first generated in October, 2006), under, "9. Risk Disclosure Statement") and Clause 4.3(a) of the Margin Loan Terms and Conditions, can be reconciled and given full commercial expression, in keeping with the principle in Codelfa Construction Pty Limited v State Rail Authority of NSW [1982] 149 CLR 337, with regard to the CBA's right under Clause 4.2(d) to:

> "take any or all of the action in Clause 4.5 to sell any or all of the security, even though we have not received instructions from you or your Client Adviser," which Colonial Geared Investments relied upon as entitling it to sell up the portfolios of Storm clients.

Clause 4.5 of the Margin Loan Terms and Conditions, July 2008 edition, only affords that right under Clause 4.5, if a client "does not meet a margin call."

Many Storm clients did not receive a margin call so they could not be reasonably considered to have failed to meet a margin call and thereby to invoke the operation of Clause 4.5 and hence, Clause 4.2(d) as constituting the "exceptional circumstances" where CGI may "consider it necessary or prudent" to sell up the client's security, "based on substantial adverse changes in the market value of the secured property."

49. Sean McArdle states that he has not forwarded a statement of his or his wife's assets and liabilities or a personal profile to Storm or the Bank since February, 2007.

THE CASE OF THE O'BRIENS

50. Andrew O'Brien, a young licensed financial planner, who became a minority shareholder in Jelich's Redcliffe Financial Planning business, is only 33 years of age today. The financial planning enterprise which he had bought into was sold to Storm Financial Limited in March, 2007, with the agreed consideration to be paid following the successful Storm IPO, scheduled for November, 2007, but which had not ultimately eventuated.

In May, 2006, Andrew O'Brien and his wife had bought a home at Scarborough for $610,000.00, subject to a $480,000.00 mortgage to the CBA. Over the years, from 2006, the property was subjected by the CBA to three (3) valuations, the last of which having been generated by the CBA itself, with an unsolicited VAS valuation for $850,000.00 in mid-2008, showed a 39% increase in just two years on the value of the property, even though the O'Briens had not made any capital improvements to it.

51. Andrew was offered a $100,000.00 specific-purpose loan by the CBA. It was styled as "a Better Business Loan – Variable Rate", for $100,000.00" (**Doc. 33(a)**), a three (3) year facility, subject to a 10.75% interest rate per annum (base rate, 9.55%), plus a margin of 1.2%, with rates subject to change and interest payments due on the first business day of each month. There was a service fee charged of just $70.00 and the purpose was stipulated as being to fund the "Purchase of Storm Financial Ltd, staff shares." The Bank represented that it might consider refinancing any residual balance, at the facility maturity date in three (3) years' time. The establishment fee was just $500.00. Under the rubric "Security" it was spelled out: "These facilities are unsecured". The loan was made to encourage Storm employees and representatives to subscribe for scrip in the Storm Financial Limited float.

52. On 9 December, 2008 the CBA's margin loan terms were varied by reducing the range of the CGI buffer from 80% to 70% which meant, given the state of the stock market on 9 December, 2008, (after the CBA had implemented the sale of the O'Briens' stock), that it was not possible for Storm clients to re-enter the market through CGI.

53. O'Brien considers that his house is presently worth only between about $600,000.00 and $630,000.00. When the float did not proceed, O'Brien was told by the CBA that he did not have to repay the unsecured $100,000.00 Storm share purchase loan but was free to invest it back into Storm-branded index investment trust products. O'Brien, who is a licensed financial planner, says that he is not aware of the Bank's approving similar loans for other purposes on an unsecured basis for in excess of $25,000.00, principal and interest, and then, with just a 12 month term.

54. David McCullough, a former CBA employee, was purveying funding offers of a similar order to many Storm employees and in some instances, the debts arising therefrom have been written-off by the CBA.

COMMON LAW

55. With regard to the *modus operandi* involved in using VAS valuations to generate more business from Storm customers and the interaction between the Commonwealth Bank, CGI and Storm in this context (and noting that at Townsville there was a separate section of the Bank which was dedicated to servicing Storm customers) there are a number of authorities which may apply to making the Bank's conduct actionable by Storm customers who obtained margin loans from the CBA or CGI, involving Colonial First State.

56. As Deane J. pointed out in Hawkins v Clayton [1988] 164 CLR 539 at 596; 78 ALR 69 (CLR at 576; ALR at 95):

> "....where the Plaintiff's claims is for pure economic loss...the categories of case in which the requisite relationship of proximity is to be found are properly to be seen as special in that they will be characterised by some additional element or elements which will commonly (but not necessarily) consist of known reliance (or dependence) or the assumption of responsibility or a combination of the two..."

This is said to describe the circumstances in which a Bank may be liable in tort for negligent misstatement or for an omission to speak, where a duty to speak can be found to

exist: per the Full Court of the Federal Court in David Securities Pty Limited et Ors v Commonwealth Bank of Australia et Ors [1990] 93 ALR at 271.

Having regard to the symbiotic nature of the relationship between Storm and CGI/CBA, the dictum of the Full Court in National Australia Bank Limited v Nobile et Anor [1988] 100 ALR at 227, to the effect that a transaction may be set aside as being unconscientious and one of a kind which equity will set aside, whenever one party, by reason of some consideration or circumstances is, in entering the transaction, placed at a special disadvantage or disability *vis-à-vis* another and unfair or unconscientious advantage is then taken of the opportunity thereby created.

In Commercial Bank of Australia v Amadio [1983] 151 CLR 447; 46 ALR at 402, Mason J. in the majority said at page 412:

> "Relief on the ground of unconscionable conduct will be granted when an unconscientious advantage is taken of an innocent party whose will is overborne so that it is not independent and voluntary ***just as it will be granted when such advantage is taken of the innocent party who, though not deprived of an independent and voluntary will, is unable to make a worthwhile judgment as to what is in his best interest.***"

This passage would *prima facie* appear to have particular application to Storm clients who had scant access to information and were being 'handled' by Storm and the CBA.

In Lloyd v Citicorp Australia Limited et Anor [1986], 11 NSWLR 286, Rogers J., in the Commercial List of the Supreme Court of New South Wales, adopted the standard applied by Mocatta J. in Stafford v Conti Commodity Services Limited [1981], 1 All ER 691; [1981] 1 Lloyds Rep. 466 at 696 to 697; 474:

> "With regard to the customer, a stockbroker's duty lies in contract and not in tort and stockbrokers are liable for failing to use that skill and diligence which a reasonably competent and careful stockbroker would exercise."

Dealing with a foreign currency exchange advisers, Rogers J. said at 289:

> "It seems to me likely that the advice to be given to the treasurer of a multi-national incorporation, in relation to dealing in foreign currencies would be minimal compared to that required to be given to a farmer in Western New South Wales who, to the knowledge of the adviser, is entering the foreign exchange market for the first time.
>
> Accordingly, it seems to me that one of the matters to which attention needs to be paid is the commercial and financial background of the borrower and lender at the time of the transaction."

57. In the High Court of Australia in Esanda Finance Corporation Pty Limited v Peat Marwick Hungerfords (Reg), [1997], 23 ACSR 71, the Court considered that in order to establish reliance there has to be a requisite degree of proximity between the person giving advice and the person relying upon it. Reliance is required to involve something over and above the fact that the Plaintiff relied on the statement in question as the basis for acting or not acting in a particular way. There has to be a reasonable expectation that due care will be exercised in relation to the provision of the information and advice.

In the majority, Toohey and Gaudron, JJ, referred to Burnie Port Authority v General Jones Pty Limited [1994], 179, CLR 520; 120 ALR 42, as identifying a special relationship of proximity, attracting a non-delegable duty of care, where it was said that the common element involved in those situations was "the central element of control" (at page 551).

It was also said in that case that when "viewed from the perspective of the person to whom the duty is owed, the relationship of proximity is marked by special dependence or vulnerability...".

The way in which the VAS valuations were provided, the almost "churning" nature of the generation of Storm business by the CBA and *vice versa*, with Storm being in a position to

process property loans from valuations gratuitously furnished by the CBA, at probably overstated values, would have encouraged an expectation on the part of a Storm customer that the CBA was standing behind Storm's advice.

The High Court in Esanda (*op. cit.*, per Toohey and Gaudron J.J. continued): "Similarly, we consider that, in that same context, assumption of responsibility should be understood in the way explained by Barwick, CJ in Mutual Life and Citizens' Assurance Co. Limited v Evatt [1968], 122 CLR 556 at 572 to 3:

> "More precisely, it should be understood that the assumption of responsibility for providing information or advice in circumstances where it is known or ought reasonably to be known, that it will or may be acted upon for a serious purpose, and loss may be suffered if it proves to be inaccurate."

Toohey and Gaudron, JJ continued:

> "However, the cases acknowledge that in some situations there may be liability, even though the statement in question is neither made with the intention that it should be acted upon nor pursuant to a professional or contractual obligations (San Sebastian Pty Limited v Minister Administering the Environmental Planning & Assessment Act, 1979 [1986] 162 CLR 340 at 357 and, it seems, that in those situations or at least some of them, liability may arise, whether or not the recipient requested the information or advice." (*op. cit.* at pages 356 to 357).

According to Gaudron and Toohey, JJ:

> "....commonsense requires the conclusion that a special relationship of proximity, marked either by reliance or by the assumption of responsibility, does not arise unless the person providing the information or advice has some special expertise or knowledge or some special means of acquiring information which is not available to the recipient.

> "Moreover, ordinary principles require that the relationship does not arise unless it is reasonable for the recipient to act on that information or advice, without further enquiry." [Page 12 of 43 of the Lexis Nexis report, Esanda, *op. cit.* at page 90.]

58. In Quade et Ors v Commonwealth Bank of Australia [1991], 99 ALR 567, a case concerned with the Bank's involvement in promoting foreign currency loans, Burchett J., who wrote the leading judgment, observed at page 3 of 23 (of the Lexis Nexis Report), that:

> "It now appears that there is evidence to suggest that the Bank was, at the time, actively promoting foreign currency loans as a matter of policy, so its officers would have in fact have had strong conscious and sub-conscious motivation to put the best complexion on the exchange situation. Furthermore, the Bank seems to have been promoting such loans to customers who were inadequately informed on the subject, so that its own senior management had expressed a number of concerns, including concern about the level of understanding of the complex issues involved, shown by loan officers and bank managers."

The case involved there being internal memoranda within the Bank, including memoranda to the General Manager, dated 16 March, 1992, headed "Foreign Currency Lending to Australian Customers". There was also a letter to State Managers of the Bank, dated 12 May, 1982, which included advice on special considerations involving the recommendation of foreign currency loans including:

> "Whether the borrower should or should not take advantage of forward cover/hedging as protection against volatile movement in overseas exchange rates." Pages 4 and 5 of 23 of (Lexis Nexis Report).

The Letter to Managers included reference to a report on "The Economic and Financial Outlook - 1983 to 1986," which concluded, "Exchange rates are expected to continue to exhibit a high degree of volatility." Page 5 of 23, Lexis Nexis report.

Burchett J. then commented that:

> "The conclusion of this report provokes the comment that it is one thing for bank officers to warn a customer of a risk that exchange rates may move adversely; it is quite another to say that they are expected to do so. An expectation of volatility involves an expectation that in unpredictable times in the future, the rates will be adverse."

59. In matters involving Storm and the Commonwealth Bank, it would be important to see whether and what internal memoranda and letters to managers and advices generally had been circulated by or within the CBA, concerning the volatility of the share market, and the deteriorating global financial situation which was descending on the world financial markets from late August, 2007, right through to December of 2008.

Einfeld J., who was also in the majority in Quade, *op. cit.*, observed:

> "It is now well established that silence, that is the failure to advise on a significant matter when the task of advising has been embraced and undertaken, or there is a duty to advise, may demonstrate a breach of s.52 in the right circumstances."

See Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Limited [1986] 12 FCR 477; 68 ALR 77 per Bowen CJ, FCR at 489; ALR at 85; Davkot Pty Limited v Customer Credit Corporation (NSW Supreme Court, Wood J., 10 May, 1988, unreported), at page 118; Mehta v CBA (NSW Supreme Court; Rogers CJ Comm D, 27 June, 1990, unreported) and the cases cited by Rogers, CJ at pages 46 to 48 thereof.

Dealing with the question of negligence, Einfeld J at page 18 of 23, dealt with "the three potential aspects of the duty to advise", as being:

"(a) to identify the nature of the risk;

(b) to explain the extent of the risk which, in turn, had two elements, namely:

(i) the likelihood of an adverse currency fluctuation, either permanently or at the time of rollover; and

(ii) the gravity of the consequence of such fluctuation, depending on its size; and

(a) to identify quite specifically what needed to be done to monitor and manage the loan, so that the appellants could be in a position to make the best decisions on whether to take the loan at all and on how to minimise the risk, on a continuing basis, once a loan was taken out."

There have been cases where something akin to fiduciary duties have been recognised as being owed by banks to Clients in certain situations, eg. Catt v Marac Australia Limited [1996] 9 NSWLR 639 and James v Australia and New Zealand Banking Group Limited [1986] 64 ALR 347 at 391 per Toohey J.

Also at page 19 of 23 (Lexis Nexis report), Einfeld J. found that:

> "A bank which has undertaken the task of advising the intending borrower on such matters is under a duty to provide a prior, full, honest and clear explanation of the nature and effect of the transaction being negotiated."

Drawing an analogy with medical negligence cases, Einfeld J. quoted Kirby, P, dissenting in Ellis v Wallsend District Hospital [1989] 17 NSWLR 553, to this effect:

> "The bigger the devastation of the possible risk, the greater is the obligation to lay it before the patient, so that he or she can make an informed decision."

Rogers J. in an address on "Developments in Foreign Currency Loan Litigation", delivered to the Banking Law and Practice Conference in Melbourne on 24 May, 1990, raised a number of factors which he said impacted on the Bank's duty of care, eg, whether:

(i) the Bank knew that such borrowing was pregnant with the danger of large capital loss unless precautions were taken;

(ii) the Bank knew its staff were ill-equipped to explain the risk to the borrower;

(iii) the Bank knew its staff were ill-equipped to explain the nature of the precautions available to be taken;

(iv) the Bank was unwilling to accept the task of management, even at a fee, and thereby to undertake the task of implementing appropriate safety precautions, as and when required;

(v) the customer was unaware of the extent of the possible risk and the available precautions which could be taken and the techniques for implementing such precautions;

(vi) the Bank was aware of the lack of knowledge on the part of the customer; and

(vii) the customer relied on the fact that the Bank gave no warning of the foregoing matters. By reason of the omission to warn of the extent of the risk, the customer relied on the belief that any risk was limited or slight.

The last point, in particular, seems to have special resonance with the position of the CBA, *vis-à-vis*, Storm clients, who were also or became CBA customers.

The fact that the CBA had set up a "Storm Division" in Townsville and effectively, *de facto* accepted the dividends from shareholdings as income for the purpose of demonstrating serviceability, operated as an effective endorsement of the Storm product by the Bank, as did CBA's imprimatur given to the Storm financial model, being promoted to Storm customers and prospective customers and in turn, by the Bank to Storm Clients.

There are a number of provisions of the *Corporations Act*, designed to deter the kind of conduct in which Storm and the CBA/CGI and Colonial were engaged: in particular, s.1041E (1), prohibits a person from making a statement or disseminating information that is false in a material particular or that is materially misleading which is likely to induce persons to

(i) apply for financial products; or

(ii) dispose of or acquire financial products.

Other sections, eg. S.1041F, are intended to deter the publication of misleading information, promises and forecasts, purposely or otherwise to induce persons to invest in financial products. There is also an analogy with the US prohibition against "churning" as referring to the excessive buying and selling of securities for the purpose of generating commissions and without regard or with insufficient regard to the client's investment objectives. For "churning" to occur, the broker must exercise control of the investment decisions in the client account, either through a formal written discretionary agreement or otherwise. For example, if a client relied on a broker's advice because he or she was unable to evaluate the broker's recommendations and exercise his own judgment, the broker would be deemed to have exercised control over the account.

Churning, though not specifically prohibited under Australian law, may nevertheless amount to unconscionable conduct within the contemplation of the *Trade Practices Act* and at Common Law.

The "tri-partite" arrangement between Storm-CGI-Client would fall short of amounting to "churning" but is conceptually analogous.

RE: APPLICABILITY OF CODE OF BANKING PRACTICE (MAY, 2004)

60. The Australian Bankers' Association, *Code of Banking Practice*, incorporating amendments made in May, 2004 (**Doc. 5**), sets out a voluntary code of conduct "which sets standards of

good banking practice for us (the banks) to follow when dealing with persons who are, or who may become, our individual and small business customers and their guarantors," according to the "Introduction" to the Code.

61. Under Part IV B, of the *Trade Practices Act, 1974 (C'wth)*, S.51 ACA, an applicable industry code is defined as meaning, with respect to a corporation that is a participant in an industry:

> "(a) the prescribed provisions of any mandatory industry code, relating to the industry; and
>
> (b) the prescribed provisions of any voluntary industry code that binds the corporation;"

Section 51AD stipulates that:

> "A corporation must not, in trade or commerce, contravene an applicable industry code."

THE CODE

62. Article 2.2 requires the bank to "act fairly and reasonably towards you (the customer) in a consistent and ethical manner".

Arguably, the CBA failed to demonstrate consistency in its approach over the years to the way it would deal with margin calls, *vis-à-vis* Storm customers.

63. Article 10.4 of the Code, states:

> "We (the banks) will include (where relevant) the following in or with our terms and conditions applying to a banking service:

(c) the manner in which you will be notified of changes to:

(i) the terms and conditions."

This may have some relevance to the ambiguity of the commitment which the CBA made concerning notification of intended action with respect to margin calls and the blurring of the lines of communication between the Client and the Bank, resulting from Storm's arguably 'middle-man' position.

64. Article 25.1 has special application to the CBA/Colonial Geared Investment role in the provision of credit to Storm clients:

"25.1 Before we offer or give you a credit facility (or increase an existing credit facility), we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay it."

65. On 3 July, 2009, Martin Collins and John Durie, in The Australian Newspaper, under the banner "ASIC probes Storm Financial Collapse", reported that CBA Chief, Ralph Norris, conceded errors of judgment but denied any suggestion that this was evidence of a systemic problem at the Bank.

Norris is reported to have commissioned an external report from accountants, Ernst & Young, to examine what should happen with the Storm loans. Ernst & Young were hired after internal bank reports were completed in early March, 2009 and its report went to Norris in late May. Norris was evidently not satisfied the external report.

66. Ron Jelich referred to having been informed by Emmanuel Cassimatis that Cassimatis had worked with Chris Cuffe from Colonial, initially to develop the Storm-branded Margin Loan Index Fund.

67. With regard to cheque disbursements, there were internal memoranda whereby CBA followed the practice of sending fees due to Storm in respect of a margin loan directly, rather than for the money to be paid to the client and for the client then to be personally responsible for paying Storm any fee due to it.

DECISION OF LOGAN J. IN THE FEDERAL COURT OF AUSTRALIA, QUEENSLAND DISTRICT REGISTRY, NO. QLD 75 OF 2009, IN THE MATTER OF STORM FINANCIAL LIMITED (RECEIVERS AND MANAGERS APPOINTED) ACN 068 804 691, BETWEEN EMMANUEL GEORGE CASSIMATIS AND JULIE GLADYS CASSIMATIS –ats- ASIC, 26 MARCH, 2009 (Doc. 34)

68. Logan J. heard an application by ASIC for Storm Financial Limited be wound up in insolvency. The Cassimatises were promoting a Deed of Company Arrangement.

69. It appears that Storm Financial itself banked with the Commonwealth Bank and the Commonwealth had a registered Fixed and Floating Charge over Storm and its associated companies, securing some $10,757,574.00, including for equipment finance, a margin loan of its own and commercial bills. Storm had also guaranteed advances by the CBA to Storm Financial of a further $16,329,000.00, bringing the total obligation which Storm had to the CBA, when Storm closed its business, up to $27,094,574.00 (Judgment pages 5 and 6).

70. The Administrators believed that the value of realisable assets available to the Receivers would be about sufficient to satisfy the CBA's Charge, however, additionally, there were some $43,470,526.38 in unsecured debts, including $9,640,000.00-odd, owed to the ATO, and another almost $24,000,000.00 claimed by vendors of financial planning firms.

71. The Winding-Up Application by ASIC was opposed only by Mr and Mrs Cassimatis. Logan quoted from paragraph 49 of the Judgment of Greenwood J. in the Federal Court proceedings, between Storm and the CBA [2008] FCA 1991 at paragraph 49, that:

"The boundaries of that relationship (ie. the relationship between Storm Financial and the CBA) are the core matter in issue in these proceedings."

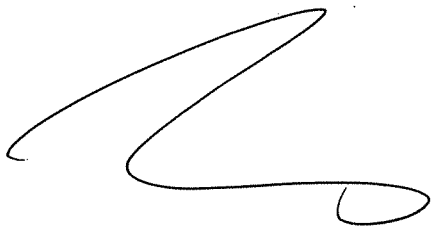
72. In the Administrators' Report opposing the D.O.C.A., Messrs Worrell and Khatri wrote:

"The initial catalyst for the dramatic reversal of Storm's financial position was, without a doubt, the very large and sustained drop in the Australian share market. Whether the company could have withstood the drop, with the assistance of its bankers, whether the investments recommended by Storm to its clients were appropriate in most cases; whether the Fund Managers managing client investments acted appropriately and whether the actions of Storm and its directors, following the drop, were appropriate, are all issues which had been called into question. They are all issues which will require detailed and sustained inquiry, perhaps with the assistance of the Courts, before a final judgment can be made." (Quoted at page 37, paragraph 68, by Logan J.)

Logan J. granted ASIC's Application and wound-up Storm over the Cassimatises' objection.

Dated: 27 July, 2009

With compliments,



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