Supreme Court

New South Wales

Case Name:	DSHE Holdings (Receivers & Managers Appointed)(In Liquidation) v Nicholas Abboud (No 3); National Australia Bank Limited v Nicholas Abboud (No 4)
Medium Neutral Citation:	[2021] NSWSC 673
Hearing Date(s):	16 - 20, 30 March 2020; 21 - 25, 28 - 30 September 2020; 1, 6, 8, 9, 12 - 16, 19 - 23, 26 October 2020; 2 - 6, 18, 19, 23 - 25 November 2020; 1, 3, 4, 7, 8, 10 - 11; 15 - 18 December 2020; 4, 5, 8 - 12 and 15 February 2021
Decision Date:	11 June 2021
Jurisdiction:	Equity - Commercial List
Before:	Ball J
Decision:	See paragraphs [612] and [613]
Catchwords:	CORPORATIONS – Directors and officers – Directors' duties – Duty of care and diligence – Where executive directors alleged to have adopted a "rebate maximisation policy" – Whether policy led to buy stock irrespective of consumer demand – Whether non-executive directors failed to put in place internal controls to monitor procurement activities CORPORATIONS – Shares – Dividends – Where dividend allegedly declared in breach of section 254T Corporations Act 2001 (Cth) – Where dividend allegedly declared in breach of directors' duties – Whether directors can act in breach of duty when declaring a dividend even without contravening section 254T – Whether reference to "creditor" in section 254T includes future creditors –– Meaning of "materially prejudice" expression in s 254T – Whether business judgment rule applies to decision to declare dividends CONSUMER LAW – Misleading and deceptive conduct

	– Whether executive directors made misleading and deceptive statements when negotiating credit facilities – Where executive director made statements concerning matters within his area of responsibility and about which he had personal knowledge – Where statements misleading or incomplete – Executive director found to have personally engaged in misleading and deceptive conduct on the facts DAMAGES – Damages caused by misleading and deceptive conduct – Proof – Where misled party acquired something of value as result of misleading conduct by way of security over loan – Held misled party's onus of proof is discharged by showing value of security lower than value of loan DAMAGES – Damages caused by misleading and deceptive conduct – Quantification – Held damages to be assessed as the difference between the amount lent and the amount actually received in the receivership – Whether payment by receivers of creditors' legal costs amounts of a distribution in the creditors' favour
Legislation Cited:	Australian Consumer Law Australian Securities and Investments Commission Act 2001 (Cth) Corporations Act 2001 (Cth) Corporations Amendment (Corporate Reporting Reform) Act 2010 (Cth)
Cases Cited:	Attard v James Legal Pty Ltd [2010] NSWCA 311; [2010] NSWCA 311 Australian Competition and Consumer Commission v LG Electronics Australia Pty Ltd [2017] FCA 1047 Australian Competition and Consumer Commission v TPG Internet Pty Ltd (2013) 250 CLR 640, [2013] HCA 54 Australian Securities and Investments Commission v Maxwell [2006] NSWSC 1052; (2006) 59 ACSR 373 Australian Securities and Investments Commission v Narain (2008) 169 FCR 211, [2008] FCAFC 120 Australian Securities and Investments Commission v Rich (2009) 236 FLR 1 Australian Securities and Investments Commission v Warrenmang Ltd (2007) 63 ACSR 623; [2007] FCA 973 Bennett v Elysium Noosa Pty Ltd (in liq) (2012) 202

FCR 72
Boyd v Leftwich (1982) 43 ALR 280
Campbell v Backoffice Investments (2009) 238 CLR 304, [2009] HCA 25
Cassimatis v Australian Securities and Investments Commission (2020) 275 FCR 533; [2020] FCAFC 52
Cleary v Australian Co-Operative Foods Ltd (Nos 2 & 3) (1999) 32 ACSR 701, [1999] NSWSC 991, [1999] NSW 1062
Connective Services Pty Ltd v Slea Pty Ltd (2019) 767 CLR 461, [2019] HCA 33
Demagogue Pty Ltd v Ramensky (1992) 39 FCR 31
DCT Projects Pty Limited v Champion Homes Sales Pty Limited [2016] NSWCA 117
EK Nominees Pty Ltd v Woolworths Ltd [2006] NSWSC 1172
Fabcot Pty Ltd v Port Macquarie-Hastings Council [2011] NSWCA 167
Genocanna Nominees Pty Ltd v Thirsty Point Pty Ltd [2006] FCA 1268
Global Sportsman Pty Ltd v Mirror Newspapers Ltd (1984) 2 FCR 82, [1984] FCA 180
Henville v Walker (2001) 206 CLR 459, [2001] HCA 52
Houghton v Arms (2006) 225 CLR 553, [2006] HCA 59
Ikon Communications Pty Ltd v Advangen International Pty Ltd [2018] NSWSC 1650
Industrial Equity Limited v Blackburn (1977) 137 CLR 567, [1977] HCA 59
Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets (No 6) (2007) 63 ACSR 1, [2007] NSWSC 124
KGD Investments Pty Ltd v Placard Holdings Pty Ltd [2015] VSC 712
Kinsela v Russell Kinsela Pty Ltd (in liq) (1986) 4 NSWLR 722
Kuhl v Zurich Financial Services Australia Ltd (2011) 243 CLR 361; [2011] HCA 11
Lam v Ausintel Investments Australia Pty Ltd (1989) 97 FLR 458
Moloney v Bells Securities Pty Ltd [2005] QSC 13
Miller & Associates Insurance Broking Pty Ltd v BMW Australia Finance Limited (2010) 241 CLR 357, [2010] HCA 31

	Pages Property Investments Pty Ltd v Boros [2020] NSWSC 1270 Pico Holdings Inc v Voss [2004] VSC 263 Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd (2003) 196 ALR 257 at [37]f [2003] HCA 10 QBE Insurance Group Ltd v Australian Securities Commission (1992) 38 FCR 270 Re Centro Property Trust [2011] NSWSC 1171 Re CSR Ltd (2010) 183 FCR 358; [2010] FCAFC 34 Swiss Re International SE v Simpson (2018) 354 ALR 607; [2018] NSWSC 233 Ted Brown Quarries Pty Ltd v General Quarries (Gilston) Pty Ltd (1977) 16 ALR 23 Wardley Australia Limited v State of Western Australia (1992) 175 CLR 514 Williams v Pisano (2015) 90 NSWLR 342, [2015] NSWCA 177
Texts Cited:	Australian Government, Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education
Category:	Principal judgment
Parties:	DSHE Holdings Limited ACN 166 237 841 (Receivers & Managers Appointed) (Administrators Appointed) (Plaintiff | Cross Defendant on Sixth Cross Claim) Nicholas Abboud (First Defendant | Cross Claimant on Second Cross Claim | First Cross Defendant on Sixth Cross Claim) Michael Potts (Second Defendant | Cross Claimant on Third Cross Claim | Sixth Cross Defendant on Sixth Cross Claim) Phillip John Cave (Third Defendant | Cross Claimant on Fifth Cross Claim | Second Cross Defendant on Sixth Cross Claim) Robert Murray (Fourth Defendant | First Cross Claimant on First Cross Claim | Fifth Cross Defendant on Sixth Cross Claim) William Wavish (Fifth Defendant | Cross Claimant on Fourth Cross Claim | Ninth Cross Defendant on Sixth Cross Claim) Lorna Raine (Sixth Defendant | Second Cross Claimant on First Cross Claim | Seventh Cross Defendant on Sixth Cross Claim)

Robert Ishak (Seventh Defendant | Third Cross Claimant on First Cross Claim | Fourth Cross Defendant on Sixth Cross Claim)
Jamie Tomlinson (Eighth Defendant | Fourth Cross Claimant on First Cross Claim | Eighth Cross Defendant on Sixth Cross Claim)
David Robert White and others listed in Schedule 1 t/as Deloitte Touche Tohmatsu (Cross Claimants on Sixth Cross Claim | Cross Defendants to First, Second, Third, Fourth and Fifth Cross Claims)

2017/81938:

National Australia Bank (First Plaintiff)
HSBC Bank Australia Limited (Second Plaintiff)
Nicholas Abboud (First Defendant | Cross Claimant on First Cross Claim | Second Cross Defendant on Third Cross Claim)
Michael Potts (Second Defendant | Cross Claimant on Second Cross Claim | Third Cross Defendant on Third Cross Claim)
David White and others listed in Annexure A t/as David Robert White and others listed in Schedule 1 t/as Deloitte Touche Tohmatsu (Cross Defendants to First Cross Claim and Second Cross Claim | Cross Claimants on Third Cross Claim)
DSHE Holdings Limited trading as DSHE Holdings Ltd ACN 166 237 841 (Receivers and Managers Appointed) (In Liquidation) (First Cross Defendant on Third Cross Claim)

Representation: Counsel:

2017/81927:

JC Giles SC with JA Arnott, JA Granger & PR Gaffney (Plaintiffs)
RM Smith SC with N Simpson (First Defendant | Cross Claimant on Second Cross Claim | First Cross Defendant on Sixth Cross Claim)
S Nixon SC with A Jordan and A Zheng (Second Defendant | Cross Claimant on Third Cross Claim | Sixth Cross Defendant on Sixth Cross Claim)
SJ Finch SC with F Assaf SC and S Hartford-Davis

(Third Defendant | Cross Claimant on Fifth Cross Claim | Second Cross Defendant on Sixth Cross Claim)
IM Jackman SC with J Williams SC and L Rich (Fourth and Sixth to Eighth Defendants | First to Fourth Cross Claimants on First Cross Claim | Fourth, Fifth, Seventh and Eighth Cross Defendants on Sixth Cross Claim)
R Foreman SC with KE Boyd and J Entwisle (Fifth Defendant | Cross Claimant on Fourth Cross Claim | Ninth Cross Defendant on Sixth Cross Claim)
P Braham SC with A Shearer, R Mansted & S Tame (Cross Claimants on Sixth Cross Claim | Cross Defendants to First, Second, Third, Fourth and Fifth Cross Claims)

2017/81938:

JC Giles SC with JA Arnott, JA Granger & PR Gaffney (Plaintiffs | First Cross Defendant on Third Cross Claim)
RM Smith SC with N Simpson (First Defendant | Cross Claimant on First Cross Claim | Second Cross Defendant on Third Cross Claim)
S Nixon SC with A Jordan and A Zheng (Second Defendant | Cross Claimant on Second Cross Claim | Third Cross Defendant on Third Cross Claim)
P Braham SC with A Shearer, R Mansted & S Tame (Cross Defendants to First Cross Claim and Second Cross Claim | Cross Claimants on Third Cross Claim)

Solicitors:

2017/81927:

Norton Rose Fulbright (Plaintiffs)
Clayton Utz (First and Second Defendants | Cross Claimants on Second and Third Cross Claims | First and Sixth Cross Defendants on Sixth Cross Claim)
Allens Linklaters (Third Defendant | Cross Claimant on Fifth Cross Claim | Second Cross Defendant on Sixth Cross Claim)
Arnold Bloch Liebler (Fourth and Sixth to Eighth Defendants | Cross Claimants on First Cross Claim | Fourth, Fifth, Seventh & Eighth Cross Defendants on Sixth Cross Claim)

Webb Henderson (Fifth Defendant | Cross Claimant on Fourth Cross Claim | Ninth Cross Defendant on Sixth Cross Claim)
Clifford Chance (Cross Claimants on Sixth Cross Claim | Cross Defendants to First, Second, Third, Fourth and Fifth Cross Claims)

2017/81938:

Norton Rose Fulbright (Plaintiffs | First Cross Defendant on Third Cross Claim)
Hall & Wilcox (First and Second Defendants | Cross Claimants on First and Second Cross Claims | Second and Third Cross Defendants on Third Cross Claim)
Clifford Chance (Cross Claimants on Third Cross Claim | Cross Defendants to First Cross Claim and Second Cross Claim)

File Number(s): 2017/81927 and 2017/81938

Publication Restriction: None

JUDGMENT

Introduction

1 Prior to its collapse in January 2016, Dick Smith was a well-known retailer of consumer electronics in Australia and New Zealand. It was acquired from its eponymous founder by Woolworths Limited between 1981 and 1983.

2 In September 2012, Woolworths sold the shares in DSE Holdings Pty Limited (***DSE***), the holding company of various subsidiaries through which the Dick Smith business was carried on, to Dick Smith Sub-Holdings Pty Limited (***DSSH***) which had been established to acquire the shares in DSE and which was owned as to 98 percent by Anchorage Capital Partners Limited (***Anchorage***), a private equity firm, and as to two percent by LMA Investments

Pty Limited (***LMA***), a company controlled by Mr Nicholas Abboud, who became Dick Smith's managing director and chief executive officer (***CEO***). The sale price for the shares was $20 million plus an amount contingent on the subsequent sale of the shares above an agreed threshold. In September 2013, Mr Michael Potts joined Dick Smith as its chief financial officer (***CFO***) and company secretary.

3 At the end of 2013, the Dick Smith business was floated on the Australian Securities Exchange (***ASX***). For the purposes of the float, a new company, Dick Smith Holdings Limited (now known as DSHE Holdings Limited (in liq)) (***DSH***), was incorporated on 25 October 2013 to acquire the shares in DSSH from Anchorage and LMA and to invite subscriptions for its shares in accordance with a prospectus which was initially lodged on 14 November 2013 and which was replaced on 21 November 2013. The offer price was $2.20 per share, which reflected a market capitalisation of $520.3 million.

4 At the time DSH was established, Mr Abboud became its managing director and CEO and Mr Potts its company secretary and CFO. Mr Potts was appointed a director of DSH on 12 August 2014. The other (non-executive) directors of DSH were Mr Phillip Cave, a managing director of Anchorage who became chairman of DSH, Mr William Wavish, Ms Lorna Raine and Mr Robert Ishak. In addition, Mr Robert Murray was appointed a director of DSH on 12 August 2014 and he became the non-executive chairman of DSH on 1 March 2015, following Mr Cave's resignation. Mr Jamie Tomlinson was appointed a non-executive director of DSH on 10 April 2015, following the resignation of Mr Wavish. In this judgment, the persons who served as non-executive directors of DSH will be referred to as ***the non-executive directors*** or ***NEDs***.

5 Trading of the shares in DSH on the ASX commenced on 4 December 2013. Anchorage retained 20 percent of the shares and committed to retain that interest until the announcement of DSH's financial results for the financial year ending 30 June 2014 (***FY14***). It sold those shares on 15 September 2014.

6 In June 2014, DSH and Dick Smith Electronics Pty Limited (***DS Electronics***), a subsidiary of DSH, entered into a vendor financing arrangement with Macquarie Bank Limited (***Macquarie***) with a $15 million limit. On 27 June

2014, various companies in the Dick Smith Group, including DSH, entered into a facility agreement with Westpac Banking Corporation (***Westpac***) and its New Zealand subsidiary with a limit of $82 million to replace a then existing $65 million facility with GE Commercial Corporation (Aust) Pty Ltd and GE Commercial Finance (NZ). The facility with Westpac was amended over time, largely by Westpac granting formally and informally temporary increases in the facility limit. On 22 June 2015, the Westpac facility was replaced by a syndicated facility agreement and associated agreements (together, ***the Syndicated Facility***) with National Australia Bank (***NAB***) and HSBC Bank Australia Limited (***HSBC***) (together, ***the Banks***) by which NAB agreed to provide working capital facilities to DSH up to a total commitment of $75 million and HSBC agreed to provide an overdraft financing facility to DSH up to a total commitment of $60 million. On 16 November 2015, HSBC agreed to increase its total commitment from $60 million to $80 million until January 2016 (***the Extension Agreement***).

7 On 29 November 2015, the board of DSH resolved to take a $60 million non-cash impairment in relation to the carrying value of its inventory. On 4 January 2016, DSH went into voluntary administration. On the same day, NAB and HSBC appointed receivers. DSH went into liquidation on 25 July 2016.

8 Originally, these events gave rise to five proceedings. Three of those were representative proceedings brought by shareholders of DSH. Those proceedings settled during the course of the hearing and nothing further needs to be said about them. The remaining two proceedings are brought by the Banks (***the Bank Proceeding***) and by the receivers in the name of DSH (***the Company Proceeding***).

9 The Banks sue Mr Abboud and Mr Potts in respect of misleading and deceptive conduct they are alleged to have engaged in connection with the Syndicated Facility and the Extension Agreement which is said to have induced the Banks to enter into those agreements. The Banks claim the total amount owing to them at the time DSH went into voluntary administration ($124,889,342.27) less amounts recovered during the receivership. Depending on how the

amounts held by the receivers are treated and the treatment of legal costs paid by the receivers, that amount is between $50,090,510.93 and $92,245,967.77, together with interest and costs.

10 The conduct said to be misleading and deceptive involves misstatements about DSH's financial position and a failure to disclose DSH's dependence on "over and above" (***O&A***) rebates (described in more detail below) and the effect that those rebates had on the quality and level of DSH's stock. Originally, the conduct was said to have extended to misstatements in DSH's audited accounts. In connection with that aspect of the case, Mr Abboud and Mr Potts filed cross-claims against Deloitte alleging that if they were liable to the Banks then Deloitte was liable to them for misleading and deceptive conduct in connection with the statutory audit of the FY15 accounts and the half-yearly review of the HY15 accounts. However, during the course of the hearing, the allegation that the HY15 and FY15 accounts were materially misstated were struck out or abandoned, with the result that the case against Deloitte was dismissed.

11 DSH sues Mr Abboud and Mr Potts and the NEDs for breaches of the duty of care they owed under s 180(1) of the *Corporations Act 2001* (Cth) (***the Corporations Act***) and the general law by:

(a) Deciding to declare an interim dividend of $16.555 million on 16 February 2015;

(b) Deciding to declare a final dividend of $11.826 million on 17 August 2015; and

(c) Failing to cause DSH to implement any adequate procedures, practices or systems to manage the obvious risks created by the alleged adoption of a scheme to maximise rebates, particularly O&A rebates.

Again, Mr Abboud, Mr Potts and the NEDs filed cross-claims against Deloitte alleging that if they are liable to DSH, then Deloitte was liable to them for misleading and deceptive conduct in connection with the statutory audits for FY14 and FY15 and the half-yearly review for HY15. Again, those claims were dismissed during the hearing following the striking out and abandonment of any allegation that any of DSH's statutory accounts materially misstated its financial position.

12 Two other points should be made by way of introduction. First, a number of the defendants prepared detailed affidavits but did not give evidence. They included Mr Potts, Mr Cave, Ms Raine and Mr Ishak. What inferences if any should be drawn from the absence of evidence from those witnesses will, to the extent necessary, be dealt with later in this judgment where the issue arises.

13 Second, one of the witnesses who provided affidavit evidence for the plaintiffs was Ms Rachel Howard, who was the Transaction Processing Manager of Dick Smith from February 2011 until the appointment of receivers to DSH. In that role, Ms Howard was involved in reconciling general ledger balance sheets, preparing payment forecasts, generating payments to vendors and interacting with vendors in relation to payment expectations and enquiries. Ms Howard died before the hearing. However, her affidavit was admitted into evidence. What weight should be given to that affidavit is dealt with later in this judgment where the issue arises.

Preliminary matters

14 Before setting out the relevant factual background in more detail, it is helpful to say something more about the Dick Smith business and some of the terminology and accounting concepts relevant to it.

15 At the time of the float, Dick Smith operated approximately 359 Dick Smith branded retail stores in Australia and New Zealand together with 30 outlets in stores operated by David Jones Limited known as "Electronics Powered by Dick Smith" and one specialist store under the brand name "Move". It also sold product online and commercially to institutions, such as businesses and schools, through dedicated sales staff. The different methods of sale (in store, online and commercial) were known as "lines" or "channels".

16 Dick Smith sourced products from a variety of manufacturers and suppliers. As is common in retail, each product of exactly the same type available for sale as an individual item was referred to as a "stock keeping unit" or "SKU". The SKUs bought and sold by Dick Smith were classified into groups for management purposes. The classification of SKUs changed somewhat over time. For much of the time DSH operated, there were four groups known as "Office", "Mobility",

"Entertainment" and "Accessories", which in turn were broken down into categories of product. Stock was bought centrally and stored in a centralised warehouse in Chullora, New South Wales, where Dick Smith's headquarters were located and from where it was distributed to individual stores.

17 The precise structure of Dick Smith's buying department is not easy to identify from the evidence and appears to have changed somewhat over time. Within the buying department, particular staff members were given responsibility for buying particular categories of product. The buying staff were divided into two groups known as merchandise planners and buyers. The merchandise planners were responsible for the internal management of stock including forecasting sales, developing budget plans, the replenishment of distribution centres and individual stores, managing aged inventory and maximising sales. The buyers were responsible for dealing with third party suppliers including negotiating the terms on which Dick Smith acquired stock from those suppliers and the terms on which suppliers provided rebates and other support in connection with the sale of their products. One such buyer was Mr Darren Freeman, who gave evidence for the plaintiffs in the proceedings. At various stages he was responsible for buying products in the Power (PO) category (comprising items used to power electronic devices including batteries, surge protectors and chargers), the Seasonal (SE) category (comprising Christmas lights and trees, children's toys, fitness products, appliances and other products that did not neatly fit into another category), the Protect (PR) category (comprising items to protect electronic devices such as bags, covers and cases) and the Imaging/Photographics (XG) category (comprising camera and photographic accessories).

18 The merchandise planners were supervised by Mr Christopher Borg, who joined Dick Smith in March 2013 as the Merchandise Planning Manager but whose title later changed to "General Manager – Planning". In that capacity, he was responsible for managing, budgeting and forecasting all key financial metrics, including stock and stock provisions. He was also responsible for monitoring and controlling buyers' compliance with targets set for the buyers, although Mr Borg says and I accept that the decisions he made in relation to the authority buyers had to buy stock were frequently modified by those who

were more senior than him, including Mr Abboud. Mr Borg was also responsible, along with other general managers, for approving the movement of certain items within provisioning classifications.

19 Mr Borg left Dick Smith in November 2015. At the time he started at Dick Smith, he reported to Mr Neil Merola, the Director of Strategy, and Mr George Papacosta, who became the Director of Dick Smith's online and private label channels. Both Mr Merola and Mr Papacosta had started with Dick Smith on 26 November 2012 as part of the team engaged by Anchorage to run Dick Smith following its acquisition from Woolworths. Subsequently, Mr Merola became the Director of Buying and in that capacity had overall responsibility for the buying function at Dick Smith.

20 For a time in 2014, Mr Borg reported to Mr John Skellern, who was the Director of Commercial, Property, Procurement and Supply Chain. Mr Skellern had joined Dick Smith as part of the original management team on 21 December 2012. In the later part of 2014, Mr Borg commenced reporting to Mr Rodney Orrock, who replaced Mr Merola as Director of Buying on or about 28 July 2014. Mr Orrock held that position until October 2015, when he was succeeded by Mr Mark Scott. Each of Mr Skellern and the director of buying reported directly to Mr Abboud. Mr Borg also gave evidence for the plaintiffs.

21 The buyers reported to merchandise managers, who in turn reported to the Director of Buying. In June 2014, there were two Merchandise Managers, one of whom was Mr Carl Bonham. Mr Bonham was responsible for the Accessories group of products. One of the buyers reporting to him was Mr Freeman. Mr Bonham also gave evidence on behalf of the plaintiffs.

22 Dick Smith set budgets for each buyer which identified the value of stock that the buyer was authorised to buy. The available budget was referred to "open to buy" or "OTB". Although OTB was set as part of the budgeting process in each financial year, it was reviewed and adjusted during the year. The overall OTB was set by Mr Potts and the finance team. However, Mr Borg, with the assistance from merchandise managers, was responsible for splitting the overall figure down by month and category of stock.

23 The procedure for purchasing inventory involved the buyer completing a stock order form, which would be signed by the buyer, the relevant senior merchandise planner and then approved by Mr Borg. If a purchase exceeded OTB, approval was required from one of Mr Orrock, Mr Potts or Mr Abboud. Mr Borg prepared regular reports comparing the OTB targets of buyers with their actual purchases.

24 Dick Smith also sold private label (***PL***) stock branded "Dick Smith" or "Move", which it sourced from China. It had dedicated staff who were responsible for sourcing that product and it reported separately on the sales performance of stock falling within that category. PL stock accounted for approximately 15 percent of sales and approximately 33 percent of gross profit.

25 Dick Smith's primary source of revenue was obviously from the sale of merchandise. However, it also earned other forms of revenue including from the payment or allowance of rebates on goods sold by Dick Smith or for services provided by Dick Smith. Dick Smith negotiated for rebates and other support in two ways. First, it negotiated rebates as part of the general terms of trade it negotiated with suppliers, which were normally set out in written contracts. Those rebates took various forms. The most common types of rebate were volume rebates, scan rebates, warehouse rebates and advertising rebates or subsidies (known as Ad Sub). Volume rebates were paid by reference to the total volume of product of that supplier sold by Dick Smith during a particular period, which were generally calculated as a percentage of the value of goods sold. Scan rebates were rebates payable by reference to actual sales of products at the register. Warehouse rebates were payable in respect of the cost of storing and distributing stock. Ad Sub was payable to support the cost of marketing a supplier's products and in some cases could exceed those costs.

26 In addition, Dick Smith, like other retailers, negotiated rebates outside the normal trading terms. Although it appears that the terminology was not universally accepted, rebates of that type were generally referred to within Dick Smith as "over and above" or "O&A" rebates. O&A rebates are generally negotiated in connection with the promotion of a particular product or range of

products or as a contribution by the supplier to a discount offered on a product as a means of clearing superseded or slow-moving stock. Again, the rebate could take various forms, such as a scan rebate payable as a contribution to the discounted price of the stock or as a rebate that was paid as a contribution to marketing. At Dick Smith, O&A rebates were often agreed informally. In some cases, they were agreed orally and in others were evidenced only by an email between the relevant buyer at Dick Smith and a representative of the supplier. Normally, they were negotiated at the time a purchase order was placed with a supplier and, as will become apparent, they were usually treated as a contribution to marketing.

27 As might be expected, Dick Smith had a stock management system, which was known as the AS400 system. It was a computerised database which contained information about each SKU, including the cost price of the SKU, any rebates payable in respect of the SKU, the price for which SKUs were sold, which stores carried the SKU and the quantity of the SKU held in each store and other information relevant to stock management. According to unchallenged evidence given by Mr Wavish, the AS400 system allowed merchandise planners and senior management to manage the amount of money allocated at a group, category or SKU basis and to allocate maximum reorder quantities by buyer, category and SKU. Separate databases existed for the Australian and New Zealand businesses. The AS400 system was a legacy system inherited from Woolworths and was somewhat antiquated. One feature of the system was that it only measured the aging of stock from the last date on which a particular SKU was purchased.

28 Until late 2014, Dick Smith did not have any centralised system for recording O&A rebates that had been negotiated by the Dick Smith buyers. Instead, Mr Skellern, who met weekly with the buyers, kept a record of them on a whiteboard in his office. In late 2014, Mr Tomer Bar-Ami, General Manager of Merchandise Planning & Business Intelligence, began copying Mr Skellern's whiteboard into an excel spreadsheet, but that information never formed part of the AS400 system and it is not possible using that system to link particular purchases or the supply of other services with particular O&A rebates. As is

already apparent from what has been said, O&A rebates and the emphasis placed on them by Dick Smith is an important issue in these proceedings.

29 The gross profit earned by Dick Smith on the sale of a particular SKU – sometimes also referred to as "second margin" and often expressed as a percentage of sales – was the amount derived from the sale of that SKU during a particular period less the Cost of Goods Sold (***COGS***) (sometimes also referred to as Cost of Sales (***COS***)) and after allowing for certain rebates payable under the trading terms between Dick Smith and the relevant supplier. At Dick Smith, COGS was (in accordance with the relevant Accounting Standard) calculated as the weighted cost price of the SKU determined across the entire inventory of that SKU held at a particular time. The difference between the sale price and COGS (excluding rebates) of a SKU was known as the "first margin".

30 A number of rebates offered by suppliers, such as volume rebates and warehouse rebates, had the effect of reducing the purchase price of the SKU and therefore COGS. When rebates of those types were agreed as part of the trading terms on which Dick Smith bought stock from a particular supplier, the value of the rebate would be spread across the entire inventory and would only be brought to account in terms of an increase in gross profit as a result of a reduction in COGS as stock was sold. Some types of rebate, such as Ad Sub rebates, did not fall into that category. Rebates of that type were payable for the provision of advertising services and could be recognised as income when the services were provided.

31 In addition to COGS, Dick Smith, like all retailers, incurred general business expenses such as salary and wages, marketing and promotional expenses and rent. These costs are referred to as costs of doing business (***CODB***). Net profit is derived by deducting both COGS and CODB from the revenue generated through sales. Gross profit is often referred to as profit "above the line" and net profit as profit "below the line". Net profits after tax (***NPAT***) is a common measure of below the line performance as is earnings before interest and tax (***EBIT***) and earnings before interest tax, depreciation and amortisation (***EBITDA***).

32 Accounting Standard AASB 102 requires that "Inventories shall be measured at the lower of cost and net realisable value". There is a risk that not all stock purchased by a retailer will be sold for more than the cost of acquisition (that is COGS). That risk is of particular significance for electronics retailers because of rapid developments and changes in technology, which may make current products unattractive or obsolete. Accordingly, it is usual for a retailer, consistently with the requirements of AASB 102, to make some general provision in its accounts in respect of that risk.

33 There are two other metrics that are important measures of the performance of a retail business which took on considerable significance in this case. One metric is known as "weeks covered" – that is, the number of weeks that it is expected to take to sell the existing inventory of a particular SKU. If weeks covered is too low, there is a risk that the retailer will run out of stock before it can be replaced, with the result that the retailer will lose sales. If weeks covered is too high, the capital of the company will be tied up unnecessarily in inventory and there is an increased risk that that stock will become obsolete and will have to be sold below cost or written off.

34 Weeks covered calculations are often forward looking. That is, the calculation is performed by dividing the total number held of a particular SKU by the projected weekly sales of that SKU. However, weeks covered calculations can also be backwards looking. That is, the calculation can be performed by dividing the total number held of a particular SKU by the average number of sales per week of the SKU in some past period – such as the past three or six or twelve months. The risk of a backwards looking calculation is that past results are not necessarily a good guide to the future, particularly if there have been significant changes in the business in the meantime or the particular SKU in question is approaching the end of its useful life because, for example, it is about to be replaced by a later model. As part of his reporting function, Mr Borg prepared reports setting out closing targets for each category of stock and the number of weeks covered for each category of stock, some of which are referred to later in this judgment.

35 The other metric is the aging of inventory – that is, the length of time (usually measured in days or weeks or months) since the inventory was received by the business. Obviously, the greater the age of stock, the greater the risk of obsolescence. At Dick Smith, the aging of stock was a somewhat unreliable metric because, as I have said, the age of stock was calculated from the date of last purchase.

36 DSH's board met monthly except in December, January and September. As might be expected, board papers, which contained monthly financial information, were distributed to board members in advance of the meetings. Like many retailers, Dick Smith reported by reference to "financial months", which ended on the last Sunday of a calendar month, unless the Sunday was the last day of the month, in which case the financial month ended on the previous Sunday. Consequently, some trading months covered five weeks and others, four. Similarly, Dick Smith's financial year ended at the end of the June financial month, which would not necessarily be the 30th of June of that year. One consequence of this method of accounting, which again took on some significance in these proceedings, is that the monthly cash flow statements and forecasts that were provided to the board would not generally show the peak debt incurred by Dick Smith during a month, since the statements and forecasts showed the position at the end of the relevant financial month whereas a number of expenses, such as some supplier invoices, were payable at the end of the calendar month or the beginning of the following month.

37 DSH's Board had two committees: a Remuneration Committee and a Finance and Audit Committee (***FAC***). The FAC met quarterly, usually in February, May, August and November of each year. Following the float, Mr Wavish became the chairman of the FAC. Its other members were Ms Raine and Mr Ishak. Ms Raine was an accountant and held senior finance roles at Fairfax Media and senior management roles at Yum! Restaurants (the master franchisor in Australia of Pizza Hut and KFC). Mr Ishak was a lawyer specialising in corporate and commercial law.

Factual background

Anchorage acquires Dick Smith

38 On 26 September 2012, DSSH, the Anchorage controlled entity, entered into a contract with Woolworths to acquire all of the issued shares in DSE, the then holding company of the Dick Smith group.

39 As part of its planning for the acquisition of the Dick Smith business, Anchorage put together a management team with the assistance of Mr Wavish, who had discussed the possible acquisition with Mr Cave and who had been engaged by Anchorage as a consultant to assist with the acquisition. Before joining Dick Smith, Mr Wavish had had extensive retail experience. Between 1969 and 1985, he had worked for The Dairy Farm, Ice & Cold Storage Company Ltd, a publicly listed Asian food conglomerate based in Hong Kong, where he rose to the position of group chief financial officer and then chief operating officer for Hong Kong, China and North Asia. In 1985, Mr Wavish moved to Sydney. He worked in various positions, including the CFO of Arnott's Biscuits Ltd, until 1999, when he was appointed Finance Director of Woolworths Ltd. He held that position until 2002, when he became Head of Supermarkets. He left Woolworths in 2004. Between 2006 and 2009 he was the Executive Chairman at Myer. Whilst at Myer, Mr Wavish had met Mr Abboud and a number of other senior executives who were offered positions at Dick Smith following its acquisition by Anchorage. Those executives included Mr Skellern, Mr Merola, Mr Papacosta, and Mr Mark Scott.

40 At the time of his appointment as CEO of Dick Smith, Mr Abboud had had about 25 years' experience in retail, 19 years of which were with Myer. Whilst at Myer, Mr Abboud had managed a number of stores, including Myer Sydney. He had also worked in various regional management roles and as the National Operations Manager of the Megamart business. In that position, Mr Abboud had obtained some buying experience. He became the Director of Retail Stores in March 2008. He had not previously held the position of CEO.

The decision to increase supplier support

41 At the time that Anchorage was considering acquiring Dick Smith, Mr Wavish was conscious that its financial performance had been poor. In 2010, its EBIT

to sales was 1.77 percent and in 2011 the figure was 1.44 percent. It was Mr Wavish's view that it should be possible to increase that figure to five and maybe up to seven percent by reducing costs and improving supplier terms. It was his view, affirmed in his mind by information obtained during the due diligence process, that Woolworths' management had "fallen asleep at the wheel" in terms of its dealings with its suppliers and had not obtained favourable terms from its suppliers and had not extracted enough supplier support (including rebates). It was his experience that rebates formed an important source of revenue for retailers. On that subject, he gave the following evidence:

> In my view, based on my retail experience, getting the best possible deal out of your suppliers is one of the most important aspects of retailing, particularly in industries which involve low margins, fierce competition and/or low levels of customer loyalty (such as groceries, supermarkets, fashion and consumer electronics). Supplier support (including rebates) is of critical importance to retailers around the world, not just in Australia.
>
> By obtaining the maximum supplier support (including rebates), retailers are able to significantly increase their profitability and competitively price their products. In my experience, suppliers have budgets to provide support (including rebates) and if you are not getting support from that budget, your competitor will be.

42 Mr Wavish also gave the following information about the importance of rebates to Woolworths' group profit during the time that he was there:

FY	Rebates ($m)	EBIT ($m)	Rebates to EBIT (%)
1999	$300.40	$539.40	55.69%
2000	$372.40	$621.60	59.91%
2001	$473.60	$706.60	67.03%
2002	$511.80	$832.70	61.46%
2003	$493.20	$945.70	52.15%
2004	$547.30	$1,065.10	51.38%

43 Mr Wavish's evidence was corroborated by evidence given by Mr Robert Murray. Mr Murray had been the CEO of Lion Nathan Limited until December 2012. After that time, he had held a number of directorships, including with Super Retail Group Limited, an ASX listed retailer, and Metcash Limited, an Australian wholesale, distribution and marketing company listed on the ASX, the businesses of which include IGA, Cellarbrations and Mitre 10, where he became non-executive Chairman in August 2015. Mr Murray was appointed to the board of DSH on or about 12 August 2014. He gave the following unchallenged evidence in cross-examination:

> Q. And you learned that Dick Smith was concerned to try to maximise rebates?
>
> A. Certainly think, as I said, that the business wanted to get the best share of rebates they possibly could. I mean, this is just what retailers do. They all do it. It is what all - it is the game that all suppliers play with them. This is the dance, you know. You look at the scale of the numbers and, frankly, when you've got O&A included, $70 million of rebates of one form or another, going into a business like Dick Smith, and you make $45 million a year profit, then this is pretty important. I think without exception, if all those discretionary moneys were taken away from the retailers that I've been involved with, they would all be in some form of significant trouble. So this is a fact of retailing life. I really believe that.

44 According to Mr Wavish, prior to the acquisition, he and Messrs Cave and Abboud decided that if they were successful in their bid for Dick Smith, increasing supplier support (including maximising rebates) should form a key part of their overall strategy to improve Dick Smith's profitability.

The "turnaround strategy"

45 Following the acquisition, Anchorage commenced work on what was described as a "turnaround strategy". That strategy had a number of components or "work streams" under the supervision of senior executives. One work stream was "category mix and buying", which included a number of initiatives. One initiative was "inventory right sizing", which involved the identification of aged and problem stock and the development of initiatives and a timeframe to clear that stock and the establishment of benchmarks for the amount of stock that should be held. Another initiative involved a review of Dick Smith's product range to identify SKUs that should no longer be carried and new products that ought to be carried.

46 While under the control of Anchorage, Dick Smith classified stock into Active (***A***), Discontinued (***D***), Not for Reorder or No Reorder (***NR*** or ***N***) and Quit (***Q***). Active stock was stock that continued to be ordered and sold. No Reorder stock was stock which continued to be sold but was the last of the product of that type to be ordered. Discontinued stock was stock that was no longer to be reordered and was to be actively moved through the Dick Smith stores. Quit stock was stock that was to be disposed at highly discounted prices and in a short timeframe. Although the position is not certain, it appears that the different categories had been developed by Dick Smith while it was under the control of Woolworths and that the division of stock into those categories continued after the acquisition by Anchorage.

47 The Dick Smith buyers manual which was current as at June 2013 set out how active stock was to be reclassified as NR, D or Q and the consequences of reclassification, although, as will become apparent, the procedures for classifying stock changed over time; and it is unclear whether classification ever occurred strictly in accordance with the manual. According to the manual, it was generally the responsibility of a buyer to "derange" stock by changing its status to NR. The manual stated (at 4.8.1.2):

> This process can occur at any time but will generally occur as a result of several key events:
>
> ➢ Range Reviews
>
> ➢ Item Performance Reviews
>
> ➢ Vendor discontinuing item / Item reaching end of life
>
> ➢ New Line Introduction (as a result of DS's *One in One Out Policy*)
>
> ➢ Business Planning (e.g. exiting a class/category)

48 Following reclassification of stock as NR, the buyer was expected to develop an exit plan for the stock which the buyer was then required to manage. The manual states:

> The key to this are negotiations with Vendors in which Buyers are able to discuss the problem lines to get support for clearance options and leverage this against purchases of new/strong-performing lines

49 The manual explains that Dick Smith's stock management system automatically changes the status of an item from NR to D when:

- No stock remained in the DC [Distribution Centre];
- No stock was on order;
- No stock was in QC reserve.

50 According to the manual, stock was automatically reclassified as Quit when:

- There was less than one unit in stock on average for each ranged store;
- There was more than two months cover.

51 The plan for dealing with aged and problem stock involved setting targets for the sale of stock falling within the D, NR and Q categories and using some of the provision in the accounts to enable some stock to be sold at a loss. The plan that was put in place proved to be successful. The evidence is that from the start of January to the end of April 2013, Dick Smith was able to sell $74.62 million worth of NR, D and Q stock utilising a provision of approximately $8.5 million. By the end of FY13, the value of inventory in DSSH's accounts had reduced from $370.55 million to $192.7 million, of which $26.3 million was classified as NR, $15.2 million as D and $1.1 million as Q.

Mr Wavish's method for provisioning for obsolete stock

52 It is not clear what method was used by Dick Smith for calculating the provision for obsolete stock at the time of its acquisition from Woolworths. There is a spreadsheet in evidence which suggests that the provision was calculated by reference to the classification of the stock and its age. So, for example, the provision for stock classified as discontinued was 25 percent if it was over 12 months old, 35 percent if it was over 16 months old and 50 percent if it was over 20 months old. According to a calculation done in April 2013 using that methodology, an appropriate provision at that time was $4,893,845, which was said to be $268,231 less than the current provision in Dick Smith's accounts. However, other evidence suggests that as at the end of April 2013, the provision was $8.6 million.

53 In any event, on 29 April 2013, Mr Tim Gunn, the General Manager, Merchandise, wrote to Mr Abboud attaching the most recent "inventory right sizing" update and saying that Dick Smith had used up its obsolescence provision and continued to hold $23.3 million worth of pre-acquisition stock falling into the NR, D and Q categories as well as post-acquisition "non-

productive stock" of $46.62 million. Mr Abboud forwarded that email to Mr Wavish, who replied that he would follow up on ""inventory provision" issue when I get back", but referred to some adjustments that needed to be made in respect of rebates and suggested the following approach to provisioning:

> Then there is a provision to exit the quit stock all to be achieved well before 30 June 2013. Today this may need to be 50%.
>
> There [sic] there is a provision to clear discontinued lines - maybe 20%
>
> Then there is a provision to clear not for reorder - maybe 20%
>
> Then there is a general provision against the balance being good stock which inevitably will today contain within it some stock that next year will become quit, discontinued or not reorder stock which will need to be discounted to move - maybe 2% general provision.

54 Mr Wavish accepted in cross-examination that the percentage discounts he proposed involved a "broad brush exercise in judgment" on his part which was informed by his general experience and his involvement with Dick Smith's inventory right sizing initiative. However, some support for the application of a 20 percent provision for stock classified as No Reorder and Discontinue can be found in an analysis undertaken by Mr Borg, which he sent to Mr Merola and Mr Papacosta on 4 May 2013. That analysis involved identifying each category of stock falling within the Discontinue and No Reorder categories, the gross profit that would be earned on products falling within that category if they sold for their then current price (expressed as a percentage), the amount by which the price of the products would need to be discounted in order to clear them and the profit or loss that would be suffered on the sale of those products at that discount expressed as a percentage. The average of those percentages came to -20.42 percent, which represented the total provision required in respect of the whole of the stock. There is an error in this approach, since the percentage reduction was calculated by reference to the then current price rather than cost, which is the price at which the goods were to be carried in the accounts in accordance with AASB 102. But adopting that as the base, the percentage reduction would be less.

55 At one time, the method of provisioning adopted by Dick Smith was an important issue in the case because it was said to be faulty and to have been one of the matters that led to DSH's accounts being misstated. However, its

significance has been greatly reduced following the abandonment of any allegation that DSH's published accounts were materially misstated.

Other changes to the business

56 Mr Wavish and others also engaged in a process of identifying the ideal quantity of stock that should be held going forward, although it appears that no formal benchmarks were adopted. So, for example, according to an email Mr Wavish wrote on 11 September 2015, shortly after Anchorage took over Dick Smith, he, Mr Abboud and Mr Skellern undertook a category by category analysis of inventory and concluded that it was appropriate for Dick Smith to hold sufficient stock to provide approximately 60 to 70 days covered, although in cross-examination Mr Wavish suggested that they had actually agreed on about 80 to 90 days cover. Similarly, on 27 June 2013, Mr Wavish sent Mr Skellern, Mr Merola, Mr Papacosta and Mr Abboud an email referring to inventory right sizing as "a big prize", which "will take time and effort" and which stated:

> Whilst I suspect that we will ultimately get store inventory down to 6 to 8 weeks and warehouse inventory down to 1 to 2 weeks (say total 8 to 9 weeks) @$17 mil = $136 to $153 mil) I have no predetermined answer and we will finish where the data leads us.

57 According to Mr Wavish, Dick Smith also commenced implementation of the strategy to increase supplier support, including by maximising rebates, although precisely what steps were taken in that regard prior to the float is not clear from the evidence.

58 Following the acquisition of Dick Smith from Woolworths, Mr Wavish became aware that, while under the control of Woolworths, Dick Smith had not been required to prepare cash flow forecasts. He gave evidence that he thought weekly and even daily cash flow forecasts "were a desirable tool to predict and assess cash flow needs, risks and opportunities" and, in particular, that they would assist the finance team to monitor creditor payments and ensure that Dick Smith complied with it banking facility limits. He worked with a number of employees, predominantly Ms Reiko Sun, Senior Commercial Analyst, on the preparation of cash flows and by the end of the process was confident in the ability of the finance team to prepare cash flows. From that time, DSH prepared

weekly and daily cash flow forecasts, as well as the monthly cash flows that were provided to the board.

The FY13 accounts

59 With one modification, the proposal in Mr Wavish's email was adopted for calculating the provision to be included in the accounts for the 10 months ending 30 June 2013. The modification involved applying a reduction of 100 percent to stock classified as Quit rather than the 50 percent originally proposed by Mr Wavish. The FY13 accounts contained a total provision of $12.4 million in respect of obsolete stock.

60 There is some evidence to suggest that at the time the FY13 accounts were prepared some steps were taken to reduce the number of SKUs classified as No Reorder, Discontinue or Quit, presumably with the intention of reducing the provision to be included in the FY13 accounts. In light of the way the case developed, the correct classification of stock ceased to be important and nothing more needs to be said about it.

61 Deloitte issued its audit report on the accounts for the 10 months ending 30 June 2013 to the DSSH Board on 17 October 2013. Two days earlier, Mr Damien Cork, an Account Director, Assurance & Advisory, with Deloitte prepared a detailed file note setting out a summary of approach and key issues in relation to the audit.

62 In relation to inventory, the note set out how management had calculated the provision for obsolete inventory. The note explained that Deloitte had independently assessed the provision. The evidence on that issue was once important because it was relevant to the question whether later sets of accounts were materially misstated and, if so, whether Deloitte bore some responsibility for that. However, following the abandonment of any allegation that DSH's accounts were materially misstated, the details of the work that Deloitte did on the provisioning methodology is no longer relevant and nothing more needs to be said about it, except to observe that, applying its own methodology, Deloitte concluded that the provision should be $379,419 greater than that proposed by DSSH, which was immaterial.

63 On 17 October 2013, Deloitte issued its audit report to the board for the period ended 30 June 2013. In relation to stock obsolescence, the report said:

> A significant amount of management judgement was required to determine an appropriate fair value adjustment to inventory at the date of acquisition. It is management's intention to review the method of inventory provisioning for the next reporting period to ensure that the provision methodology adopted continues to be appropriate for the profile and ageing of its inventory based on the new business structure and experience.
>
> To assessing the adequacy of the inventory provision at 30 June 2013 we have performed various alternative analyses, including reviewing the various categories of inventory, the split of inventory between that acquired pre and post acquisition by Dick Smith Holdings Pty Limited, subsequent sales in the 3 month period to 30 September 2013, and the type of inventory held by the trading department.
>
> Of the $19.1 million acquired inventory at 26 November 2012 unsold at 30 June 2013, $4.2 million was sold and $3.5 million was written off in the 3 month period to 30 September 2013.
>
> The provision for inventory obsolescence as at 30 June 2013 is considered to be reasonable based on the profile of inventory and subsequent sales made to 30 September 2013.
>
> We note that the current system does not allow for an accurate ageing of inventory as the ageing is based on the last activity date for a SKU rather than the individual SKU date of purchase. We have therefore recommended to management that a means of generating a more accurate ageing report is developed to assist their review of aged inventory and in determining an appropriate inventory provision.
>
> We recommend that management undertake a review of inventory provision methodologies as the legacy inventory is sold or disposed, utilising past history, expectations of future obsolescence rates and stock ageing.

The recommendation relating to a more accurate ageing report was never adopted by Dick Smith. However, as will be seen, the recommendation to undertake a review of inventory provision methodologies was.

64 At about the time the accounts were finalised, Mr Wavish prepared a paper dealing with an adjustment for rebates that could only be brought to account when the relevant goods were sold and with the provision for obsolescence. In relation to the provision for obsolescence, the paper records the following:

> Not for Reorder is generally quite good current stock and is not a significant problem
>
> The provision is arguably overstated
>
> We also provide 20% on this stock but Nick [Abboud] argues for a much lower %

> As we provided 20% at June 2013 this provision is arguably overstated by 15% or **$3 mil.**
>
> Active stock is not provided against in many retailers (eg Woolworths)
>
> We provide 2% - although Nick would state that it overstated by at least 1% or **$2 mil**

Applying his provisioning methodology, Mr Wavish concludes that the provision (said to be $12.3 million) was overstated by $1.940 million, which is said to have arisen from accounting errors resulting in inventory being overvalued by $1.9 million.

The prospectus

65 On 13 November 2013, the directors of DSH met to approve the prospectus for the IPO. At the same time, a copy of DSH's constitution was tabled. The final version of the prospectus was lodged on 21 November 2013. It is not relevantly different from the version approved on 13 November 2013 and lodged on 14 November 2013. The financial information included in the prospectus included the results for 1Q14. By then, the inventory had increased to $211.8 million, reflecting an increase in purchasing activity in September as the business started to build inventory levels ahead of the Christmas trading period. Of the total inventory, $177.4 million was classified as Active, $13.3 million as No Reorder and $21.1 million as Discontinued. None was classified as Quit. Applying the percentages suggested by Mr Wavish, the total provision for obsolete stock (leaving aside a one-off item of $0.1 million) was $10.4 million.

66 Under the heading "Investment Overview" the prospectus included the following table setting out a summary of the pro forma historical results for FY2011 to 1Q2014 and a pro forma and statutory forecast for FY2014:

	Pro forma historical				**Pro forma forecast**	**Statutory forecast**
($m)	**FY2011**	**FY2012**	**FY2013**	**1Q2014**	**FY2014**	**FY2014**

Sales	1,281.1	1,369.5	1,280.4	273.3	1,226.0	1,226.0
Gross Profit	335.2	340.0	303.6	68.4	307.8	307.8
EBITDA	36.5	32.6	23.4	11.6	71.8	46.6
EBIT	23.9	20.1	10.9	9.0	58.7	33.5
NPAT	15.9	13.2	6.7	6.1	40.0	11.5

67 On 28 November 2013, the board adopted charters for the board and for the FAC. The board charter stated that the board's role included monitoring the performance of Mr Abboud and Mr Potts as CEO and CFO, approving management's corporate strategy and performance objectives, determining and financing dividend payments, approving and monitoring financial and other reporting, and reviewing and ratifying systems of risk management, internal compliance and control, and legal compliance, to ensure appropriate compliance frameworks and controls were in place.

68 The FAC charter stated that the purpose of the FAC was to assist the board to achieve its governance objectives in relation to financial reporting, the application of accounting policies, business policies and practices, legal and regulatory compliance, and internal control and risk management systems. One of the objectives of the FAC is stated to be to "ensure effective internal and external audit functions and communication between the board and the internal and external auditor". Paragraph 5 of the FAC charter relevantly states:

5. Risk management and internal control

The responsibilities of the Finance and Audit Committee are:

Risk management and internal compliance and control systems

(a) overseeing the establishment and implementation of risk management and internal compliance and control systems and ensuring that there is a mechanism for assessing the ongoing efficiency and effectiveness of those systems;

(b) reviewing and approving policies and procedures on risk oversight and management to establish an effective and efficient system for:

(i) identifying, assessing, monitoring and managing risk; and

(ii) disclosing any material change to the Group's risk profile;

(c) receiving reports from management concerning the Group's material risks in order to assess the internal processes for determining, monitoring and managing these risks and to monitor the risk profile of the Group.

Events immediately following the float

69 Following the float, Mr Potts, who had joined Dick Smith on 18 September 2013, replaced Mr Tim Fawaz as the CFO. Mr Potts had previously worked as the CFO and Company Secretary of Nicki Scali Limited, a listed furniture retailer and had had over 20 years' experience in senior finance roles with major retail companies, including Sussan Group, Bunnings and Myer. Mr Wavish assumed the role of a non-executive director and was no longer involved in the day to day operations of the business. A series of weekly management meetings was introduced. The meetings included a buyer/planning meeting that was attended by buyers, merchandise planners, Mr Borg and the Director of Merchandise, which occurred on most Mondays. At those meetings the results of the previous week were discussed, including which products worked, who achieved sales and second margin targets as well as planning for the current week.

70 As I have said, the board of DSH met monthly, except in the months of December, January and September. The directors were provided with board papers in advance of the meetings, which were primarily prepared by Mr Potts and Mr Abboud, with the assistance of management. The format of the board papers changed somewhat over time. They included a CEO update, which included a table showing how profit and loss and CODB were tracking to budget for the month and year to date and a summary (in bullet point form) of the principal points of note. They also included a CFO update, which included a

series of tables showing for the current financial year on a monthly basis actual and forecast balance sheets, working capital statements and monthly cash flow statements. The working capital statement included a calculation of net inventory days covered and a breakdown of the value of stock by reference to the four categories of Active, Discontinued, No Reorder and Quit and a calculation of the provision. The CFO update also generally included a summary of DSH's debt facilities, and, in most cases, confirmation that the company complied with its debt covenants. The monthly cash flow forecasts provided to the board differed from the daily cash flows prepared by management in one significant respect in that they, like the weekly cash flow forecasts, included cash in transit, which consisted of actual cash collected from stores by Armaguard and credit card sales which had not been processed, and cash held in a number of subsidiary bank accounts, including an account in the name of MAC 1 Pty Ltd, a company acquired by DSH during FY15. Given the size and nature of Dick Smith's business, on any given day those amounts could be millions of dollars and on some days up to about $13.5 million.

71 In 2014, a new category for the provisioning of stock was introduced called "End of Life" to which a provision of two percent was applied.

Deloitte retained for FY14 audit

72 On 13 December 2013, DSH retained Deloitte to audit the FY14 Financial Statements and conduct a review of the HY14 Financial Statements. According to Mr Wavish, shortly after Deloitte was engaged, he had a conversation with Mr David White, of Deloitte, in which Mr Wavish said that he wanted the accounting for and collection of rebates to be a key focus of the audit. Mr White responded that it already was.

73 In January 2014, Deloitte provided to Mr Potts a document setting out its audit strategy for the FY14 accounts. Mr Potts provided that document to other members of the board on 16 January 2014. According to that document, "key risk areas" included (1) rebates and vendor allowances, (2) the stock obsolescence provision, and (3) AASB 102 costing.

74 On 4 February 2014, Deloitte issued a "Report to the Finance and Audit Committee for the half-year ended 29 December 2013", which was considered at a meeting of the FAC on 18 February 2014. At that meeting the FAC resolved to recommend to the board that the HY14 Financial Statements be approved. They were released to the market on 19 February 2014.

Increase in targeted stock on hand

75 The Project Turnaround Steering Committee continued to meet during this time. One of the issues it continued to address was "Ranging right sizing & Trading Terms". According to the material accompanying the agenda for the committee meeting to be held on 5 February 2014, one of the issues to be addressed was described in the following terms:

> Dick Smith's extensive range of products includes many duplications of type, generating different margins. Right sizing the range should improve gross margin and free up shelf space for better selling, higher margin product.

The material stated that the "deliverables" in respect of that item included:

> - Minimise obsolescence/stock overhang
> - Reduced inventory holding (weeks cover reduce from 13 to 10 weeks by June 2014)

76 According to Mr Wavish, at the time DSH was floated, it had adopted a benchmark of $200 million as the value of stock on hand. Mr Wavish gives evidence that in early 2014 Mr Abboud sought to obtain his agreement to increasing that benchmark to $250 million in order to provide sufficient stock for new stores and to stock more fully existing stores. Initially, Mr Wavish resisted that proposal. However, by mid-2014 he says that he was convinced that it was appropriate.

77 The plaintiffs take issue with this evidence. In particular, they point to a cash flow forecast for FY15 that was provided to Mr Wavish on or around 21 July 2014 which showed that stock at the end of September would be $224 million and stock at the end of the financial year would be $220 million, which does not appear to be consistent with an agreed target of $250 million. In addition, on 6 August 2014, Mr Wavish had previously requested and obtained from Mr Potts the July 2014 financial statements. Those financial statements projected that inventory would be $205 million by the end of September 2014, would peak at

$265 million at the end of November 2014 in preparation for Christmas trading and then close at $208 million at the end of January 2015 and $197 million at the end of the 2015 financial year. In response, Mr Wavish said in an email dated 6 August 2014:

> Inventory reduction is disappointing (along with lower payables) so I hope that by Aug 18 you will be able to say inventory is back to normal as previously discussed with Nick.

78 The plaintiffs suggest that Mr Wavish was expressing his disappointment at the fact that the cash flow showed that stock would peak at $265 million, well above what they say was Mr Wavish's original target of $200 million. However, that appears to be a misreading of the email. As will be explained, it is apparent that by the time Mr Wavish wrote his email the board had accepted (at least tacitly) that $250 million was an appropriate level of stock; and it appears that Mr Wavish's concern was that the cash flow suggested that stock would be substantially below the amount he had agreed with Mr Abboud.

Greater emphasis placed on O&A rebates

79 In the first half of (calendar) 2014, DSH began to place greater emphasis on obtaining O&A rebates. It appears that that was prompted at least to some extent by the fact that the accounts presented at the board meeting on 18 March 2014 indicated that DSH was $0.9 million behind budgeted EBITDA for the year to date (which reflected the figures set out in the prospectus) and by a further deterioration in gross profit later in the financial year. Mr Abboud, delegated responsibility for collecting O&A rebates to Mr Skellern. At some stage, Mr Skellern began setting budgets for each buyer setting out the amount of O&A rebates that each was expected to obtain. Although Mr Borg and Mr Freeman have different recollections on the matter, it appears that from about April 2014 Mr Skellern introduced what Mr Borg describes as “O&A meetings” which were initially held each Friday in Mr Skellern's office and which became more frequent later in the year. Those meetings were attended by buyers, merchandising managers, the head of buying and Mr Skellern. At those meetings, targets were set for O&A rebates and Mr Skellern encouraged buyers to meet those targets. He was critical of buyers who had failed to do so and offered a prize each week to the buyer who had reported collection of the most O&A rebates. There was also an O&A achievement incentive offered in

each quarter for the buyer who achieved the highest percentage collection of O&A rebates above their target for the quarter. From April 2014, buyers were required to complete tracking sheets showing O&A and other support received against all orders. Mr Skellern's approval was required before an order could be placed with a supplier and often his approval was conditional on obtaining O&A rebates from that supplier.

80 It was Mr Freeman's evidence that Mr Abboud would often say in Monday morning buyers meetings words to the effect of "What's your plan to close the gap?", referring to the gap between targeted and actual O&A rebates. Mr Borg gave evidence to similar effect. From time to time, Mr Skellern circulated emails setting out the amount of O&A rebates collected by each buyer in the current quarter measured against the targets for those buyers. The following email sent by Mr Skellern on 13 April 2014 is illustrative:

> Hi All
>
> Pls attached as of Friday the current O&A collect for the qtr
>
> 67.4% (3.2mil) for April so far 1.5mil to go needs to be in play before we go to Easter as per Nick's email
>
> 6.1mil so far collected for the qtr
>
> I have also added a ranking column purely on % of April collected
>
> Greg leads the MM's with 70.2%(2.0mil), Carl some work to do at 57.3%(534k)
>
> Anthony at 106% is the star closely followed by Marisol 100% and Matt at 82%
>
> Frank, Karolina and Adam all below 50% collected for April some work to do
>
> Lets all go hard this week do [sic] you can all have an Easter break lots more to do for the qtr but a great start
> Cheers

81 Similarly, on occasions Mr Abboud encouraged the collection of O&A rebates. An early example is an email dated 27 April 2014 he sent to Mr Skellern and others saying:

> Guys,
>
> The gp [gross profit] dollars fell short for the week.
>
> We will need 5.5 in O/A for April.
>
> I suggest we meet at 745am in the board room.
>
> …

82 In order to meet budgeted EBITDA for the year, Mr Abboud, Mr Potts and Mr Skellern developed a plan in April 2014 which involved reducing the marketing expenses for the remainder of FY14 from $9.7 million to $7.6 million and increasing the target for O&A rebates from $10.2 million to $17.2 million. In order to achieve that increase, Mr Abboud approved an increase in OTB by $20 million and subsequently $23 million. It also appears that, in line with projections provided by Mr Paul Backo, General Manager of Finance, to Mr Abboud, DSH proposed to recognise in FY14 fees totalling $1 million that it expected to recover from participants in a conference organised by it to be held in late July 2014. Those projections were prepared at Mr Wavish's request to show how DSH planned to achieve the $71.8 million target for EBITDA set out in the prospectus. A final version of the projections together with a final draft of the ASX announcement stating that DSH was on track to meet the prospectus forecast was provided to Mr Wavish by Mr David Cooke, Company Secretary, on 10 April 2014. Later in the financial year, the budget for O&A rebates for May and June 2014 was increased to $17.9 million, which included an additional $2 million in conference fees.

83 Mr Abboud says in his affidavit evidence that his reason for releasing the additional $23 million in OTB "was to enable the purchase of sufficient stock to achieve the forecast sales for June 2014" and that he "released the additional OTB to drive sales and profit during June when sales are higher than an average month". However, after giving a somewhat evasive answer, he conceded in cross-examination that "the increase in the over and above rebate collect would be achieved, at least in part, by $20 million extra OTB", although he said that the release of a further $3 million in OTB was because " a lot of our regional stores didn't have enough stock to get the sales, and we were about to go into the June tax time period".

84 In some cases, DSH refused to buy product from suppliers who declined to provide O&A rebates. So, for example, Mr Abboud said in an email dated 9 May 2014 to Mr Bonham in relation to issues concerning stock in the Neutral Bay store:

> The no 'O&A' no 'order' is a factor also.

> Force charges for example, they refused O&A so we have sourced an alternate brand, Not ideal, and I get your point about customer experience when you see that bay at Neutral Bay.

85 From about May 2014 (Mr Borg's recollection was that it was not until September 2014), buyers were given a budget for the O&A rebates they were to obtain from vendors and those budgets formed part of a buyer's KPIs, along with sales, first margin, second margin and stock on hand. As I have said, Mr Skellern had a whiteboard in his office and from early 2014 to late 2014 or early 2015, he recorded on the whiteboard weekly O&A targets and the amount buyers reported had been promised by suppliers. At the end of each month, the amounts recorded on the whiteboard were entered into DSH's accounts.

Collection of O&A rebates as part of "fighting fund"

86 In order to increase the level of O&A rebates, some buyers suggested on occasions that suppliers increase the price of their products and provide the difference in the form of O&A rebates. An early example of that practice is contained in a series of emails sent in early May 2014 between Mr Brett Leyshon, a buyer with Dick Smith, and others in which Mr Leyshon proposed that Take 2 (a supplier of games) increase the price of a particular game by ten percent so that Take 2 "can show the 10% O&A to your business". A number of other suppliers including Belkin Limited, Jackson Industries Pty Limited, Maxwell International Australia Pty Limited, Targus Australia Pty Limited and Cellnet Group Limited, agreed to that practice. Mr Freeman gave evidence that the amounts raised by that practice was sometimes referred to within Dick Smith as a "fighting fund".

87 How widespread that practice was, however, is unclear. Both Mr Freeman and Mr Bonham give evidence of it. Indeed, the evidence suggests that Mr Bonham was the architect of the practice. Mr Freeman gives evidence that the expression "fighting fund" was used openly in the business, including during Mr Abboud's Monday meetings. However, it appears that the expression "fighting fund" was used ambiguously to refer both to that practice and more broadly to "a bucket of fund [sic] that a vendor might hold to be drawn down for certain agreed events" (to quote from the evidence of Mr Borg).

88 There is no evidence that the board, including Mr Abboud and Mr Potts, were aware of the practice. There is evidence that on one occasion in December 2014 Mr Bonham became aware of an opportunity to make a purchase from the supplier Kaiser Baas, involving a purchase order of $2 million which would attract an O&A rebate of $400,000, which he raised with Mr Abboud. Mr Bonham suggested that "we could uplift price to make it $500 collect". Mr Abboud replied "No uplift of product please, I don't want to play in that space". The plaintiffs suggest that this is evidence that Mr Abboud was aware of the practice and was prepared to authorise it on some occasions. No such conclusion can be drawn from the email. There is no evidence that the practice was raised again with Mr Abboud. The only reasonable inference is that it was raised with him once, he rejected it and it was not raised with him again.

FY14 accounts and FY15 budget

89 On 26 May 2014, there was a board meeting to approve the FY15 budget. The meeting was attended by Mr Abboud, Mr Potts, Mr Cave, Mr Wavish, Ms Raine and Mr Ishak. The proposed budget, which was approved at the meeting, forecast that DSH would earn $32.8 million in O&A rebates and $29.2 million in Ad Sub rebates, with a gross marketing spend of $45 million. It also forecast net profit of $47.3 million and projected that inventory would be $226 million at 28 June 2015 and that net end of financial month debt would peak in March 2015 at $55 million.

90 In connection with the preparation of the FY14 accounts, it appears that Mr Potts asked Deloitte for advice on whether, consistently with the accounting standards, it would be possible to recognise O&A rebates as a reduction in COGS so as to increase gross profit. In response to that request, on 26 May 2014, Mr Cork sent Mr Potts an email in which he said:

> Further to the discussion on Friday around the O&A rebates, we would like some further information around the transactions and their treatment for the company before we can provide our view on the arrangements. …
>
> …
>
> The proposed change is to continue to recognise the rebates immediately, however shift the rebate received from CODB to within Cost of Sales, having the impact of increasing the Gross Margin but also increasing CODB. Our view is that, generally, where a rebate is negotiated as part of a purchase of inventory, and the purchase is conditional on the rebate being provided, then

> the rebate should be taken up into the cost of inventory and recognised in the P&L only when the inventory is sold (through COS). If there is no condition and the two negotiations are separate, then the rebate may be recognised immediately but should be entered through CODB rather than Cost of Sales.
>
> Ordinarily it would be inconsistent to recognise the rebate immediately AND through Cost of Sales. We note that previously under WOW, the rebates were recognised in this manner however we raised an unbooked adjustment based on the AASB 102 calculation.
>
> Given this has the potential for a significant impact to the margin and/or the profit, would one of your team please be able to provide us with some commentary/justification in the treatment which we can then corroborate with the buying team and perform some testing around.

91 Mr Abboud says that he did not see the email. However, the likelihood is that he did or that Mr Potts passed its contents on to him. On 27 May 2014, Mr Abboud sent Mr Potts an email in which he said:

> Please get them in and resolve the O/A.
>
> It's not a rebate, we already have a 5.5% rebate.
>
> I want to meet them if it's not resolved and I may change companies.
>
> Just because Damian is new in dick smith does not excuse the consistency I expect and the principles already set with Deloittes for the last 2 years...

92 Although Mr Abboud denied it in cross-examination, it seems clear that Mr Abboud was indicating a willingness to sack Deloitte if they did not accept DSH's method for accounting for O&A rebates.

93 In response to Mr Cork's email, Mr Potts, on 6 June 2014, sent Mr Cork two accounting papers. The first provided a summary of the types of rebate obtained by DSH and included the following description of O&A rebates:

> Whilst the majority of Over and Above rebates are described as "Marketing", they are adhoc in nature and are usually not supported by formal agreements.
>
> If these rebates relate specifically to marketing support in the form of paying for additional or preferential space, it Is generally applied against the marketing cost in CODB.
>
> However, if the rebate relates to additional support to clear product, or assist in promoting a product via discount, then it will be applied to the Gross Profit line to offset the loss in margin.

94 The second paper dealt with the transfer of O&A rebates from CODB. It stated:

> Dick Smith collects a variety of rebates, discounts and support from vendors. While the majority of the support is in the form of standard trading agreements, a large amount of support is received in the form of "Over and Above" (O&A) rebates that are negotiated on an ad hoc basis. These O&A rebates have generally been treated as an offset to marketing expense in CODB. These

> rebates are often described as marketing support, but also relate to additional vendor support to clear inventory or offer price protection on discounts or promotions. If the O&A rebates do relate to support to clear or promote inventory, then they should be applied to the Gross Margin line rather than the CODB line.

95 Responding to the last two sentences of the second paper, Mr Corke said in an email dated 10 June 2014 that "These types of rebates are essentially extra product-based rebates and theoretically should be deferred into inventory and only recognised when the product is sold".

96 Mr Abboud accepted in cross-examination that in around June 2014, approximately $17 million of O&A rebates were transferred to gross profit. Commenting on the proposed transfer, Mr Nigel Mills, Finance Manager, said in an email dated 12 June 2014 to Mr Potts that:

> The process of justifying the $17.5m t/fer will be a challenge as, for example, I noticed a number of the Profectus claims being described as Purchase Rebate.

97 In the middle of June 2014, Mr Abboud agreed to the release of a further $5 million in OTB to generate $250,000 in Ad Sub and $500,000 in O&A rebates as part of a strategy to obtain an additional $2 million in gross profit in order to meet the projections contained in the prospectus. Evidence given by both Mr Freeman and Mr Bonham suggest that Dick Smith bought stock in June 2014 that it did not need in order to generate additional gross profits through O&A rebates.

98 On 16 June 2014, Mr Potts sent an email to various people, including Mr Abboud, Mr Skellern and Mr Borg concerning a "$2 million contingency planning meeting" which is obviously a reference to the goal of finding a further $2 million in profit before the end of the year. The email set out the following plan:

> 1. $400k – Collect additional 5% on MTC purchases to 29 June (John Skellern)
>
> 2. $600k – Collect additional O&A by asking for net terms with suppliers (Greg Hirsch)
>
> 3. $250k Ad Sub, $500k O&A – Use an additional $5m in OTB to collect (Greg Hirsch)
>
> 4. $200k – Accrue telco rebates for June assuming lift in connections through Vodafone launch (Dave MacKenzie)

5 $40k – Additional scans (Chris Borg)

99 Following that email, there were negotiations in late June with Garmin to purchase additional product in exchange for O&A support of AUD70,000 and NZD16,150. Similarly, in late June, DSH reached agreement with Canon Australia to place "$2.35m worth of camera / photo products for delivery in July (invoiced in June) … in return for $481,750 in O&A return".

100 On 11 July 2014, Mr Potts distributed to the members of the FAC two documents, one showing the results for the FY14 year compared to the forecast in the prospectus. The other providing comments on the results. The documents indicated that sales were $1,227.6 million compared to a forecast of $1,226 million and that EBITDA was $74.1 million compared to a forecast of $71.8 million. The draft accounts also showed that receivables had increased from an amount of $10.4 million shown in the prospectus to $48.7 million and that inventory had increased from $168.5 million to $252.9 million. Mr Potts's commentary explained that the increase in inventory was "due to stock for new stores and David Jones ($35m), a lift in stock levels to a more normalised level ($30m) and additional stock purchased in June to ensure a strong start to FY15 ($20m)". The commentary also stated that "The non-active stock component has been well managed in FY14 and reduced by 25% ($42m) in June 2013 to 6% in June 2014". Similar information was contained in the board papers for the board meeting held on 22 July 2014.

101 Mr Potts gave a somewhat different explanation for the increase in inventory in an email he sent to Mr Abboud on 9 July 2014 in anticipation of a meeting Mr Abboud had arranged with Mr Wavish the following day. In that email, Mr Potts explained that stock:

> Closed at $253m, up $85 on 30 June 2013, and up $15m on Dec 13.
>
> Driven by new stores and DJ's ($35m), higher Stock in Transit ($3m) and higher closing inventory to achieve O&A

Mr Potts also said that receivables

> Closed at $47.9m, up $37.5m on 30 June 2013.
>
> Higher than normal as we accrued a large amount of O&A income from suppliers we are still to collect. A large amount was collected on June 30 in our payments to suppliers but was post year end.

Increase in weeks covered

102 One consequence of the decision to increase the level of stock was to increase weeks covered substantially above the goal set by the Project Turnaround Steering Committee in February 2014. Mr Abboud explained the position in these terms in cross-examination:

> So what we've learnt with a 40-year-old business very quickly was that these stores needed stock, because we had a store network of 370, not 180 [a reference to JB HiFi], and to put a range out, we were seeing that in 2012, we lost sales by 100 million on 2013. 2014 to 2013 was 100 million. The 253 is at 13 weeks cover. If you multiply that out by the cost of goods in that year, it's 13 weeks cover. That's with that purchase.
>
> I was very comfortable that the business was learning a lot in a very short period of time, of running a billion dollars business, that the inventory required in 370 stores was definitely not 200 at this stage. And June, the board pack clearly states what happened in June.

103 In fact, the weeks covered for a substantial number of SKUs were well in excess of 13 weeks. For example, according to an email dated 1 July 2014 from Mr Bonham to Mr Borg, the weeks covered for various categories of stock for which Mr Bonham was responsible exceeded 16 weeks. Similarly, according to an email dated 13 August 2014 that Mr Borg sent Mr Orrock and others, which was copied to Mr Abboud, the top 100 SKUs across the group with 20 weeks cover or more had a total value of $29 million.

104 On 13 August 2014, Mr Borg sent an email to Mr Orrock, buyers and planners which was copied to Mr Skellern and Mr Abboud, among others, attaching a list of Australian SKUs that were overstocked. The covering email summarised the position in these terms:

> I have pulled together our top overstocks action list for AUS.
> I have used the last 4 weeks sales average excluding commercial to calculate the weeks cover - bear in mind some lines are new or we are building levels for Father's Day etc - I have not factored this in.
>
> At a total AUS level, our top 100 skus across the business with 20 weeks cover or more totals $29M on hand.
> This is mostly Computers, TVs, Mobiles, some Visual Components, Nav, Gaming and Security.
>
> In Accessories, the top 50 lines per category with more than 25 weeks cover totals $8.2M on hand
>
> - Connect has $3.8M
> - Power has $2.2M

- Protect has $2.3M

In Audio Visual, the top 50 lines per category with more than 20 weeks cover totals $16M on hand

- Audio has $3.6M
- TVs has $10.8M
- Visual Components has $2M

In Home Solutions, the top 50 lines per category with more than 25 weeks cover totals $25M on hand

- Cameras has $7M
- Gaming has $4.5M
- Nav has $3M
- Security has $2.8M
- Home Solutions has $900k
- Fitness has $4.5M
- Seasonal has $2.5M

In Mobility, the top 50 lines per category with more than 12 weeks cover totals $7.7M on hand

- Outright has $5.3M
- Prepaid has $2.5M

In Office (non tech), the top 50 lines per category with more than 16 weeks cover totals $13.7M on hand

- Cordless Phones has $1M
- Printers has $3.2M
- Ink has $3.4M
- Storage has $4M
- Software has $1.8M

In Office (tech), the top 50 lines per category with more than 10 weeks cover totals $41M on hand

- Apple has $11M - we are building for 10% off activity and heading towards Apple end of quarter where supply tightens
- Computers has $25M - many skus have just come in
- Tablets has $4.8M

Mr Borg sent a similar email in relation to the position in New Zealand the following day. According to that email "At a total NZL level, our top 100 skus across the business with 20 weeks cover or more totals $9.7M on hand. This is mostly Computers plus some TVs, Tablets, Mobiles, Fitness and Cameras".

FAC meeting on 12 August 2014

105 The FAC met on 12 August 2014 to consider the FY14 accounts. On the same day, Mr Murray and Mr Potts were appointed directors of DSH. The accounts were approved at a board meeting held on 18 August 2014.

106 Reflecting what Mr Potts had told the FAC on 11 July 2014 the minutes of the FAC meeting record Mr Abboud as saying:

> Other highlights include NPAT of $42.1m, up 5.3$ on the full year Prospectus forecast of $40.0m. The Company has a strong balance sheet at year end with $29.9m in cash and no gross debt. Closing inventory of $253.8m was up $90m on the 30 June 2013 number due to new stores and David Jones ($35m) and uplift in stock based on a more normalised level of inventory and higher stock levels to assist sales for the start of the new year ($55m).

107 It is apparent that that explanation was accepted at the subsequent board meeting to approve the FY14 accounts. The Directors' Report included in the Annual Report records:

> The movement in working capital during the year of $6.6 million is largely due to the increase in inventory levels being partially offset by the improvement in trading terms with suppliers.
>
> The increase in inventory levels to $253.8 million reflects the opening of net 54 new stores during the year and a healthier stock position. The quality and ageing of inventory has also improved significantly during the year.

108 A report prepared by Deloitte was distributed to members of the FAC in advance of the meeting on 12 August 2014. In relation to inventory obsolescence, the reported observed that the total provision for obsolete stock was $8.7 million calculated in accordance with Mr Wavish's provisioning methodology. The report said:

> Whilst the gross inventory balance has increased, the inventory provision has decreased mainly due to an improvement in the quality and ageing of inventory. In addition, management have implemented an 'End of life' category which identifies the inventory approaching the end of its life cycle but not under an active clearance program

A two percent provision was applied to stock falling within the "End of Life" category.

109 The report also observed that:

> During FY14 management has reviewed its methodology for calculating its inventory provision in light of the continued evolution of the business's operating model. As at 29 June 2014, a process was undertaken to assess the inventory obsolescence provision based on:

> - Inventory status
> - Inventory aging
> - Sell through rates and months cover
> - Negative margins at current selling prices
> - Current promotions or other adjustments
>
> …
>
> The calculation of the obsolescence provision based on this model resulted in a provision of $7.2 million, compared to the provision recognised under the previous methodology of $8.7 million. No adjustment has been made by management as at 29 June 2014 to reflect this new approach on the basis that the previous assumptions were built into the prospectus forecast. However we understand the new methodology will be implemented in FY15.

110 In relation to rebates, the report stated:

> Management have undertaken a program of maximising the vendor rebates obtained, either through price protection, advertising subsidies or over & above rebates. The increase in rebate receivables at 29 June 2014 is also due to the increased amount of rebates obtained from vendors, as well as the timing of claims, as the set-off of the accrued rebate and the creditor occurs only when the claim is made.
>
> Where a rebate relates specifically to a product purchase or promotion, the income relating to the rebate received should be deferred so as to match the recognition of the cost of that product or promotion in profit or loss. Generally, over & above rebates are not specifically allocated to a product purchase or promotion, however are often negotiated in parallel to a purchase of inventory or the clearance of an existing product.

The report sets out the procedures that had been adopted for testing the classification of rebates and assessing whether any of those rebates represented amounts which ought to be deferred and recognised in profit or loss in FY15. It also stated that "We have recommended that management perform a review at each reporting date to identify any over and above rebates which relate to ongoing promotions or volume discounts and these should be recognised as deferred income until the promotional period is completed or the stock is sold".

Recording of O&A rebates

111 It is apparent that there was some delay in finalising the audit report on the FY14 accounts because of the difficulties that Deloitte were having in obtaining audit evidence for O&A rebates. A substantial number of rebates were obtained in connection with identified marketing and support services that would be provided by Dick Smith in return for the rebate. In all, the written

submissions provided by Mr Abboud and Mr Potts identify 72 instances where that occurred during the period from April 2014 to January 2016. However, in many instances, particularly prior to August 2014, the agreement to provide an O&A rebate was recorded in an email which gave no indication of what the rebate was for. On a number of occasions in connection with the FY14 audit, buyers requested suppliers who had provided O&A rebates to provide emails confirming that the rebates were provided for "marketing support". So, for example, on 1 August 2014, Mr Freeman sent an email to Mr Tony Peck of Cellnet saying "To assist our finance team in raising claims for June 2014, could you please re-confirm your approval of marketing support of $111,000 for activity in June". Mr Peck replied the same day "Yep, just confirming back that the below is as per our agreement". Similarly, in an email dated 6 August 2014, Mr Frank Kavanagh asked Mr Luke Rochaix of Canon to confirm "ASAP … that Canon agreed to pay 10% O and A for all orders placed in June" coming to a total of approximately $260,000. Mr Rochaix gave a confirmation to that effect by email on the same day. Deloitte relied on emails such as these in auditing the amount for O&A rebates in the accounts. Mr Bonham said in cross-examination that in August 2014 buyers, on instructions from Mr Michael Sullivan, General Manager Procurement & Strategic Buying Operations, were collecting information from suppliers which they knew to be untrue to support Dick Smith's accounting for O&A rebates. He also gave evidence that buyers were instructed by Mr Abboud, Mr Potts, Mr Skellern and Mr Sullivan about the importance of recording that O&A rebates were paid for promotional support irrespective of the real reason for payment so that the rebates could be recognised as profit immediately.

112 Following conclusion of the audit, Deloitte provided Mr Potts with a management letter dated 16 October 2014. That letter raised concerns about the classification of O&A rebates. Relevantly, it stated:

> The buyers have been given responsibility of their portfolio and the management and the accounting for the rebates that are being earned. There is no oversight from a management's point of view other than the review of subsequent receipts related to these rebate accruals. There are two major risks associated with this activity:
>
> 1. The buyers have the incentive to inflate the accruals to meet targets as there is no review

> 2. The buyers would not have appropriate accounting knowledge per Australian Accounting Standards which would result in the incorrect treatment of rebates (e.g. recording rebate income on a cash basis rather than an accrual basis)
>
> The above reasons could pose the risk of fraud or material misstatements in the financial statements.

The letter also said:

> Upon review, it was noted that a large number of rebate deals were agreed verbally/through e-mail correspondence and there was no formal support/evidence trail available. Upon request for audit testing, the buyers had to manually search through their records (i.e. email inboxes) to obtain the appropriate evidence for the sampled rebate items. There needs to be support readily available for every accrual journal posted due to the fact that all the accruals are immediately recognised in profit or loss. Absence of proper documentation could result in fraudulent, duplicate and incorrect amounts which could get posted in the accounting books being unable to be substantiated.

Emphasis on O&A rebates continued in FY15

113 The emphasis placed on collecting O&A rebates continued throughout FY15. According to Mr Freeman, it was difficult to get Mr Skellern to approve a purchase order which stated that no O&A rebates would be paid by the supplier and Mr Skellern “typically required a minimum 10% O and A before signing an order”. Mr Bonham gives evidence to similar effect. According to Mr Borg, from about September 2014, Mr Abboud became increasingly involved in allocating the OTB budget and at his request OTB started to be allocated to categories in which the supplier paid more O&A rebates, so that in the case of categories where the supplier paid low or no O&A rebates, the business retained lower weeks covered but in the case of categories where the supplier paid higher O&A rebates the business worked to higher weeks covered. At that time, Mr Borg says that Mr Abboud also started to convene meetings of the leadership team and merchandising managers in which he would set out the financial results of the company against budget and invited the merchandising managers to suggest how any shortfall in budgeted profit could be made up by O&A rebates. On 30 October 2014, Mr Abboud sent an email to Mr Orrock, Mr Skellern and others, which was copied to Mr Potts, referring to an “extra spend” of $15 million and asking for a breakdown of how it would be spent with the “Key rules” including “20% o/a Ad sub on the 15 million……=3 million”.

114 Mr Abboud gave affidavit evidence that he released the additional OTB "to increase the stock available to be sold in the Christmas sale period and to generate more sales and GP". That may have been a factor. However, it is apparent from the conditions attaching to the release of the additional OTB and Mr Abboud's emphasis on the fact that it would raise an additional $3 million in O&A and Ad Sub that the primary reason he released the additional OTB was to obtain additional profit that could be booked immediately. If Mr Abboud's decision was really driven by a need to buy additional stock to fill perceived gaps in inventory, it might have been expected that Mr Abboud would say something about the nature of the stock that was to be bought, but he did not. In general, the impression I formed of Mr Abboud's evidence was that he down-played the significance of O&A rebates to many of his purchasing decisions and exaggerated the importance he attached to O&A rebates as a means of funding promotional activities so as to drive sales.

115 By 23 October 2014, DSH had a spreadsheet in place which listed the O&A targets for each buyer and the "OTB Overspend Required" in order for the buyer to meet that target. The spreadsheet as at 23 October 2014 indicates that an overspend of $25.5 million was required to obtain additional O&A rebates of $937,000. It also listed the amount of further O&A opportunities "to close the gap". Although Mr Abboud denied in cross-examination that he was aware of the spreadsheet, it is likely that he was given that the file name of the spreadsheet is "O and A Template – Nick Update" and his close involvement in the strategy to increase profit by negotiating O&A rebates.

Private label suppliers required to pay O&A rebates

116 In about September or October 2014, Mr Abboud introduced a system of requiring private label suppliers to provide O&A rebates in exchange for an agreement by Dick Smith to increase the price it paid for stock that the suppliers paid. He said that it was part of a strategy to expand the range of private label inventory and sales. He gave the following explanation for his decision to introduce that system:

> Mr Cocciolone had suggested to me, I am now not sure of the date but believe in about September or October 2014, that the PL [private label] group was disadvantaged relative to the Buying department responsible for national brand products, because suppliers of national brand products supplied

> inventory under trading terms, which provided for rebates and also O&A was negotiated with those suppliers. He said that PL inventory was more profitable than national brands but was disadvantaged because it dealt with Chinese suppliers who were not on trading terms and who did not provide O&A. He said that PL products competed with national brand products but PL products did not have marketing support through O&A. I agreed that trading terms should be negotiated with the Chinese suppliers and that they should contribute to the cost of marketing their products through O&A which would be negotiated with them.

117 Following the introduction of the practice, on 10 December 2014, Mr Potts sent Mr Bar-Ami an email asking Mr Bar-Ami to reduce the O&A targets shown in his spreadsheet. Mr Potts said that “Mario [Cocciolone] will collect an additional $3.5m in O&A from private label to cover this reduction”. Mr Abboud gave the following evidence concerning this change:

> Q. The private label uplift didn't actually involve Dick Smith actually paying the supplier any more money?
>
> A. That's correct.
>
> Q. And it also didn't involve the supplier paying Dick Smith any money?
>
> A. That's correct.
>
> Q. To record it in the company's accounts, the technique was wholly artificial, wasn't it?
>
> A. I reject that claim. The business here was - you're talking about a business that was generating 13 to 15 per cent of the sales and delivering 33 per cent of the profit in that 2015 year. You're talking about a unit price arrangement in the business where we moved it to a national branded contract. That supplier agreed to that. But all the assets that that supplier got did occur, and that's an important part of the change that we made within that business.
>
> Q. From a technique of increasing the price and recording a rebate for the difference, when no change in the amount of money was paid, the company booked, on these figures, an additional $3.5 million to gross profit, didn't they?
>
> A. The company changed the arrangement with the supplier and that 3.5 was booked as marketing within the business across 300 to 400 stores, and that was the change going into a national branded contract.

According to an entry made in AS400 on 2 January 2015 with effect on 28 December 2014 (the last day of the financial half year), a total of $6.9 million of profit was recognised in the form of O&A rebates in respect of private label stock.

118 The plaintiffs were highly critical of the practice of uplifting the price of private label stock so that suppliers paid O&A rebates, describing it as “artificial”. However, Deloitte was informed of the practice when conducting the FY15

audit and were aware that the rebates were accounted for in CODB as a reduction to marketing expenses. They raised no issue in relation to the practice or its treatment in the accounts. There is substantial evidence that Dick Smith undertook advertising and promotional activities in relation to private label stock, including in its catalogues, on its website and on television and radio. In circumstances where there is no longer an issue in relation to the FY15 accounts, the practice no longer appears to be of any great significance to the case. The plaintiffs suggested that adoption of the practice was relevant to Mr Abboud's credit. But in circumstances where the practice was explained to Deloitte and Deloitte accepted it, that submission must be rejected.

Further evidence concerning O&A rebates

119 Attachment 1 to this judgment is a graph prepared by the plaintiffs' legal advisers setting out the value of O&A rebates and the amount spent on advertising as recorded in the accounts of DSH for each financial month from July 2013 to December 2015. The graph is said to demonstrate two things. The first is that the amount of O&A rebates collected by Dick Smith increased over time. The second is that in most months the amount of the rebates exceeded by a large proportion the amount spent on advertising, which is said to undermine the defendants' contention that the rebates were paid for promotional services.

120 The defendants (in particular, Mr Abboud and Mr Potts) take issue with that analysis. First, they point out that the amounts recorded as O&A rebates did not make allowance for the fact that in June 2014 approximately $17 million of O&A rebates were transferred to gross profit and that in December 2014 a further amount of $26 million in O&A rebates was transferred to gross profits. The journal entry relating to the second transfer explained the transfer in these terms:

> Over the past 6 months, vendors have supplied over and above rebates that supported the business in scan and promotional sell through activities. It has been agreed to transfer these rebates to Gross Profit which reflect the true nature of these rebates.

121 The defendants point out that Deloitte was aware of and approved these transfers. They also point out that, although at one stage in the case the plaintiffs took issue with the transfers in connection with an attack on the FY15

accounts, they no longer do so. According to the defendants, the transfers must be understood as being the result of a periodic review by Dick Smith of rebates originally classified as O&A rebates (paid in respect of promotional support) and a reclassification of those rebates that were properly classified as a reduction in COGS (such as scan rebates) and therefore to be taken to gross profits on the sale of the relevant stock. Precisely how that reclassification task was undertaken is not the subject of evidence. In any event, according to the defendants, the true position for HY15, for example, was that the amount booked in that half year for O&A rebates (in the sense of rebates paid in respect of promotional activity) was $11.1 million, compared to advertising expenses during the same period of approximately $22.1 million. That is consistent with the financial information contained in the February 2015 board papers, which show that gross marketing spend for the year to date was $25.518 million whereas O&A rebates were $11.651 million. For the full year, the figures were $48.148 million and $26.894 million. These figures, of course, do not take account of Ad Sub, which was $18.294 million for the year to the end of January 2015 and $25.354 million for the full year.

122 Although each of Messrs Borg, Freeman and Bonham gave evidence of a policy of seeking to maximise O&A rebates, each of them accepted in cross-examination that that policy was not pursued at the price of buying stock that it was known could not be sold within a reasonable time for a reasonable margin. So, for example, Mr Freeman gave this evidence:

> Q. Obviously when considering whether to purchase product, you look at, in effect, the price, saleability, whether there is likely customer demand for the product?
>
> A. Those things and a lot more, yes.
>
> Q. And what margin can be achieved, what O&A can be negotiated, what adsub is available - all of those things?
>
> A. All of those things and more. Adsub was written into trading terms, so it wasn't something that we thought about, because it was fixed. But certainly all of the others were part of the decision-making process, yes.
>
> Q. You wanted to ensure that you bought product which could be sold at an attractive margin and generate profit for Dick Smith?
>
> A. We always tried to.
>
> Q. That was your position throughout 2014 and 2015?

A. That was certainly what we tried to do the whole time, yes

And later:

Q. Let's come back to my proposition. You did not knowingly purchase product during 2014 and 2015 which you thought could not be sold and would result in a loss to Dick Smith, did you?

A. No, I didn't, based on I thought that it would sell at some stage profitably, yes.

123 Similarly, Mr Borg gave this evidence:

Q. When considering the purchase of particular product, as a general proposition, buyers would look at the saleability of the product, the margin they thought they could achieve, whether or not there was demand for that product and any O&A or adsub which might be achieved in respect of the sale; do you agree?

A. Yes, that's all things they should consider, correct, yes.

Q. In the case of vendors which offered O&A, of course, any purchase of product from them would need to, or should, comply with all of the requirements you've just agreed with; do you agree?

A. They should, yes.

Q. That's because competent buyers, complying, as you understood it, with the company's requirements should consider all of those matters when purchasing stock; correct?

A. They should, yes.

Q. That's true for the period 2014 and 2015; correct?

A. The fact they should consider it, that's true always, not just for 2014/2015.

124 And Mr Bonham gave this evidence:

Q. In this category [mobility], you were spending OTB in a way that would mean that you would hit sales, profit and O&A targets; is that right?

A. That's correct, yes.

Q. You were focusing on working within the amount of OTB allocated to you, and using it to buy products which delivered sales and margin as well as O&A?

A. That's correct.

125 Even so, it is apparent that the emphasis on the collection of O&A rebates was making it difficult, at least on occasions, for buyers to meet their other KPIs. So, for example, on 25 September 2014 Mr Borg sent the following email to Mr Anthony Liberto, Dick Smith's Category Buyer - Apple, Computer Hardware and Software between 19 November 2005 and 13 January 2016:

> We are stuck between a rock and a hard place trying to balance the mix between margin and O&A.
>
> Rod [Orrick] asked for a quick review of brochure. As I alluded to earlier, Nick [Abboud] has hounded us all day (you can see the trail from him this week below).
>
> Rod's feedback to Greg / Carl / myself today was to be more upfront / transparent with impacts re shifting buckets.
>
> O&A is killing us – I know you are always fighting this so let's work on a plan to articulate to John [Skellern] about how much scan money goes into O&A and try and stop what we can.

126 Mr Borg was not cross-examined on this email, and it is not entirely easy to follow. However, it appears that Mr Borg was saying in the email that it was difficult to buy product that both met the requirement to obtain O&A rebates in exchange for all purchases and that could be sold for an appropriate margin, that he had raised the issue with Mr Orrock and that Mr Orrock had said that Mr Borg should be more transparent (presumably with Mr Abboud) on the effects of the policy in relation to O&A rebates.

DSH acquires too much stock

127 On a number of occasions in FY15, Mr Borg, in particular, expressed concern about DSH becoming overstocked. Some of those occasions have already been referred to. On 24 October 2014, Mr Borg sent an email to Mr Bonham and Mr Kavanagh and Ms Lidia Konakov, among others, which relevantly said:

> Frank, the team have called out needing help to address plox Difot issues and overstocks / poor sales and weeks cover building. I don't have the detail but sounds serious.
>
> Frank & Lidia, please fast track putting together the summary of incoming private label commitments that are causing the overspend in q2. If we have stock due to land that is just fat and not needed until feb / March in store, work with Hk sourcing office and the pl team to move these out.

128 On 19 November 2014, Mr Borg sent an email to Mr Orrock and Mr Skellern saying "As you know, we have over-ordered for the quarter and our closing stock is at risk" and putting forward a proposal to move or cancel some purchase orders to deal with the problem. Mr Orrock replied suggesting that they discuss the issue the following day. In response, Mr Borg relevantly said:

> No worries. Let's catch up tomorrow.
>
> As some pre reading, in simple terms, we needed to push out $25m of orders from last week to free up room for the remaining spend requirement and close week 26 on $280m based on $360m sales for the quarter.

> Since last week it is fair to say there has been very little moved out, in fact additional requests have arisen in addition to the $15m extra nick money plus more mobility orders plus the $5m iPhone order for dec plus the circa $5m IPAD allocation that came through today.
>
> Whilst I am confident these will sell, they are not 100% incremental sales to budget so will add to the $280m closing.
>
> If we don't address areas that are substantially behind budgeted sales now, we will not be able to land on $280m assuming we achieve sales budget from this week onwards.

129 On 26 November 2014, Mr Borg sent an email to merchandise planners, Mr Skellern and Mr Orrock, among others, saying:

> As you know, we have raised a significant amount of POs [purchase orders] this quarter to deliver our sales budget and drive the Ad sub and O&A.
>
> Combine the overspend with the COGS fallout across Oct and November and we are facing a very untidy closing stock number at the end of Week 26.
>
> …
>
> I have already buffered out overseas stock that wont [sic] land and commercial purchases.
>
> …
>
> What I need you to do urgently is review all open POs and in conjunction with your Buyer, determine what can be reduced or split with January without any significant impact to Sales, Ad sub or O&A.

130 On 19 December 2014, Mr Borg sent an email to a number of people, which was copied to Mr Potts and Mr Abboud. Relevantly, the email said:

> We currently have almost $20M of POs due between the 29/12 and 31/12.
>
> Whilst we have done this to maximise Dec O&A, the business is requesting extended terms on these so they fall into January statement by the vendor.
>
> …
>
> Working with you MM, please organise to have the payment terms pushed out and please send me and Accounts a confirmation once complete.

131 The position in relation to excessive stock was compounded by the fact that there were delays in delivering a number of containers of private label stock from China in time for the Christmas trading period. After being taken to a number of emails referring to the delays, Mr Borg gave the following evidence in cross-examination:

> Q. You are aware, aren't you, that private label stock which was originally scheduled to be in the stores prior to Christmas and be sold in that Christmas period was delayed and was not sold and contributed to the stock on hand position at the end of January 2015; do you agree?

> A. That all seems reasonable reading those emails, yes.

DSH delays paying some suppliers

132 During FY15, DSH began increasingly to push out the payment of some suppliers, with around $20 million to $30 million being pushed out at any one time. Mr Abboud accepted in cross-examination that that was because DSH could not pay the creditors on the day their debts fell due, although he added that they got paid after that. So, for example, on 17 October 2014, Mr Potts sent Mr Abboud an email which identified $32 million of payments due to suppliers on 31 October 2014 that Mr Potts proposed to delay paying by six weeks "to ensure we can pay everyone without risk". The suppliers were Samsung, Toshiba, Synnex, Roadhound, Sony, Nikon, Acer and Vodafone. Similarly, in an email dated 27 October 2014, Mr Potts told Mr Abboud and Mr Orrock that it would be necessary to push out at least $20 million in payments due on 31 October 2014 until 14 November 2014. That was despite the fact that the Westpac facility limit had increased temporarily by $15 million on 24 October 2014.

133 In some cases, the extensions were agreed with suppliers. In others, they were not. Typically, ad hoc extensions were not recorded in the AS400 system. In some cases, they were recorded in an email. In others, they were agreed orally. Ms Howard, who was a Transaction Process Manager with Dick Smith and who as I have said swore an affidavit in the proceedings, kept a hard copy working list of those extensions that were notified to her. However, that list has been lost and consequently there is now no reliable record of which extensions were agreed and which were not. From about November 2014, Mr Abboud at Mr Potts's request regularly sent various creditors pro forma emails advising them that there would be a delay in payment. The following sent to Sony on 27 January 2015 is typical:

> I wanted to advise you that the end of month payment of $4,379,478.38 will be made on Monday 9th February.
>
> Don't hesitate to call if you need to discuss.

A similar email was sent to Samsung, which resulted in DSH being placed on "stop supply" until the payment issue was resolved.

134 In some cases, the delays in payment led suppliers to place DSH's account on hold. In their written submissions, the plaintiffs identify what are said to be 62 instances of where that occurred during the period from 24 June 2014 to 24 December 2015, although the majority of those occurred after July 2015 and as the defendants point out in a detailed submission in response, a number of the examples pointed to by the plaintiffs are not actually examples of the account being put on hold because of non-payment and most of those were resolved within a few days.

135 For the purposes of these proceedings, Ms Howard prepared an analysis of invoices that were paid late based on information contained in the AS400 system. She summarised the results of her analysis for Australia and New Zealand in the following tables:

Australia

Month	**Number of delayed payments**	**Valued of delayed payments**	**Average days late**
October 2014	6,250	36,862,929.37	12
November 2014	7,880	36,809,267.59	11
December 2014	966	9,805,419.97	31
January 2015	3,362	24,649,729.38	12
February 2015	5,985	12,626,938.47	18
March	3,596	59,628,082.25	14

2015			
April 2015	3,002	37,599,083.79	9
May 2015	1,167	17,239,507.09	21
June 2015	3,175	11,905,889.13	12
July 2015	1,418	30,920,116.94	20
August 2015	3,174	23,064,700.12	29
September 2015	8,463	43,349,275.38	28
October 2015	7,438	52,569,612.33	26
November	3,487	18,260,507.94	17
December 2015	492	3,242,558.03	10

New Zealand

Month	**Number of delayed payments**	**Valued of delayed payments**	**Average days late**
October 2014	49	469,667.97	14
November 2014	39	498,785.99	15
December	25	349,468.34	17

2014			
January 2015	54	1,860,771.06	12
February 2015	71	435,798.70	7
March 2015	106	2,959,011.52	12
April 2015	49	511,028.43	12
May 2015	57	3,302,181.92	22
June 2015	88	1,635,238.22	12
July 2015	68	2,769,809.08	11
August 2015	54	4,054,418.40	10
September 2015	53	1,593,987.64	16
October 2015	51	630,754.64	11
November 2015	45	2,119,751.65	10
December 2015	44	555,241.96	11

Although Ms Howard was not available for cross-examination, it was not suggested that the information contained in these tables was an inaccurate record of the information contained in the AS400 system. In my opinion, the evidence should be accepted as an accurate record of what it purports to record.

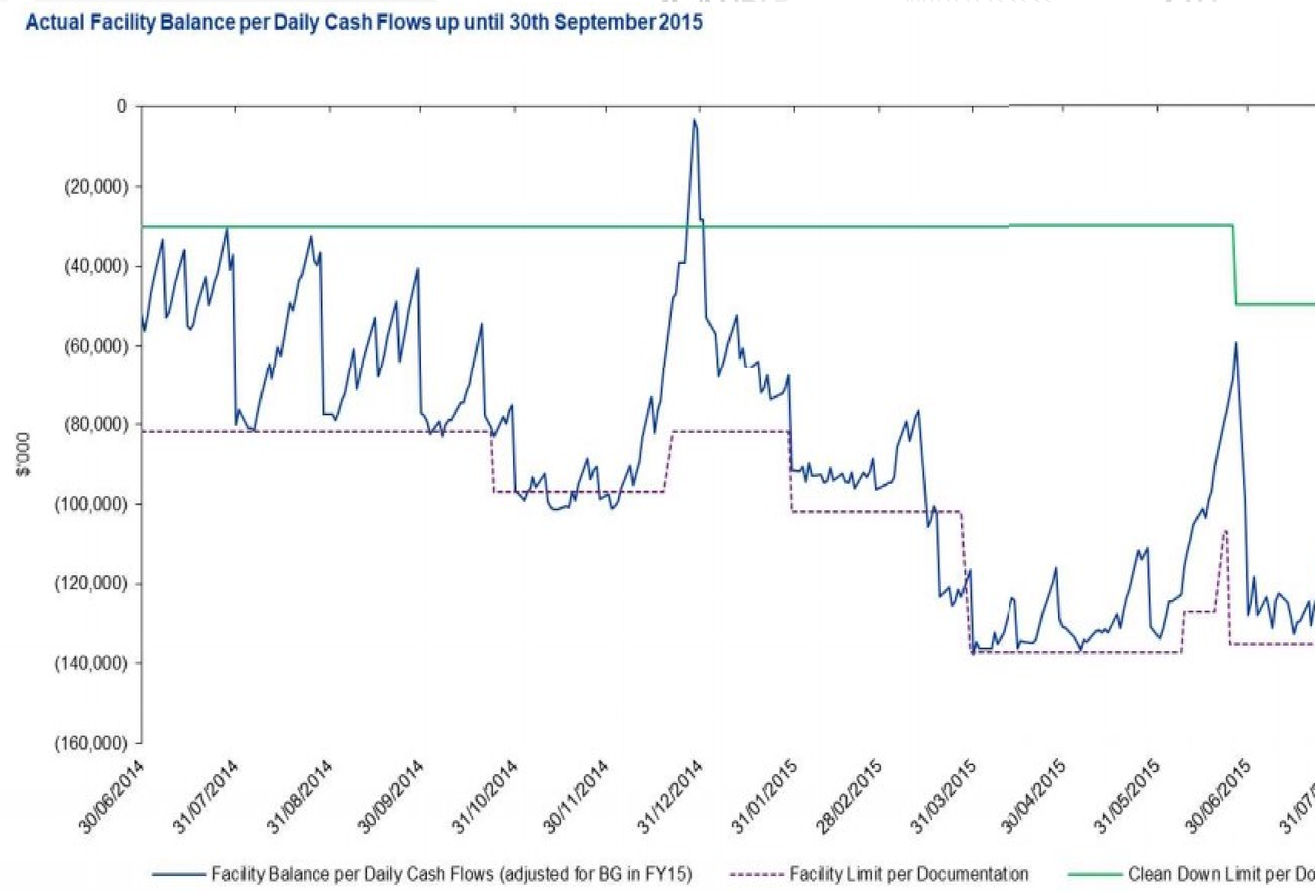
136 Mr Martin Dougall, an expert retained by the plaintiffs, also conducted an analysis of invoices that were paid late. Mr Dougall's analysis was based on Ms Howard's data. However, Ms Howard treated an invoice as being paid late if it was paid more than five days after the date it was due for payment according to the AS400 system. Mr Dougall, on the other hand, only treated an invoice as being paid late if it was paid in a month after the calendar month it was due for payment. That is so even if the invoice was due at the end of one calendar month and was paid at the beginning of the next. Unlike Ms Howard, Mr Dougall (in his second report) also gave credit for rebates to which Dick Smith was entitled. The following table summarises the results of Mr Dougall's analysis contained in his second report (for Australia and New Zealand):

Month in which invoices were due	**Total payment due**	**Paid prior to or within the month**	**Payments delayed (paid in subsequent months)**	**% of payment delayed**
Oct-14	84,839	56,445	28,393	33%
Nov-14	79,661	42,841	36,820	46%
Dec-14	82,252	53,444	28,808	35%
Jan-15	85,680	58,324	27,356	32%
Feb-15	36,349	28,388	7,961	22%
Mar-15	109,198	95,237	13,961	13%
Apr-15	62,422	39,148	23,274	37%

May-15	53,913	36,284	17,629	33%
Jun-15	129,370	120,517	8,854	7%
Jul-15	87,495	70,751	16,744	19%
Aug-15	90,492	66,983	23,509	26%
Sep-15	76,441	44,707	31,734	42%
Oct-15	77,940	41,139	36,801	47%
Nov-15	54,302	31,083	23,220	43%
Dec-15	42,751	41,921	829	2%

DSH exceeds its banking facilities on some occasions

137 DSH also exceeded its facility limit on a number of occasions from October onwards. Set out below is a graph based on daily cash flows showing the occasions on which DSH exceeded its Westpac facility limit between 30 June 2014 to 30 September 2015.



Instructions in relation to O&A rebates in preparation for half yearly review

138 On or about 30 October 2014, Mr Sullivan sent an email to all category buyers, which was copied to Mr Abboud and Mr Potts, regarding the reporting of O&A rebates in the context of the upcoming half yearly review. The email relevantly said:

> Feedback from Deloitte suggests that transactions within 1392 will again be a focus of their audit procedures
>
> From now and ongoing, it is the expectation that all buyers can summarise claims outstanding by vendor and have the appropriate supporting documentation for the value committed internally. Attached is a tracker to assist.
>
> To avoid a repeat of the work required for the June year end audit, could you please instruct your teams
>
> 1 Reference all O&A claims as **promotional support** or **promotional activity**
>
> ...

139 It seems plain that that instruction was to provide support for DSH's practice of taking O&A rebates immediately to profit. A similar instruction was given to all

category buyers and assistant buyers by Mr Bar-Ami on 5 January 2015. In that email, Mr Bar-Ami said:

> In preparation for the Deloitte audit -
>
> I suggest you all go through your own un-claimed lines and make sure you have sufficient evidence to support the numbers and are comfortable with those, if and when asked to provide them.
>
> I've highlighted below the few high amounts you each have under unclaimed. Of course you have to ensure you have the facts behind all claims however double checking your emails from the vendors for the below would be a good start.
>
> Remember, this email must state the period of claim (up to December) and the wording must **not** relate to an order and such. 'Promotional Activity' is okay as it covers both scans support, marketing spend, etc

140 Attachment 2 sets out a number of tables summarising information contained in the board papers for FY15 and FY16. The first table sets out the actual and forecast inventory for each month as shown in the board papers for each month there was a board meeting in FY15. The second shows the same information for cash or borrowings at the end of the month and the third shows the same information for NPAT. The following three tables show the same information for FY16 up to and including the November 2015 board meeting.

Events in January 2015

141 On 8 January 2015, Mr Borg sent an email copied to Mr Abboud and Mr Potts setting out the current stock on hand ($356 million) and weeks covered by category. According to the email, weeks covered was 19.14 across all categories against what was said to be an agreed position of 13.2 weeks. In the case of the "Home Solutions" group, which included In-Car and Navigation, Fitness, Surveillance, Seasonal, Digital Cameras and Gaming & Accessories, all categories were more than 100 percent overstocked. The email also pointed out that there was "over $100M" in stock on order, which Mr Abboud agreed in cross-examination included some orders that had been pushed out from delivery in December 2014 to January 2015.

142 Mr Abboud replied to that email on the same day saying:

> The stock reduction is clear.
>
> Put the hand break now on the red areas.
>
> No otb February March

143 On 9 January 2015, Mr Potts sent Mr Abboud an email setting out a list of “key priorities to be worked on” to deal with the position in relation to inventory. They included:

> **4. Cash flow (Michael Potts) Ongoing**
>
> Based on current cash flow prepare list of suppliers (merch and non merch) to push out in February and March.
>
> Prepare meeting with HSBC, ANZ and CBA with NA prior to meeting with Westpac in February. Request increase in facility with Westpac in February
>
> Lock in Macquarie facility with Samsung and HSBC facility with MTC.
>
> Move Apple to Synnex.
>
> Chris Borg to model impact of $50m (?) clearance activity to reduce stock and increase cash.

144 On the same day, Mr Potts also sent Mr Abboud documents which summarised the HY15 results and provided revised forecasts for FY15 in preparation for a meeting Mr Abboud was to have with Mr Cave on 10 or 11 January 2015. The covering email observed that the comparison of the actual and forecast results to market forecasts “shows EBITDA on the edge of the 90% range, but NPAT below the 90% range for both the first half and full year results”.

145 On 14 January 2015, Mr Borg sent Mr Abboud, Mr Potts and Mr Skellern an analysis he had prepared which showed that if OTB was reduced to target a closing inventory position of $260 million to $270 million, then it was likely that DSH would fall $14.9 million behind its target profit projections. That analysis assumed that there would be an “Extra Private label uplift” of 20 percent, which would add $4.6 million to profits. In fact, it appears from DSH’s accounts that the following amounts were booked to private label O&A in January to June 2015:

January	$900,000
February	$1,000,000
March	$2,350,000
April	$3,500,000
May	$4,163,000
June	$4,784,000
Total	$16,697,000

146 Mr Borg also suggested various ways DSH might overcome the shortfall in O&A rebates. He proposed a revised plan in an email dated 18 January 2015 following feedback from Mr Abboud. That plan, which was intended "to close the $14.9M gap entirely", included moving $8 million of purchases away from Apple to "Ad sub and O&A attracting vendors" and acquiring $40 million of extra stock to deliver an extra $6 million of "ad sub + O&A collect". In cross-examination, Mr Abboud rejected the suggestion that Mr Borg's plan involved buying additional stock of $40 million. He gave the following evidence:

> It's not extra, because how could you add 40? It just won't add up, if you are on 360 at the time and you add 40, then you close at 290 20 weeks later. I'm not sure what Mr Borg's referring to there, but what we do know from the board packs is that, February, the board packs were updated and the business did hit 290 million in stock and did reduce it approximately 100 million on the previous year in that period.

It is not easy, however, to follow this response. The clear suggestion of Mr Borg's email is that DSH buy $40 million of stock above what he originally proposed to obtain additional O&A rebates. That proposal appears to have been based on a suggestion made by Mr Abboud. Nonetheless, as is apparent from Attachment 2, inventory was reduced to $293.044 million by the end of FY15.

147 On 29 January 2015, Mr Potts sent Mr Abboud revised financial results for HY15 and the forecast for the remainder of the financial year. The revised results made two adjustments to the results Mr Potts had provided on 9 January 2015. They were "to reflect $6.5m payment from Toll vs $7.5m and moved the O&A up to margin as discussed", with the result that NPAT was increased from $23.4 million to $25 million. In addition, the forecast NPAT for FY15 was increased from $38.5 million to $45.2 million, apparently as a result of the second change.

148 According to Mr Borg, buyers remained responsible for classifying stock. According to him, there were no set rules on how that was to be done, although he says that buyers were discouraged by Mr Potts from placing stock into the Quit category. It appears from an email dated 25 February 2015 from Mr Borg to Mr Potts that no items had been moved from "end of life" to "discontinued" since September 2014 and that by 25 February 2015, DSH had $16.9 million of

"end of life" stock that was aged more than 12 months. A subsequent email from Mr Mills to Mr Potts dated 27 February 2015 suggests that if end of life stock aged more than 12 months was moved to the discontinued category, that would increase the provision by $2.5 million to $3 million.

Bank facilities

149 At the time of the float, DSH had a finance facility with GE Commercial Corporation (Australia) Pty Ltd. The original facility limit was $75 million, but that limit was reduced to $65 million on 1 February 2014. In March 2014, Mr Potts took steps to replace the facility with a facility from one of the major banks on more favourable terms. Ultimately, on 26 June 2014, DSH entered into a facility agreement with Westpac which comprised tranches A and B of a working capital facility of $27 million and $25 million respectively and an overdraft facility of $30 million. At about the same time, DSH entered into an extended vendor financing arrangement with Macquarie with a $15 million limit.

150 The limit on the Westpac overdraft facility was increased to $45 million from 24 October 2014 to 19 December 2014. On a number of occasions in October, November, December 2014 and January 2015, DSH exceeded the approved limit. On 30 January 2015, the overdraft limit was increased to $50 million until 30 April 2015. On 1 April 2015, the overdraft limit was increased to $85 million; and, until that increase, DSH exceeded the limit of $50 million on a number of occasions in March 2015. The overdraft was due to expire in June 2015. Tranches A and B of the finance facility were due to expire in September 2015. It appears that none of the NEDs were told of the increases in the overdraft limit.

151 Prior to February 2015, there had been a number of discussions between Mr Potts and representatives of HSBC about HSBC providing one or more facilities to DSH. Mr David Katiforis, State Manager NSW, Commercial Banking, of HSBC, had met Mr Potts when Mr Potts was the CFO at Nick Scali. Mr Chris Kowik, Global Relationship Manager HSBC, had taken over responsibility for maintaining a relationship with Mr Potts after Mr Potts became CFO of DSH. In February 2014, HBSC officers, including Mr Katiforis, had supported putting forward an indicative offer to DSH to replace the GE facility,

although that proposal had been rejected by credit. In November 2014, HSBC had given credit approval to an indicative term sheet for a supply chain financing facility up to $10 million to be provided to Dick Smith. However, that facility was not taken up. In connection with that facility, Mr Kowik prepared a credit application – known within HSBC as a "Credit Analysis & Risk Management" document (***CARM***) – which included an analysis of the FY14 results and of forecasts for FY15 and FY16 based on broker estimates.

Meeting with HSBC on 3 February 2015

152 On 3 February 2015, Mr Potts and Mr Abboud attended a meeting with Mr Kowik, Mr Katiforis and Mr Matthew Sargent, Senior Global Relationship Manager, HSBC. The purpose of the meeting was for HSBC to get an overview about where the DSH business was going and to talk about what HSBC could offer DSH. Mr Kowik prepared a file note (referred to internally as a "call report") of the meeting. During the meeting, Mr Abboud and Mr Potts took the HSBC representatives through a hard copy of a PowerPoint presentation on DSH's history, the terms of its current facility with Westpac and its plans. Mr Abboud could remember little about the meeting but recalls the presentation and said that he spoke predominantly about the slide addressing DSH's banking requirements. The presentation included a slide which noted that there had been "Strong improvement in gross margin on better sourcing and review of price points". Another slide stated "New CEO, Nick Abboud commenced the turnaround lifting net profit from $6.7m in FY13 to $42.2m in FY14".

153 During the meeting, Mr Katiforis suggested that DSH obtain its replacement facility from a syndicate of at least two banks and suggested that security could be provided through a security trust deed mechanism. The call report included the following:

> Keys turnaround strategy (1) centralise buying power; (2) cost control and commission base sales; (3) supply chain by using each store as warehouses (as compared to JB HiFi has centralise warehouse in Melbourne).
>
> NA increased stores from 320 stores (Dec12) to 400 stores (Feb15) with aspiration to increase another 50 stores starting Jun15 (JB HiFi has 185 stores).
>
> …

> NA advised his expansion aspiration to 450 stores with smaller stores can be located to min 50k population town.
>
> NA is targeting 10% growth FY15 & FY16 at the back of stores expansion, and will consider acquisition for brand, network, etc to create growth beyond FY16.

154 There is a question whether Mr Abboud used the expression “centralise buying power”. He denied that he did, or that he understands what the words mean. Nothing, however, turns on that dispute. Mr Abboud accepts that the note relevantly otherwise accurately records what he said.

155 At about the time of the meeting, DSH was in a tight financial position. By 4 February 2015, it had spent almost all of its OTB budget for the month. On 9 February 2015, the supplier of Go Pro cameras placed DSH on credit hold, which apparently was holding up delivery of an order of about $1 million. On 13 February 2015, Canon demanded payment of overdue invoices up until the end of December 2014 totalling $3.9 million and stated that if payment was not made within seven days, DSH’s account would be placed on hold. Most of the amounts claimed were 15 days overdue. However, according to a spreadsheet provided by Canon with the demand, an amount of approximately $300,000 was 137 or more days overdue. Subsequently, DSH negotiated an extension until 2 March 2015. Nonetheless, the difficulties in paying a number of creditors continued until the Westpac overdraft was increased on 1 April 2015.

Deloitte’s report in relation to the HY15 review

156 On 11 February 2015, Deloitte sent Mr Potts a report for the FAC in connection with the HY15 review. After reporting that the amount of O&A rebates for HY15 was $33.1 million (compared to $16.9 million up to 29 June 2014), the report relevantly said:

> Since FY14, management have undertaken a program of maximising the vendor rebates obtained, either through price protection, advertising subsidies or over & above rebates (‘O&A Rebates’). The increase in rebate receivables at 28 December 2014 is due to the increased amount of purchasing for the new stores opened and anticipated sales over the coming months.
>
> Where a rebate relates specifically to a product purchase or promotion, the income relating to the rebate received should be deferred so as to match the recognition of the cost of that product or promotion in profit or loss. Generally, over & above rebates are not specifically allocated to a product purchase or promotion, however are often negotiated in parallel to a purchase of inventory or the clearance of an existing product.
>
> …

> During our audit for the year ended 29 June 2014, we highlighted that there were internal control deficiencies in the accrual process for O&A Rebates. Since this time, management has undertaken a review of the process for recognition of these rebates and while we note that our work at the half year is limited in scope in comparison to the year end audit, we have noted a significant improvement in the quality of information and supporting evidence for rebates accrued. …

157 One of the procedures that had been put in place to ensure that O&A rebates were accurately recorded was that Mr Bar-Ami would check that there was documentary support for every rebate included in his spreadsheet and Mr Mills would check each month that there was appropriate support for what had been booked.

158 In relation to inventory, the report stated:

> Inventory balances have increased from FY14 as a result of additional stores open at 28 December 2014 and increased buying activity in the period. Obsolescence provisions have decreased due to the change in the obsolescence methodology to reflect an improved stock quality and profile.

159 That comment was based on an analytical review of stock. The workpaper recording the results of that review states:

> Stock in transit and stock on hand (#1320, 1324 & 1360) have increased by $85m. This is due to build up of stock to cover sales during the December holiday period. However despite the increased sales during this period, stock balance has still increased due to management targeting more aggressive marketing strategies. In order to do so, management needs to ensure that there is sufficient stock on hand to manage the risk of stock outs that can result in loss of sales. Furthermore management also assessed the movement in FX rates over the coming months (Jan & Feb 2015) and in order to reduce the risk of unfavourable FX movements, management made a conscious decision to purchase additional stock. Any unfavourable movements in FX are generally not able to be passed on to the end consumer immediately, with the market moving slower than the exchange rates due to FX hedging and absorption of the additional costs into retail margins. The category of stock that has been purchased is one that has a high turnover, hence there is a reduced risk of obsolescence in a future period.
>
> Management has also built up its private label stock in line with its FY15 strategy to increase the sale of PL stock items. PL stock items generally have a greater margin as opposed to other branded items and the products range across from office, accessories to entertainment.

160 The report to the FAC also observed that management had revised its methodology for calculating its inventory provision in June 2014, although that methodology had not been used in the preparation of the FY14 accounts. The revised methodology involved taking account of inventory status, inventory aging, sell through rates, months cover and other factors. According to the

report, management has further refined the calculation in HY15 "whereby aged stock items which are selling at significant positive margins are provided for". The following is an extract from the report setting out the amount allowed in respect of obsolete stock:

Status	**HY15 Inventory**	**Prov'n**	**FY14 Inventory**	**Prov'n**	**Diff**
Active	284.7	0.4	205.3	4.1	(3.7)
End of Life	54.2	2.0	54.0	1.1	0.9
No Reorder	2.9	0.4	4.7	0.9	(0.5)
Discontinue	6.3	2.0	10.0	2.0	(0.0)
Quit Stock	0.3	0.3	0.4	0.2	0.1
Other	0.3	0.3	0.3	0.3	0.0
Total	348.7	5.4	274.7	8.6	(3.2)

FAC meeting on 12 February 2015

161 The Deloitte report was considered at a meeting of the FAC on 12 February 2015. At that time, the members of the FAC were Mr Wavish, Ms Raine and Mr Ishak. The meeting was also attended by Mr Abboud and Mr Potts. At the same meeting, the FAC considered a dividend discussion paper and a proposed ASX release in relation to the HY15 results.

162 The dividend discussion paper had been prepared by Mr Potts. Mr Wavish had discussed a draft of the paper with Mr Potts before it was distributed. At the time of that discussion, Mr Wavish did not have current daily or weekly cash flows for DSH. However, he says that he asked Mr Potts "Do we have enough money to pay it [the dividend]?" and "are there any other issues you need to tell me about?" and it appears that he got an affirmative answer to the first question and a negative answer to the second.

163 The paper itself, which was one page long, did not contain any financial information. It noted that "In the July 2014 Board meeting the Directors of Dick Smith Holdings Limited resolved a dividend payment policy based on a dividend payout ratio of 60-70% of normalised Net Profit Before [sic] Tax (NPAT)". On that basis, it recommended an interim dividend of 7 cents per share, which represented a payout ratio of 65.7% and a total dividend of $16.56 million. The report recommended that the dividend be paid on 30 April 2015. According to the paper, "This timing reflects the Company's operational cash flow requirements and has been factored into the weekly cash flow forecast". Those recommendations were accepted by the FAC.

164 It is not clear which cash flow forecast formed the basis of the recommendations in the paper. Unsurprisingly, not all weekly or daily cash flow forecasts of DSH are now available. There is in evidence a daily and weekly forecast from about 9 February 2015. The daily cash flow forecast predicts that on several occasions before the dividend was due to be paid, DSH would exceed its facility limit (which was $102 million at the time the cash flow was prepared and was expected to stay at that level until the end of April 2015, when it would revert to $82 million). However, it suggested that at the time the dividend was due to be paid, DSH would be within its facility limit and would remain within its limit until 26 June 2015 (the last day covered by the cash flow forecast). Moreover, as previously mentioned, the daily cash flow forecasts do not include cash in transit. The evidence suggests that Westpac had no difficulty in allowing DSH to exceed its facility limit if the excess was covered by cash in transit. Contained in the same Excel workbook is a weekly cash flow that does include cash in transit. According to that cash flow forecast, DSH was

expected to exceed its facility limit only once – at the end of the first financial week in March 2015 (starting in February 2015) by approximately $10 million.

Board meeting on 16 February 2015

165 The DSH board met on 16 February 2015, which was the first meeting since November 2014. Present at the meeting were Mr Cave, Mr Wavish, Ms Raine, Mr Ishak, Mr Murray, Mr Abboud and Mr Potts. Mr Orrock, among others, also attended the meeting.

166 The trading update included with the board papers that were circulated prior to the meeting stated that "Inventory increase in line with seasonal requirements for Christmas trade". In fact, the financial information included with the board papers showed that the net inventory figure for January was $356,700,000, well above the November 2014 forecast of $213,800,000. The financial information also showed that sales for January 2015 were $100,377,000, approximately $10.5 million ahead of budget and that sales for FY15 to the end of January were $794,177,000, approximately $2 million ahead of budget. The explanation for the above budget performance in January 2015 was a sale of Apple products at a ten percent discount. NPAT for the month was $1,599,000, approximately $354,000 or 17.7 percent behind budget. For the year to date, NPAT was $26.803 million compared to a budget of $29,777,000, a decrease of approximately ten percent.

167 The financial information also stated that as at January 2015 the working capital was $139,410,000. It was forecast to be $156,017,000 in April 2015 and $124,515,000 at the end of June 2015. Below the table containing those figures was the following statement:

> January stock comprises:
> • $367.9m Active (2% provision);)
> • $6.1m Discontinued (20% provision))
> • $3.4m No-reorder (20% provision)) Total Non-Active $9.9m
> • $0.3m Quit – (50% provision))

168 According to Mr Murray, inventory was usually discussed as a matter of course at all Dick Smith board meetings that he attended and it was one of the main topics of conversation at the February 2015 meeting. Mr Murray says, and I

accept, that the NEDs questioned Mr Abboud and Mr Orrock about the reasons for the unexpected build-up in inventory between November 2014 and January 2015 and how management intended to sell down that inventory. On that topic, Mr Murray gave the following unchallenged evidence:

> [I] recall Mr Abboud in particular saying in substance that he had made a decision to acquire additional inventory in order to build Dick Smith's private label stock and to take advantage of beneficial exchange rates. My observation of Mr Abboud when he was responding to these questions was that he did not regard the acquisition of this inventory as a problem, but rather as an opportunity for the business.
>
> I and the other non-executive directors asked Mr Abboud to assure us that he had plans in place to bring inventory down significantly by the end of the financial year. Mr Abboud gave those assurances.

Mr Murray says that he cannot recall whether Mr Abboud was asked to articulate those plans, but that he has a general recollection "that management did refer to their plans and activities for bringing down inventory".

169 The payment of the interim dividend was also considered at the board meeting. The board papers distributed prior to the meeting included the dividend discussion paper prepared by Mr Potts.

170 The minutes of the board meeting, which were signed by Mr Murray on 17 March 2015 as a true record of what occurred at the meeting, record the following in relation to the interim dividend:

> BW [Mr Wavish] presented the 1H15 Dividend discussion paper and advised a dividend of 7cps was consistent with the 60-70% payout ratio adopted by the Board in its resolution at the July 2014 meeting and the appropriate amount is 7.0cps. BW indicated a record date of 12 March and payment date of 30 April would be appropriate taking in to account cash flow requirements,

171 The board also approved the HY15 accounts and the ASX release. The ASX release included the following under the heading "Balance Sheet":

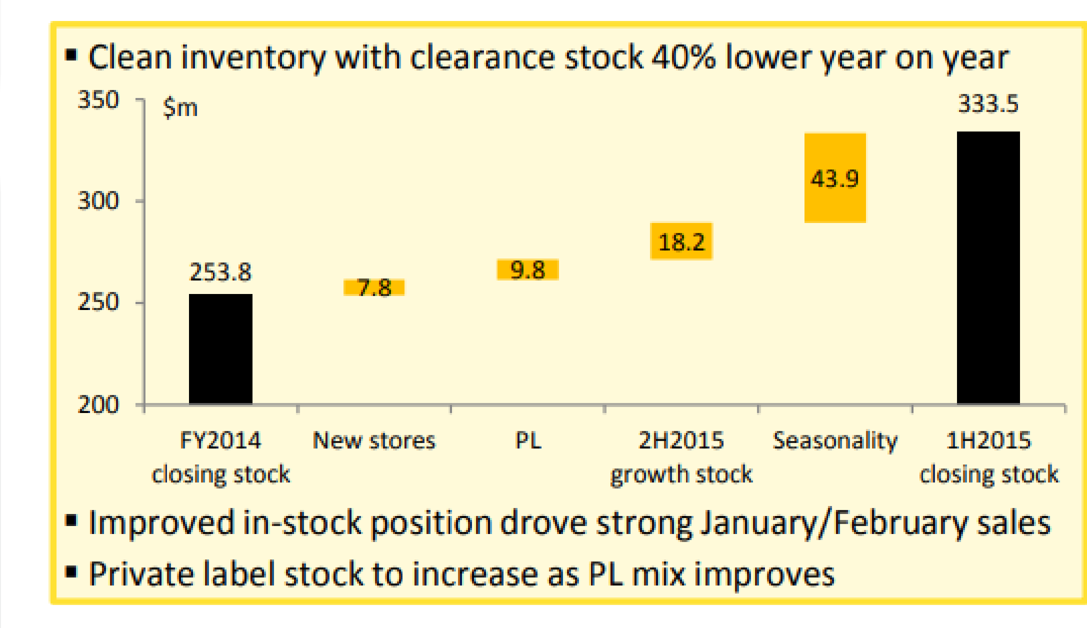
> Dick Smith's balance sheet remains strong, with no debt as at 28 December, 2014. Inventory was tightly managed throughout the half. The increase in inventory levels during 1H 2015 strongly positions the Company for sustainable growth. This includes the ongoing opening of new stores, continued expansion of our Private Label brands, utilising our warehousing capacity in Sydney and Auckland to benefit from currency movements and positioning the Company for future growth, including five new 'MOVE by Dick Smith' locations at Sydney Airport. The Company also availed itself of a number of opportunities in January/February, which necessitated purchasing inventory prior to Christmas.

172 Under the heading "Outlook" the release stated:

> Dick Smith's sales performance in the second half year to date has accelerated from the 8.9% total sales increase reported in 1H 2015, despite continued challenging conditions in New Zealand. With January (calendar) month sales up over 17% and February sales to date exhibiting double-digit growth, total sales growth for the year to date now exceeds 10% and comparative sales growth is over 3%. Incorporating anticipated benefits from the Company's growth initiatives, management expects FY2015 sales to increase by more than 10%, with comparative sales growth of over 3% (subject to market conditions).
>
> …
>
> "Dick Smith is well placed to deliver further strong sales and profit growth over the next 18 months. We have a solid Growth Strategy and a track record to date of delivering both sales and cost reduction targets outlined in our strategy. In addition to the Sydney Airport Duty Free stores, commencing today, we plan to open 9 new stores in 2H 2015 and aim to open 20 new stores in FY2016. Lower supply chain and streamlined operational processes should underwrite improved profitability in 2H 2015 and FY2016. In FY2015, we anticipate EBITDA growth of 7-10% and NPAT and EPS growth of 2-5%, reflecting the continued investment in future growth opportunities," said Mr Abboud.

173 The minutes of the meeting also record that DSH had received and accepted the resignation of Mr Cave as a director effective 28 February 2015 and had resolved to appoint Mr Murray as chairman in his place.

174 On 17 February 2015, Mr Abboud and Mr Potts gave a results briefing to brokers, which was in the form of a PowerPoint presentation. That presentation included a copy of the balance sheet with comments. Reflecting the published accounts, the balance sheet showed an increase in inventories from $253.8 million as at 29 June 2014 to $335 million as at 28 December 2014, an increase of $81.2 million. That increase was explained by the following waterfall graph and notes:



Waterfall graph and notes - data table (57308, rtf)http://www.caselaw.nsw.gov.au/asset/179f99784a7ad0d489f4e8fb.rtf

Reduction in O&A collection following reduction in OTB

175 It appears that, as a result of the reduction in OTB implemented by Mr Abboud at the beginning of February 2015, there was a substantial reduction in the collection of O&A rebates. On 24 February 2015, Mr Bar-Ami, who by about this stage had taken over from Mr Skellern responsibility for recording the targets and the O&A rebates collected by each buyer, sent an email to Mr Abboud, Mr Orrock and Mr Borg setting out the collection of O&A rebates for the month of February 2015, which showed that the total amount of O&A rebates collected for the month was $2,084,830, which represented 5.76% of the total amount spent on inventory for the month. After receiving that email, Mr Abboud sent an email to Mr Borg late that night saying:

> I just had a nightmare so I'm up again as you modeled [sic] 11% on non Apple/pb.
>
> This is under 6%.
>
> We must educate March ramp up.

176 Mr Borg replied to that email the following day saying:

> Please have the confidence that we are under control.
>
> Feb was always the tough month due to the amount of purchases pre raised in Dec and elements of the o and a brought forward eg $10m of computers.

> We also were very tough on approvals, not approving anything we didn't need. The high collect areas also had minimal otb for feb so this diluted the total.
>
> We are being tough on March approvals and the buyer roadmap for q4 will be finalized this week. Similar to Feb, March has low otb for the high collect areas, indicative of the $3.1M collect (now $3.4m accirding [sic] to John).
>
> We have our plan and are being methodical.
>
> Some risk, yes, but expectations are clear.

177 Despite the forecast in the weekly cash flows prepared in early February 2015 that DSH would exceed its facility limit at the end of February, it did not do so. In late February 2015, it negotiated extensions from a number of creditors including Vodafone, Toshiba and Acer and a further extension from Canon, who together were owed approximately $20 million.

HSBC's credit approval process

178 Following the meeting with Mr Abboud and Mr Potts on 3 February 2015, Mr Kowik, who was not called to give evidence, began preparation of a CARM for a $50 million overdraft facility for DSH. The person at HSBC responsible for approving any credit application relating to DSH was Mr Gregory Rogers, who was at the time and is the Senior Manager, Wholesale & Market Risk with HSBC. Mr Rogers did give evidence.

179 In connection with the preparation of the CARM, HSBC also prepared a financial model of DSH known as a "CRR". The CRR was prepared using one of a number of standard models used by HSBC and the most recent accounts of DSH.

180 On 18 March 2015, Mr Kowik submitted to Mr Rogers a CARM dated 5 March 2015 seeking approval for a $50 million three year committed overdraft facility as well as the $10 million supply chain facility that had been approved by Mr Rogers in December 2014, but which did not proceed at that time. On the same day, Mr Katiforis called Mr Potts to provide him with an update on the progress of the credit application.

181 The CARM prepared by Mr Kowik contained a number of general statements relating to DSH's financial position, including the following:

> Dick Smith pays suppliers once a month on the 30th of the month, while on the other hand, they collect sales on a daily basis. Due to this cash collection

operation, Dick smith [sic] explained that Revolver Facility is not their optimum solution.

And:

- DSE normally settles its suppliers during the first five days on the next month after delivery, with proceeds generated from retail stores collected on a daily basis. This pattern is in line with DSH's financial report with relative cash rich positions at month end.

- FY14 working capital was A$69.1m, virtually unchanged from the FY13 level of A$68.9m. Given the zero outstanding debt balance, working capital is currently funded by equity. It is expected that working capital requirements will increase in FY15, however will be largely funded by the current cash balance and operation cash flow and that debt drawings under the Westpac facility will remain relatively modest.

182 The CARM included the following information in relation to inventory:

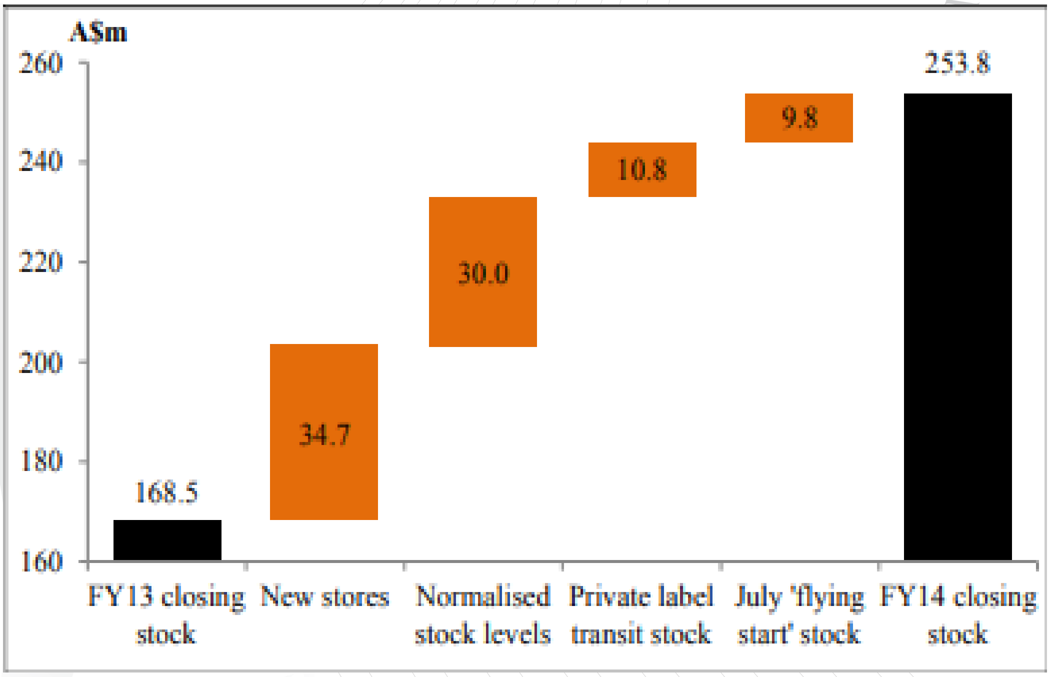
- Inventory increased by A$85m to A$254m in FY14;

  - Increase of A$35m due to new stores and A$30m due to normalizing inventory levels post previous stock clear-out;

  - Inventory is viewed as clean, with clearance stock 40% lower yoy;

  - Stock turn was 101 days in FY14, up from 85 days in FY13. DSE management has confirmed that stock turn is expected to remain at around 100 days going forward;

  - The increase on FY13 is due to a number of factors including: (i) net new stores +54, (ii) normalization of stock levels following the stock clearance that occurred in FY13 to clear obsolete stock and refocus the product portfolio, (iii) private label stock in transit, and (iv) expected strong start to FY15 in July. The following chart demonstrates the change in inventory level from FY13 to FY14:



Inventory level from FY13 to FY14 chart - data table (50760, rtf)http://www.caselaw.nsw.gov.au/asset/179f9b1e4e4cb9821ca1fb55.rtf

183 The CARM included the following information in relation to trade payables:

> ▪ Trade payables increased by A$144m to A$217.3m at FY14 due to improved supplier trading terms, higher inventory and timing of creditor payments;
>
> - Creditor turn was 86 days in FY14, up from 37 in FY13. The increased in -suppliers term is mainly due to supplier renegotiation program FY13-FY14 implemented by the new management. This renegotiation program includes (1) increase in rebate and/or (2) extend payment terms. DSE management has confirmed that creditor turn of 80-90 days is considered sustainable

184 There is a question where this information (to the extent that it is not recorded in the presentation itself or in the call report prepared by Mr Kowik) came from. The plaintiffs submit that the Court should infer that it came from Mr Potts and that Mr Kowik spoke to Mr Potts on one or more occasions after the meeting on 3 February 2015 and before 18 March 2015. The likelihood is that Mr Kowik did speak to Mr Potts after the meeting on 3 February 2015 and obtained some additional information from him. But what that additional information was is unclear. Mr Kowik already had substantial information about DSH which he obtained in connection with preparation of the earlier CARM. In particular, much of the information in relation to inventory and trade payables quoted above was lifted from the earlier CARM. It is unclear where the information in that CARM came from. Mr Kowik did not produce a call report of any conversation he had with Mr Potts, as might be expected if he attached some significance to the conversation. In addition, Mr Kowik had a copy of a research report prepared by Macquarie following the release of DSH's HY15 accounts and it is apparent that a number of statements included in the March CARM came from that report.

185 Neither Mr Kowik nor Mr Potts was called to give evidence. In my opinion, no relevant inference arises from the fact that neither was called. HSBC bore the onus of proving that Mr Kowik obtained the information included in the CARM from Mr Potts (or Mr Abboud). If it did not call Mr Kowik to prove that fact, it must bear the consequences of not doing so. No adverse inference arises from the fact that Mr Potts was not called to deny what HSBC has failed to prove. At

most, the only inference that could arise from a failure to call Mr Potts is that his evidence would not have assisted his case: see *Kuhl v Zurich Financial Services Australia Ltd* (2011) 243 CLR 361; [2011] HCA 11 at [64]. Given that much of the material was already available to HSBC, I am not satisfied that any of the information contained in the March CARM was supplied directly by Mr Potts or Mr Abboud.

186 On 19 March 2015, Mr Rogers sent an email to Mr Kowik asking a number of questions about the information contained in the CARM. Mr Kowik replied the same day.

187 One question concerned a proposed term of the facility agreement that the facility be "cleared out" periodically. Mr Rogers asked "When do you propose to do the clear out? How effective do you believe this really is?". Mr Kowik replied:

> We do not set the exact timing of the clean down period, however more to the following conditions:
>
> - Complete (zero) cleandown of overdraft facility for not less than 3 consecutive calendar days.
> - Once every 6 months calendar, within period of Jan-Jun and Jul-Dec.
> - Minimum 2 months apart for each cleandown (this is to prevent cleandown between Jun28-Jun30 then 01Jul-03Jul).
>
> DSE has demonstrated that they do not have any debt outstanding for every F/S end, hence we believe that this o/d will be use only for working capital and have fluctuation behaviour. In short, I believe this mechanism is effective.

188 Mr Rogers also asked a question about "Your views on stock turn and obsolescence" to which Mr Kowik replied:

> There is no obsolescence stock anymore under the new management.
>
> Post Woolworth acquisition, one of the initial strategies is to push the obsolescence stock. This was done in late 2012 until late 2013, by offering big discount.
>
> This is part of closing 'some' of their non performing stores as well.
>
> This is evidence by compression in GPM in FY13 (23%) vs. 25% in FY14.
>
> Please also note that Dec14 inventory is high due to Boxing Day/year end clearance.

189 In addition, Mr Rogers asked a question about retention of title (ROT) to which Mr Kowik replied:

> DSE has 260+ suppliers. CFO has advised that most of DSE suppliers do not have ROT. Further investigation only several that has PIMSI [presumably a

> reference to a purchase money security interest] record (as per co search 19Mar15), namely:
>
> …

Mr Kowik goes on to give details of customers who have and did not have PIMSI.

190 Again, it is difficult to draw inferences about what Mr Kowik was told by Mr Potts from this exchange. It seems plain that Mr Kowik spoke to Mr Potts. He says that "CFO has advised" and that advice was based on a search done on 19 March 2015. But it is not clear whether the other information given to Mr Rogers came from Mr Potts or whether it represented Mr Kowik's views based on what he already knew. Again, there is no written record of the conversation.

191 Mr Rogers approved the facility on 20 March 2015, shortly after receiving Mr Kowik's response.

192 Following that approval, several additional CARMS were submitted seeking variations to the facility including an increase of $10 million to the proposed overdraft. The increase was first requested by Mr Potts in a conversation he had with Mr Kowik on 23 March 2015. During that conversation, Mr Potts told Mr Kowik that DSH was looking to obtain a total facility of $130 million, made up of a $60 million overdraft and $70 million revolving capital facility (***RCF***). According to a call report Mr Kowik prepared of the conversation, Mr Potts gave the following explanation for the RCF:

> As promised this morning, CK called Michael Potts to discuss DSE needs. MP is looking to upsize DSE facility to AUD 130m, with the below 'ideal' structure
>
> Overdraft AUD 60m;
>
> RCF AUD 70m
>
> Total AUD 130m
>
> MP advised the above AUD 130m is supported by EBITDA AUD 90 (FY15) x 1.5 leverage = $135m (seems like he is only focusing in this leverage ratio).
>
> …
>
> The RCF is needed for capex.
>
> Capex requirement: expansion 15-20 stores p.a.
>
> Capex 1 store: $500k layout + $750-$800k inventory = $1.25m-$1.3m
>
> DSE usually spend c. $25m capex p.a. including other (non new store capex) IT, current store refurbishment (fixture, replacement POS), etc.

193 Following that conversation, Mr Kowik prepared a further CARM relating to the increase in the overdraft. The CARM explained that DSH was looking for total on balance sheet borrowings of $130 million and that the Sydney office proposed a two bank structure, with HSBC providing an overdraft facility of $60 million and that the remaining facilities be provided by Westpac. The CARM stated:

> Additional total borrowing is requested by DSE to accommodate DSE's capex program, which mainly to support store expansion program.
>
> DSE has store expansion strategy from 400 stores to 450 stores by FY17, which represents c 18-22 stores p.a.
>
> Investment cost per store with avg 500sqm is:
>
> Fitting Out $500k
>
> Inventory $750k - $800k
>
> Total per store $1,250k – 1,300k
>
> Hence 20-22 stores capex is c. $25m - $28.6m

194 Mr Rogers approved the revised CARM with certain conditions "for the same reasons as the original approval".

Board meeting on 17 March 2015

195 There was a board meeting on 17 March 2015. Present at the meeting were Mr Murray, Mr Wavish, Ms Raine, Mr Ishak, Mr Abboud and Mr Potts. Mr Orrock and Mr Bar-Ami, among others, also attended the meeting. According to Mr Murray, by that stage he knew that DSH was operating beyond its facility limit, although he understood that that was with the support of Westpac. The likelihood, however, is that Mr Murray did not become aware of the position until the matter was raised by Mr Jamie Tomlinson in the April board meeting. There is nothing in the March board papers which would have alerted Mr Murray to the position at that time. Mr Murray gave the following explanation of why the increase in borrowings did not concern him:

> [M]y view of the business, if you remember at this stage, we actually were growing. It seems strange in all this analysis to talk about that, but the business was growing between, you know, 8 and 10 per cent, depending on which measure you used. We were opening stores – we were closing stores, but net we had opened about 17 more stores. One of them was a $15 million revenue store at Sydney Airport. We were growing our range in support for the Move brand and we were growing our range in support for private label. So I expected the cash needs of the business to go up. It was logical to me that the

> business needed a bigger facility, and that $82 million wasn't a sufficient facility to meet the needs of the business. So I would have preferred the number to be lower, but I understood why we were where we were.

196 At the board meeting, there was a presentation given to the board on the vendor rebate process. That presentation was made following a request Mr Murray had made to Mr Abboud sometime in March 2015 before the board meeting for a report to the board on Dick Smith's O&A rebate processes. Mr Murray had made the request because he was conscious of the significance of O&A rebates to DSH's profits and was conscious that they were in the discretion of suppliers. The presentation consisted of several PowerPoint slides, the first of which contained the following information:

> ➢ DSH receives Approx $70m in O & A Rebates per annum - a significant increase since acquisition
>
> ➢ Over and Above is the only rebate not documented within vendors terms
>
> ➢ The initial process of collecting O & A rebate is not considered robust enough for a listed company
>
> ➢ As part of June 30th 2014 Audit, Deloitte recommended that DSH management review the O & A rebate collection process

197 The presentation also explained that DSH's existing Profectus System (which enables claims to be raised on suppliers) was not set up to enable timely and accurate reporting of O&A claims and that Software Paradigms International Australia Pty Ltd (***SPI***) (a company with whom Mr Mike Holtzer was a consultant) had been engaged to assist DSH to implement a more robust vendor rebate collection process which involved two stages. The first was an Excel version that had been implemented. The presentation explained that under that process "Buyers are required to enter their OTB spend, rebate collection value, claim status & details" into the Excel tracking file. The second stage, which was expected to be implemented by 30 June 2015, but which in fact was never completed, involved modification to DSH's Profectus System. It appears that there was no discussion of the accounting treatment of O&A rebates or of the payment of O&A rebates on private label stock through a process of increasing the price of the stock.

Mr Tomlinson appointed to the board

198 Mr Tomlinson was appointed a director of DSH on 10 April 2015 and was appointed chairman of the FAC at the board meeting on 20 April 2015, following Mr Wavish's resignation from the board. On 22 April 2015, Mr Tomlinson sent an email to Ms Raine, who was chair of the board's remuneration committee, raising concerns about how the remuneration of management was encouraging risky behaviour. Relevantly, he said:

> Sales/CODB/EBITDA drives a focus on cash profit and ignores depreciation/capex, so management are not penalised for over spending (as is the case today), the depreciation hit is irrelevant for STIP, but the benefits of capex flow to EBITDA. So a free kick for management. Also inventory build (which is happening now) has no short term impact - no interest impact. I also note quite aggressive cost capitalisation into inventory (e.g. 60% of buying group overhead, please W&D). So there's also a risk that the targets drives accounting policy/behaviour. No criticism of management/Board intended - I see it as a hangover from PE days and time to transition to a more balanced scorecard.
>
> I also note the operating cash flow is negative and has been for some time, and debt levels are above the facility limit. Again, no consequence for management's EBITDA target.
>
> The key for me is to better align management targets to shareholder outcomes.

Meetings on 20 April 2015

199 There was a board meeting on 20 April 2015. Present at the meeting were Mr Murray, Ms Raine, Mr Ishak, Mr Tomlinson, Mr Abboud and Mr Potts. At that meeting, Mr Potts presented a paper in which he recommended that the board authorise him to run a competitive tender for a facility of $135 million between WBC, the Australia and New Zealand Banking Group Limited (***ANZ***), the Commonwealth Bank of Australia (***CBA***) and HSBC to replace the current facility with Westpac. The board accepted that recommendation and agreed to add NAB to the tender. It was also resolved at that meeting that "management should report monthly actual results against Budget until the half year, and then against a Current Approved Forecast (CAF) for the balance of the fiscal year. The CAF would be presented to the board by management and once approved, would replace Budget in all reporting to the board. The CAF can only change with Board approval".

200 The cash flow statement included with the board papers showed that cash and cash equivalents were negative $101 million, which Mr Tomlinson noticed was more than the $82 million limit of the Westpac facility. He raised the issue at the board meeting. Mr Potts explained that he had arranged an extension to the Westpac overdraft facility to a maximum of $50 million. There was a discussion at the board meeting of the fact that the board had not been informed of the extension. That was despite the fact that the delegation of authority in place since February 2013 had stated that Board approval was required to a change in existing debt facilities. At the FAC meeting held on 19 May 2015, Mr Abboud and Mr Potts sought to justify the increase in the facility without board approval on the basis that the reference to "board approval" in the delegation was a reference to approval by two directors. Mr Tomlinson accepted in cross-examination that the increase in the facility without board approval was one of a number of matters "early on in your tenure as a director which, together with things which occurred later, indicated to you that … Mr Abboud and Mr Potts were out of their depth".

201 At the meeting on 20 April 2015 the board also approved the FY16 budget. That budget forecast EBITDA of $88.9 million, which was an increase of $7.5 million or 9.3 percent on FY15. It also forecast NPAT of $47.0 million, an increase of $3.1 million or 7.2 percent on FY15.

202 Also on 20 April 2015 there was a meeting between Mr Abboud, Mr Potts, Mr Orrock, Mr Bar-Ami, Mr Skellern and Mr Borg among others to review the position with stock. Mr Potts circulated minutes of that meeting the same day. The minutes record that the position with stock would be reviewed weekly. The minutes record:

> Stock Management
>
> 1. New closing stock now $270m gross (previously $260m gross)
>
> ***Michael to update reports to reflect new closing target***
>
> 2. OTB for May and June now $104m (previously $112.9m)
>
> ***Tomer to manage the split of the $104m by buyer by supplier to ensure we don't overspend***
>
> ***NA, RO, MP and JS to meet weekly to ensure targets are met***
>
> 3. Clearance activity for May and June now $5m COGS (previously $15m)

NA and RO to manage clearance activity

4. Expo sales and stock excluded from these numbers

Cash Flow

1. No OTB spend for May and June to be due for payment prior to 29 June 2015

Tomer to ensure payment dates for May and June purchases fall past 29 June 2015

2. Update cash flow model to exclude $10m additional sales for clearance activity

MP to update cash flow model

3. Model required push out of payments to achieve $10m closing cash position

MP to model what amount of payments need to be pushed out

203 On 27 April 2015, Mr Tomlinson sent an email to Mr Potts raising a number of questions. The first related to the fact that the cash flow at the end of March was negative $91 million. Mr Tomlinson asked whether that was normal and seasonal. Mr Potts replied:

> The -$91m NOCF to end March is not normal. A retailer will normally build inventory to peak in November, and then wind it back through December and January. There is an element of seasonality as high levels of cash come in to the business in December and payments generally go out later. But by the end of March the stock and payables balances should be back in line, as should cash. As you will see, stock peaked in January (not November) and February was still higher than November. Higher levels of stock purchases in December and January to drive sales growth has caused the negative OCF to end March as stock has been paid for, but not sold.

Meeting with representatives of NAB on 28 April 2015

204 On 28 April 2015, Mr Abboud and Mr Potts met with representatives of NAB at DSH's head office in Chullora. Present from NAB were Mr Tim Cohen, a Director in NAB's Client Relationship Team within the Corporate & Institutional Banking Division, Mr Cameron Clarke, Senior Associate who reported to Mr Cohen and Mr Andrew McKissock, a Director in NAB's Foreign Exchange team. Only Mr Clarke was called by NAB to give evidence of what occurred at the meeting.

205 At the meeting, Mr Abboud and Mr Potts provided a PowerPoint presentation which was substantially the same as the one that had been provided to HSBC. The presentation included some background to the Dick Smith business and its current facilities with Westpac. Mr Clarke described the presentation in his

affidavit evidence as "relatively generic". One slide included the following bullet point:

> Dick Smith benefit: lower cost; improved inventory management; store efficiency benefits

206 Another slide headed "Grow Private Label – *Protect gross margin and grow sales*" included the following bullet points:

> ■ Private Label penetration to increase to >15% of sales
>
> ■ Strong improvement in gross margin on better sourcing and review of price points
>
> ■ Extensive range across office, accessories, entertainment
>
> ▪ 1,400 SKUs today, increasing to 1,600 on shelf for Christmas
>
> ■ Pricing hierarchy introduced with Move range of premium product

207 Mr Cohen, who did not give evidence, prepared a file note of the meeting (referred to as a "Call Report"), which records information supplied by Mr Abboud and Mr Potts at the meeting. Relevantly, the file note states:

> ▪ Inventory is now focused on a weeks cover in store,
>
> ▪ Inventory requirements is seasonal, on average $80m funding requirement through year, with high peak season of Dec getting up to c.$160m. (CFO will send through projections to validate this).
>
> ▪ Supplier payments are made throughout the month, however end of month biggest cash time, with 1st day of month they pay everyone (50% of payments). Within the month WC volatility ranges up to $60m. Rent is paid first day of month ($8m p.m), suppliers spread 45, 60, 75. End of month (50% of payments (really first day of month)), 25% payments made mid month, 25% spread weekly. COGS make up 75% of payments, CODB 20%.
>
> ▪ CCC [cash conversion cycle – that is, the time between when DSH bought stock and received cash from its sale] is better for first half of year as opposed to 2nd half. This is brought on by seasonal peak periods in December.
>
> …
>
> ▪ 5,000 SKU's. Each SKU unit margin is monitored and a report is reviewed weekly for un-performing stock or slow moving stock. Discounting can be used to push sales through, however for larger brands this is usually negotiated with supplier. Because it's usually the supplier who wants stock pushed through, because shortly they have a newer model coming out. In this instance DSH call it, Scan & Support. Whereby Support for % discount becomes rebate from supplier, this way DSH gpm [gross profit margin] remains the same.
>
> ▪ Private Label – Helps restore margin for DSH. New products and innovation focused on private label. Strongly looking and consumer trends, particularly in accessories for larger tech items. Ie IPAD covers, cables, batteries etc.

208 Mr Abboud denies that statements to the effect of the first and penultimate were made. As to the first, he said that he did not recall making the statement and that it would not be commercially appropriate to have only one week's cover in stores. He said that any comment he made on the subject had to be understood as a statement that DSH's focus was on weeks covered as a management tool. I accept Mr Abboud and Mr Pott's submission that what was said cannot be resolved by a careful analysis of the syntax of the file note. The file note is a rough record of what occurred at the meeting. It is not a carefully drafted document and cannot be analysed as if it were. There is no direct evidence that Mr Abboud unambiguously said that DSH was focussed on ensuring that there was no more than one week's cover in stores. Certainly, the file note cannot be read in that way and Mr Clarke does not contradict Mr Abboud's evidence. Mr Abboud's evidence on the subject is plausible and I accept it.

209 As to the penultimate paragraph, Mr Abboud says that he would not have said that the margin on each SKU was monitored. Instead, he believes that he said that the margin on each product category in which an SKU belonged was monitored. He also denies saying that scan rebates always meant that the gross profit margin was maintained. Instead, he says he said that the objective of obtaining a scan rebate was to protect the gross profit margin, even if it could not always be achieved. Again, in my opinion, these issues cannot be resolved by a careful analysis of the syntax of the file note. The file note actually records "Each SKU unit margin is monitored and a report is reviewed weekly for un-performing stock or slow moving stock". It is not entirely clear what that means. The AS400 system did record information in relation to each SKU and it seems to be accepted that a report was prepared and reviewed each week to identify un-performing or slow-moving stock. Understood in that way, the statement was true. There is no evidence that Mr Abboud made some broader claim than that. His evidence of what he said is plausible and I accept it.

210 Similarly, I accept Mr Abboud's evidence concerning what he said about the effect of scan rebates on gross profit margins. It seems unlikely that Mr Abboud would have said that gross profit margins remained the same. That depended

on the scan rebates DSH managed to negotiate with suppliers and the discounts necessary to sell stock. They would not always be the same and there was no reason for Mr Abboud to say that they would be. Again, Mr Clarke does not contradict Mr Abboud's evidence on the point. The likelihood is that Mr Cohen misunderstood or mis-recorded what Mr Abboud had said.

211 Mr Abboud accepted in cross-examination that he did not recall anything being said about the practice of increasing the price of private label stock to obtain O&A rebates. He also accepts that there was no mention of DSH delaying paying creditors.

NAB's credit application

212 Under NAB's procedures, Mr Cohen was required to direct any proposed tender or loan to Mr Paul Taylor, who at that time was an Associate Director with NAB's Corporate Banking Division in the Client Fulfilment Team and who was responsible for preparing the relevant credit application and associated documents for approval. Mr Taylor was assisted by Mr Alan Menzies, who at the time was a Senior Associate in the Client Fulfilment Team. The loan to DSH required the approval of Mr Graeme Johnson, Director Credit Risk, and Ms Karen Peter, Head of Credit – Property, Consumer, Telecommunications, Media and Entertainment, to whom Mr Johnson reported.

213 For the purpose of preparing the credit application a financial model of DSH's business (known within NAB as an EVO) was prepared. Mr Menzies obtained the most recent publicly available accounts of DSH for that purpose. NAB also had access to a number of broker reports including two prepared by Macquarie, which were read by a number of NAB employees involved with the DSH loan, including Mr Taylor and Mr Menzies.

214 The broker reports were generally favourable. However, the Macquarie report dealing with the results of the first half of 2015, states under the heading "Cash flow was weak" that:

> • Inventories increased by $81m from end of June. Inventory per store has increased over 25%
>
> • Around half or $44m of the increase was attributed to seasonality (inventory levels are up close to $100m on the pcp) and the remainder to the growth in

> stores ($8m), private label ($10m) and build to improve Jan/Feb in store position ($18m).
>
> …
>
> • Creditors increased $90m with the higher inventory position, improved supplier terms, and timing of creditor payments.

It is apparent that the information in relation to inventory had come from Mr Abboud and Mr Potts's results presentation.

215 In accordance with arrangements made at the meeting on 28 April 2015, and following further requests from NAB, on 5 May 2015 Mr Potts sent Mr Cohen DSH's monthly financial information for FY15, who forwarded it to Mr Taylor and Mr Menzies. Mr Potts indicated that "I will send the FY16 forecast numbers across to you tomorrow morning", which he did.

216 Both Mr Menzies and Mr Taylor noticed that the monthly figures revealed that DSH's inventory peaked in January 2015, which was contrary to their expectations. They had expected the inventory to fall following the Christmas trading period which the figures disclosed "was a critical driver of the EBITDA and cash flow of DSH" (to use the words of Mr Taylor).

Payment of the interim dividend

217 The interim dividend was paid on 30 April 2015. At the weekly meeting of senior management on 27 April 2015, Mr Potts is recorded as saying "dividend paid this week, holding other payments". Mr Abboud accepted (reluctantly) in cross-examination that "In order to pay the dividend, you caused the company to defer payment of some of its creditors".

Meeting with Mr Potts on 6 May 2015

218 NAB arranged to meet with Mr Potts to discuss the management accounts. That meeting occurred on 6 May 2015. The meeting was attended by Mr Cohen, Mr Taylor and Mr Menzies. Mr Menzies kept a handwritten file note of that meeting and both Mr Taylor and Mr Menzies give a detailed account of what occurred at the meeting by reference to the note.

219 According to Mr Taylor, either he or Mr Menzies asked why inventory went up in January 2015 rather than down.

220 According to Mr Taylor, Mr Potts replied in words to the following effect:

> We were overstocked after the November / December peak period because a big private label order the buyers had placed with a Hong Kong supplier before Christmas was delayed and did not arrive until late January. However, the good thing about this stock is that it all has good shelf life and will not be superseded. I am confident we can sell the extra stock during the year through normal sales without discounting.

221 Mr Menzies then asked what steps had been taken to prevent that happening again. According to Mr Taylor, Mr Potts replied that he had initiated weekly meetings with all the buyers at which he discussed their purchasing and checked that they were buying right stock at the right levels. He said that non-performing buyers had their OTB reduced.

222 According to Mr Taylor, either he or Mr Menzies also asked whether DSH had any way of tracking how inventory was performing. Mr Potts is said to have replied in words to the following effect:

> Our inventory management system tracks sales on a SKU by SKU, store by store basis and reports on sales and inventory in realtime. We can drill down into each SKU and see how it is selling in each store and how much stock we have on hand. This is used to plan inventory purchases and monitor SKU and store performance in real time.

223 Mr Menzies gives evidence to similar effect. He also says that Mr Potts explained that the excess stock had a good shelf life and would not give rise to any write-offs. That recollection is consistent with Mr Menzies's file note which records:

- Overstocked (Nov/Dec) - $270 ($250 net) June
  - private label (after arrived late-Jan)
  - goods halve [scil - shelf] life
  - ↑ aged stock 2-2 months
- $270K – gross standard stock FYE15
- Weekly meeting OTB – discuss purchasing
  - □ tighter controls

224 According to Mr Menzies, Mr Potts also said that it was DSH's practice to ask for rebates from suppliers in order to provide promotional support for the products and that, by obtaining those rebates, DSH was able to maintain its margins on products that it was otherwise discounting. Again, that evidence is broadly consistent with Mr Menzies's file note which records:

- Moderate sales - ask for rebates for [from] suppliers

225 Although not referred to in Mr Menzies file note or the affidavits of Mr Taylor or Mr Menzies, the version of the credit memorandum prepared by Mr Menzies following the meeting contained the following bullet point:

> - The seasonal facility is to provide headroom for any abnormal events in the business. For example, in the lead up to Christmas in 2014 Dick Smith increased orders for private labels; however the shipment was delayed and did not arrive in time for pre-Christmas sales. As a result DSH was heavily overstocked placing pressure on funding requirements and Westpac increased facilities for liquidity.

226 There is a question whether Mr Potts gave other reasons for DSH being overstocked and, in particular, whether he referred to the other reasons given in Mr Abboud and Mr Potts's results presentation. Mr Menzies evidence was to the effect that he had no real recollection of the meeting beyond what was contained in the file note. Mr Taylor accepted that he could be wrong, but his recollection was that the principal or only reason given by Mr Potts for the fact that DSH was overstocked at the end of January 2015 was the late arrival of a shipment of private label stock. He gave this evidence:

> Q. No. What I'm putting to you is that he gave an explanation as to the reasons for the additional stock existing as at the end of January 2015, to represent the purchase of new private label stock with high margins, including the stock which had been delayed and had not arrived in time for Christmas sales?
>
> A. My memory is that it was focused on that shipment that hadn't arrived.
>
> Q. But he may well have referred to new private label stock in addition to the delayed private label stock?
>
> A. He may have, yes.
>
> Q. Also, that he said that the stock purchased included stock for new stores which were being opened, including five new stores at Sydney Airport?
>
> A. My recollection was that that stock was included in the delayed shipment.
>
> Q. What I am putting to you is that he said that another reason for the additional stock purchase was stock for new stores opening, including stock for five new stores at Sydney Airport?
>
> A. My recollection was that that was just making the delayed shipment worse.
>
> Q. Do you accept that he said something to that effect as an explanation for the stock purchased at the end of January 2015?
>
> A. I recollect that he said that as part of the delayed shipment, that they'd made a big order and it was late, and that was one of the reasons why it was such a large order.
>
> Q. I'm not suggesting this was a big order necessarily limited to private label stock, but they had purchased stock for new stores opening, including the stores at Sydney Airport?

A. As part of that shipment, yes.

Q. An additional reason was that he said, didn't he, that stock had been purchased to take advantage of growth opportunities, including fitness and to push an increase in January sales?

A. As I mentioned earlier, my recollection was that was in regards to the future view.

Q. You might be wrong about that; would you accept that he was talking about stock that had been bought, which explained the additional stock purchased at the end of January, which was stock bought to take advantage of growth opportunities, including fitness and the push to increase January sales?

A. I may be wrong, but that's the way I recollect, that that wasn't part of it; that was the future.

227 Mr Taylor's recollection is consistent with the extract from the version of the credit memorandum prepared by Mr Menzies after the meeting, which is quoted above. The file note itself is not as clear. It suggests that Mr Potts said that DSH was overstocked in November and December 2014 compared to June 2015 and remained overstocked in January 2015 because of the late arrival (in late January 2015) of a shipment of private label stock. However, the file note does not record Mr Potts giving any explanation of the position in November or December 2014. Mr Taylor and Mr Menzies were presumably aware of the stock position at the end of December 2014 and the reasons for it because they had read the broker reports including the one issued by Macquarie that gave an explanation for that position. Consequently, no further explanation was necessary. The issue that concerned NAB was why DSH remained overstocked in January 2015. I accept Mr Taylor's evidence that the principal reason Mr Potts gave for that was the delay in receiving a large shipment of private label stock.

Events following the meeting with Mr Potts

228 Following the meeting with Mr Potts, Mr Danesh Shroff, an employee of DSH, sent Mr Menzies an email attaching a spreadsheet showing DSH's projected financial position for FY16. The projection showed only a small increase in sales.

229 After the meeting, Mr Menzies circulated several drafts of the credit memorandum internally within NAB and received a number of comments and questions. Following those comments, he had a telephone conversation with Mr Potts on 11 or 12 May 2015. According to Mr Menzies, in that conversation,

Mr Potts explained that the projections for 2016 showed only a small increase in sales because the data for 2016 excluded commercial sales, which had been included in the data for 2015. Mr Potts is also said to have provided some additional information in relation to the level of inventory in June and December each year that DSH would carry and more information about the additional controls that had been put in place to prevent a recurrence of the problem that had occurred in January 2015 with the overstocking of private label products. Following that conversation, Mr Menzies largely rewrote s 4.2 of the credit memorandum entitled "Working Capital and Facility Requirements". He circulated a further draft of the memorandum in the evening on 12 May 2015.

230 On 13 May 2015, Mr Menzies sent a further version of the credit memorandum for review by Mr Calvin Cordle, Head of New South Wales Corporate and Mr Lewis Williams, General Manager [Risk Team]. Some further changes were made as a consequence of comments made by them before the credit memorandum was submitted for approval on 15 May 2015. Those changes did not affect the substance of the memorandum.

231 The credit application sought approval for 50 percent participation "in a two Bank club facilities" to enable Dick Smith to refinance its existing facilities. Under the heading "NAB Hold Strategy" the memorandum explained (in a paragraph that had been first included following the conversation with Mr Potts on 11 May) that:

> The Borrower is seeking a two Bank structure with total limits at least $135m; however noted DSH desire is to obtain facilities of $150M to match their seasonal cycle, namely peak period from October through to February, and provide flexibility for opportunistic trade purchasing.

232 The memorandum also stated under the heading "Facility Purpose" that:

> Purpose of the facilities is to fund both working capital and general corporate purposes, with the quantum of facilities requested being driven by the level of stock required to be held, particularly at peak trading times leading up to Christmas.

233 The credit memorandum includes the following graph setting out DSH's working capital and facilities requirements:

*Based on actual accounts to 31 March 2015 and forecasts thereafter

234 Under that graph, there was a discussion of DSH's working capital requirements, which included the following points:

- Working Capital facilities are to support the seasonal period during Christmas and intra month funding movements (up to ~$80M). Peak debt occurs on the first day of each month, when rental payments and 50% of supplier payments are made (wages are paid weekly).
- Total proposed facilities including seasonal peak are $150M.
- As can be seen in the chart above, facilities a fully fluctuating, with a positive cash balance held during Jan-15.
- Excluding the abnormal peak in May 15 (discussed below), the "normalised" seasonal fluctuation entails a buildup of inventory leading into Christmas, which is paid down in January/ February. Seasonal peak period is extended to 28 February, to allow a buffer of collections over the Christmas / summer period.
- It is noted DSH reported zero debt at December 14 period end and forecast zero debt at December 15 period end; however debt spikes on the 1st of each month when supplier payments, wages, and rent are paid.

235 This section of the memorandum had been substantially redrafted since the draft prepared following the conversation with Mr Potts on 11 May 2015. Relevantly, the earlier draft had included the following bullet point:

> Excluding the delayed private label shipment and opportunistic purchasing, the "normalised" working capital fluctuation is a build-up of inventory leading into Christmas and paid down is [scil in] January.

236 The final draft of the credit memorandum referred to the problem with the late delivery of private label stock in Christmas 2015. After setting out graphs of actual and projected inventory levels from July 2014, the memorandum stated:

> • As illustrated in the graph above DSH was holding $335M stock in December 14 compared to forecast $288M in December 15. Inflated stock holdings of ~$47M was driven by overstocking of private label (discussed below).
>
> • Furthermore, management made opportunistic purchasing during January/February 15 to hold an additional ~3 month's stock, to avoid price increases that suppliers were implementing. This and the private label holding have driven the inflated debt requirement in May 15.

237 The credit memorandum continued with the following:

> Outcome
>
> ▪ The shelf life on the products are sufficient that management do not intend to reduce inventory by discounting products or expect any write-offs. Inventory level for private label is forecast to return to normal during 2015.
>
> Improved Controls
>
> ▪ The CFO has implemented a weekly meeting with the buying team to review purchasing.
>
> ▪ IT systems provide real time reporting, down to the SKU level. These are being used to help monitor inventory levels and make buying decisions.
>
> ▪ Large orders outside of standard business are discussed with the board; i.e. opportunistic purchasing or large stock purchases for sales.
>
> ▪ Minimum lead times to supply inventory are set with suppliers, and DSH is to accommodate a further buffer. Contracts now include penalties for not meeting agreed timelines.
>
> ▪ In terms of overseas suppliers for private label products, the top 10 suppliers account for 90% and DSH have contacts with another 10-20 substitute factories.

238 Mr Menzies said in cross-examination that the information contained in these sections of the memorandum came from his discussions with Mr Potts. That evidence is plausible and I accept it.

239 The final version of the memorandum submitted to the credit team included the following comment under the heading “Rational for Recommendation””:

> Whist there was a misjudgement in over-ordering private label stock last year, exacerbated by the delayed shipment, we are comfortable that no significant loss will occur as a result, and that new controls in the purchasing supply chain have been implemented.

240 On 18 May 2015, Mr Johnson sent Mr Menzies an email raising a number of questions in relation to the credit memorandum which he had identified in consultation with Ms Peter which related to the inventory management system. Mr Menzies prepared a revised version of the memorandum addressing those issues. The revised version included the following:

> Inventory is monitored via a real time inventory management system, to the SKU level. DSH runs two identical inventory systems through Macquarie Data Centres located in Sydney and Melbourne. The systems mirror each other to prevent loss of data if one system crashes. The systems cross check every 15 minutes and furthermore the Data centres provide additional backups.

241 Mr Johnson and Ms Peter approved the memorandum on 20 May 2015 subject to a number of conditions including the following:

> ▪ Clean down is required $50m (aggregate) for 10 consecutive business days every 6 months across total bank facilities.
>
> …
>
> ▪ Confirmation by Bankers that DSH will fully liquidate the $45m in excess stock within 12 months.
>
> ▪ Trade and Working Capital support …

242 The reference to trade and working capital support was a reference to approval by the Working Capital Solutions (***WCS***) team at NAB to a seasonal facility that it was originally intended that group would provide as part of the facilities NAB offered DSH. The product support paper seeking approval to that facility was prepared by Mr Ronald Lin, Director Trade and Working Capital NSW/ACT. For the purpose of preparing that paper, Mr Lin obtained trade and working capital information from Ms Puja KC, an employee of DSH, on 20 May 2015. After receiving that information, Mr Lin asked a series of questions about DSH’s inventory, suppliers, debtors and the Company’s aged creditors. The information in relation to aged creditors included the following:

		Answer

		Current	30 Days	60 Days	+90 Days	Total
	Aged Creditor Ledger	31,515,632	73,469,222	51,778,068	7,103,357	163,866,278
	Aged debtor ledger – DSG Trade	6,822,355	689,181	2,027,006	1,971,346	11,509,888

243 On 22 May 2015, Mr Lin circulated a draft of his paper to Mr Clarke, Mr Cohen and Mr Menzies. It appears that Mr Menzies provided a copy of it to Mr Johnson. Mr Lin circulated a revised draft on 26 May 2015. Both drafts contained a table setting out a summary of stock and debtors by month for FY15 and the proposed facility limit in each month, which was $135 million increasing to $150 million in October to January. Following that table it included the following comment:

> Based on historical data, the facility limit proposed represents on average 40% of stock and debtors. We note that extended suppliers terms supported inventory funding during peak periods, and we understand that DSE has payable finance facility with Macquarie Bank to extend payment terms for selected supplier.

244 Following that approval, DSH negotiated a number of amendments to the facility, the last of which was approved by Mr Johnson and Ms Peter on 5 June 2015. One of the amendments involved reducing the "clean down" period from 10 to 5 days. Ms Peter was initially opposed to that amendment, but she was persuaded to agree to it by Mr Williams, who was one of the directors of the client facing team and to whom Mr Taylor reported, on the basis the other banks who participated in the tender were prepared to agree to a more favourable clean down period.

Board meeting on 19 May 2015

245 There was a board meeting on 19 May 2015. Present at the meeting were Mr Murray, Ms Raine, Mr Ishak, Mr Tomlinson, Mr Abboud and Mr Potts.

246 Mr Tomlinson gives the most detailed account of this meeting. In unchallenged evidence he says that he noticed that the level of inventory had not decreased as forecast in the April 2015 Trading Update. That issue was raised with Mr Abboud and Mr Potts. Mr Tomlinson says that he cannot recall the discussion in detail. However, he gave this evidence:

> I recall that Mr Potts gave the same explanation for the level of inventory that had been given at the board meeting on 20 April 2015, to the effect that management was making deliberate decisions in building inventory to take advantage of the high exchange rate, to implement the private label and appliances strategies [that is, the strategies of investing in private label inventory and building DSH's appliances business], and to support new store growth.
>
> I recall that during the discussions at and around the time of the May 2015 board meeting, one or more directors in substance said that they were developing concerns about the way in which these strategies were impacting DSH's balance sheet, about the fact DSH had inventory levels above expected levels, about management not reducing inventory in line with forecasts, and about DSH having an anticipated $40 million dollar debt position compared to the approximately $30 million dollar cash position at the prior year end. I said to management and the other directors that I shared these concerns. I said that I had a concern that the market would notice and react to a significant increase in debt, a significant change in the cash flow and an increase in inventory, if DSH were unable to change the forecast outcomes.

Board meeting on 16 June 2015

247 There was a board meeting on 16 June 2015. Present at the meeting were Mr Murray, Ms Raine, Mr Ishak, Mr Tomlinson, Mr Abboud and Mr Potts.

248 For the first time, following a request by Mr Tomlinson at the previous board meeting, the board papers included a "KPI summary", which contained some information about DSH's net debt position. The summary indicated that DSH's net debt as at the end of May 2015 was $104.7 million and indicated that the forecast net debt position at the end of the financial year was $40.1 million. It also indicated that days covered ranged from approximately 90 days to approximately 120 days during the financial year, that they had remained above 110 days since October 2014 and were still at 110 days at the time the board papers were prepared, although they had declined from a peak in about early February 2015 and were forecast to decline again slightly in June.

249 Mr Murray says that at that board meeting he sought assurances from management that they believed that Dick Smith would achieve the forecast inventory figure of $275 million. That evidence is consistent with the fact that he had placed a question mark against that figure in his copy of the board papers. Mr Murray gave the following evidence on this topic:

> Broadly I recall there were discussions … about the nature of trading in the month of June, why management thought it would be a big sales month, and why the inventory forecast was achievable. While inventory levels had fluctuated and had not reduced in line with forecasts, they had been coming down significantly since February 2015, and I accepted management's statement that the June forecast net inventory figure would be achieved.

250 Mr Tomlinson's recollection was somewhat different. He agreed that inventory was a focus of the discussion at the meeting. He gave this evidence:

> Management in substance said that there were a number of variables affecting DSH's trading, including the fact that mid-winter was not a peak trading period, and there was aggressive competition in the market from DSH's competitors including Harvey Norman. For these reasons, DSH's trading was subdued. In addition, DSH was continuing to grow its store network and pursue opportunities in new SKUs and in private label.

251 The board also approved the Syndicated Facility with NAB and HSBC.

Syndicated Facility entered into

252 On 22 June 2015, NAB and HSBC entered into the syndicated facility agreements, security trust deeds, general security deeds and fee letters with DSH and its related bodies corporate.

253 So far as NAB was concerned, the Syndicated Facility contemplated a transaction in two parts:

(a) Tranche A, being a multi option working capital cash advance facility in the amount of $35 million extended for the purpose of trade refinance, issuing letters of credit instruments and ancillary facilities; and

(b) Tranche B, being a multi option facility comprising of working capital cash advance facility totalling up to $40 million extended for the purpose of refinancing the Westpac facility, general working capital and corporate purposes and trade refinance.

254 On the part of HSBC, the Syndicated Facility contemplated an overdraft facility in the amount of $60 million.

255 Mr Johnson and Ms Peter give evidence to the effect that had they been informed that the following was the case with respect to DSH and its business:

> (a) the result of a policy (that DSH had been pursuing since at least May 2014) of seeking to obtain and maximise certain types of rebates from suppliers was that DSH management made purchasing decisions based on the rebates available from suppliers, rather than based on current or likely demand for the stock;
>
> (b) these purchasing practices were the real reason why DSH had ordered significant additional inventory before Christmas 2014;
>
> (c) DSH had requested certain suppliers defer delivery of goods ordered before Christmas 2014 to January 2015 or later because DSH had insufficient funds to pay for that inventory;
>
> (d) rebates from suppliers were not always properly accounted for by DSH in accordance with Australian accounting standards and the misapplication of the accounting standards had facilitated DSH reporting gross profit, EBITDA and net profit of higher amounts than it should have, had it complied with the accounting standards;
>
> (e) DSH did not have in place adequate procedures, practices or systems to detect, value or, where necessary, provision for or write-off obsolete or near end-of-life inventory; and
>
> (f) in the period between August 2014 and May 2015, DSH had exceeded the limit of its finance facility with Westpac and had requested suppliers delay delivery of inventory or extend time for payment of invoices.

then they likely would not have given credit approval.

256 Mr Rogers gives evidence to similar effect in relation to the HSBC facility, although he says that his decision would have been influenced in part by whether a satisfactory explanation could have been given by DSH for the conduct. However, he says that the issues would have raised a question whether DSH was a well operated retailer. He also says that if he had been told that DSH was delaying the payment of invoices or deferring delivery of stock because of insufficient funds to pay for what it had ordered, it was very unlikely he would have approved the facility because those actions are indicative of a retailer with cash flow problems. He also says that obsolescence of inventory was a key area of interest for him and that if information had been provided which suggested that DSH was not properly managing inventory that would have been a substantial 'red flag'. He says that depending on the magnitude of the inventory obsolescence problem, the issue may have been sufficient to dissuade him from providing credit approval.

Events leading up to end of FY15

257 In the lead up to the end of the 2015 financial year, DSH continued with its strategy of seeking to improve its financial results by maximising O&A rebates. So, for example, it is apparent from an email that Mr Borg sent buyers on 25 May 2015 that Mr Abboud had agreed to release an extra $12 million OTB in June "based on total 20% ad sub + o&a collect" on the proviso that it "must be good stock and will be treated as a pull forward from July and August". On the same day, Mr Borg sent an email that was copied to merchandise planners and buyers, among others, saying:

> As we approach end of year and audit, we need to freeze stock movement.
>
> Until further notice, please refrain from moving anything to EOL / out of Active. If there is anything urgent, please let me know.

258 At some stage it appears that the additional OTB was increased to $20 million. That is apparent from an email chain between Mr Abboud and Mr Bar-Ami on 12 June 2015 in which Mr Abboud asked for an "o/a update" and Mr Bar-Ami replied "Right at this point We're [sic] down to $2.5M still to collect (on the $7.7M target for June), $6.3M are left to be spent (of the $20M additional)". From about that time, Mr Bar-Ami sent daily updates to merchandise

managers, Mr Borg and Mr Orrock of the amount of O&A rebates obtained from use of the additional OTB.

259 DSH's daily cash flow as at 26 June 2015 forecast that the net cash position would be negative $136.234 million on 30 June 2015, which was in excess of its new facilities. The forecast suggested, however, that the cash position would improve substantially after that date.

Board meeting on 20 July 2015 and subsequent events

260 There was a board meeting on 20 July 2015. All directors attended the meeting. The KPI summary in the board papers record that net debt at the end of FY15 was $41 million against a forecast of $40.4 million and that inventory days covered was slightly above 110 days. At that time Dick Smith had 393 stores and stock on hand of $293.044 million.

261 Excess inventory continued to be a topic of Mr Borg's emails in July 2015. For example, on 7 July 2015, Mr Borg sent an email to merchandise planners and others stating that the business had $33 million of stock aged 12 months or greater compared to $14 million at the same time last year. The email included a table which indicated that in the case of a number of categories the stock that was 12 months or older exceeded ten percent of the total stock in that category, in some cases by a large margin.

262 On 28 July 2015, Mr Borg sent an email to Mr Abboud, with copies to Mr Orrock and Mr Potts requesting a meeting to discuss stock. The email stated that the overstocking of accessories, including private label accessories, meant that OTB was being squeezed for other categories which were understocked, such as office, TVs and mobiles. The email included the following table setting out the position for the first four weeks of FY16:

FY16 July First 4 weeks

All groups $ 000			
	Average inventory $	Average sales $	Average COGS $
FY14	202,822	20,584	16,625
FY15	280,426	22,071	18,960
FY16	317,320	21,889	18,678
16 vs 15 $	36,894	(182)	(282)
16 vs 15 %	13.2%	-0.8%	-1.5%

Accessories $ 000			
	Average inventory $	Average sales $	Average COGS $
FY14	21,384	2,999	1,189
FY15	33,671	2,898	1,171
FY16	55,446	2,916	1,309
16 vs 15 $	21,775	18	138
16 vs 15 %	64.7%	0.6%	11.8%

Total ex Accessorie		
	Average inventory $	Ave sal
FY14	181,438	17
FY15	246,755	19
FY16	261,874	18
16 vs 15 $	15,119	
16 vs 15 %	6.1%	-

FY16 July First 4 weeks tables - text version (90286, rtf)http://www.caselaw.nsw.gov.au/asset/179f9b6b5a57ea92d4789cfa.rtf

263 It appears that Mr Abboud did not reply to that email and on 30 July 2015 Mr Borg sent Mr Abboud and Mr Potts an email proposing a meeting the following Monday to discuss stock. In that email, Mr Borg said:

> **Ideal stock levels**
>
> Based on reasonable category weeks cover targets, we should sit on $265-$270M of stock
>
> We currently have $312M, +$42M
>
> The categories driving the overstocks are:
>
> Accessories - overstocked by $15M, currently on 42 weeks cover, should be on 30
>
> Fitness - overstocked by $8M, currently on 38 weeks cover, should be on 20
>
> Gaming - overstocked by $6.8M, currently on 48 weeks cover, should be on 18
>
> Cameras - overstocked by $5.8M, currently on 30 weeks cover, should be on 18
>
> Seasonal - overstocked by $4.3M, currently on 66 weeks cover, should be on 26
>
> Audio - overstocked by $3M, currently on 20 weeks cover, should be on 18
>
> Subtotal - overstocked by $43M
>
> These categories are highlighted in red below.
>
> There are a further 7 categories highlighted in orange with a combined $12M of overstocks – this is causing us to be tight in categories such as TVs who are below target and need stock but company OTB needs to be managed (most of

the TVs shortage is from extra sales above forecast in PL and some delays in factory replenishment)

…

	Stock value $ 000	Avg weekly COGS (last 4 weeks)	Current Weeks cover	TGT weeks cover	TGT weeks cover $	Weeks cover vs TGT	St valu T
All Groups	311,657	17,107	18.2	15.6	267,659	2.6	43
ACC - Accessories	54,560	1,309	41.7	30.0	39,259	11.7	15
ACC - CO - Connect Accessories	21,165	670	31.6	30.0	20,109	1.6	1
ACC - PO - Power Accessories	17,951	361	49.8	30.0	10,821	19.8	7
ACC - PR - Protect Accessories	15,435	278	55.6	30.0	8,328	25.6	7
AVI - Audio Visual	56,503	3,349	16.9	19.3	64,577	(2.4)	(8
AVI - GE - Visual Products	25,753	2,337	11.0	16.0	37,397	(5.0)	(11
AVI - C - Audio	26,307	1,285	20.5	18.0	23,129	2.5	3
AVI - GH - Visual Components	4,443	225	19.7	18.0	4,051	1.7	
HMS - Home Solutions	64,585	1,177	54.9	29.9	35,232	24.9	29
HMS - FT - Fitness	16,812	441	38.1	20.0	8,824	18.1	7
HMS - XG - Digital Cameras	14,667	493	29.7	18.0	8,875	11.7	5
HMS - YG - Gaming & Accessories	10,851	225	48.3	18.0	4,046	30.3	6
HMS - SE - Seasonal	7,166	109	65.7	26.0	2,837	39.7	4
HMS - L - Surveillance	6,375	218	29.2	20.0	4,360	9.2	2
HMS - D - In-Car & Navigation	6,307	288	21.9	20.0	5,759	1.9	
HMS - HM - Home	2,326	27	87.5	20.0	531	67.5	1
MOB - Mobility	26,182	2,408	10.9	10.6	25,503	0.3	
MOB - E - Unlocked Mobile Devices	21,864	2,286	9.6	10.0	22,863	(0.4)	(1
MOB - EB - Prepaid Mobile Devices	4,229	262	16.2	10.0	2,617	6.2	1
MOB - ES - Sim Packs	87	2	37.6	10.0	23	27.6	
OFF - Office	109,573	8,864	12.4	11.6	103,088	0.7	6
OFF - XC - Computer Systems	47,367	3,193	14.8	14.0	44,699	0.8	2
OFF - XA - Apple Computers	18,620	2,580	7.2	7.0	18,059	0.2	
OFF - XM - Data Storage & Networking	16,200	1,117	14.5	13.0	14,524	1.5	1
OFF - TA - Tablets	9,341	749	12.5	13.0	9,740	(0.5)	
OFF - PA - Print Accessories	7,792	323	24.1	20.0	6,458	4.1	1
OFF - XP - Printing and Office Equipment	3,920	176	22.2	16.0	2,822	6.2	1
OFF - F - Phones, TAMs, Accessories	3,953	288	13.7	16.0	4,613	(2.3)	
OFF - XS - Computer Software	2,367	362	6.5	6.0	2,174	0.5	

Ideal stock levels table - text version (156567, rtf)http://www.caselaw.nsw.gov.au/asset/179f9c0f12aed9e0be7c7c98.rtf

264 Mr Borg was cross-examined extensively on this email and its attachment. He said that the email set out what he regarded as reasonable stock levels for different categories of stock. He accepted that in the case of some categories, at least, it was reasonable to hold more than 16 weeks cover. However, he qualified that evidence by saying:

> It was reasonable for the time. But, Mr Smith, can I add that when you're working with stock levels that keep going up, up, up and up, if you have a category that is, say, at 40 weeks cover currently, to put 10 weeks cover as a reasonable target when there are so many - you know, 30 weeks in between, it would not be wise nor reasonable to say that a category needs to go from 40

> to 10 for the purpose of what this document was put together for. The targets were adjusted against my own personal view because you couldn't course-correct these categories too quickly, or to a point where it just looks like it's so unrealistic that it's not worth the paper it's written on.

265 That evidence itself must be considered against an analysis performed by Mr Abboud and Mr Potts's legal advisers which summarised Mr Borg's recommended number of weeks covered by category in various documents he produced over the period from 1 June 2014 to 25 November 2015 and distributed within Dick Smith. In the case of many categories, Mr Borg's targeted number of weeks covered did not change substantially over time, particularly in the period up until 5 October 2015. From then, it increased in the case of some categories. So, for example, in the case of the category "ACC – CO – Connect PB Accessories", the targeted number of weeks covered ranged from 26 weeks to 30 weeks from 1 June 2014 to 5 October 2015, although it increased to 52 weeks in a document produced by Mr Borg on 18 October 2015. Why that was so is not explained in the evidence. Leaving aside a number of outliers such as that, the targeted weeks covered ranged from 8 weeks to 30 weeks, although they were generally higher in the case of the "Seasonal" category.

266 Set out below is an extract from a table prepared by Mr Abboud and Mr Potts's legal advisers summarising the results of their analysis. The fifth column shows the minimum targeted weeks covered referred to in one or more of Mr Borg's documents for each category of product. The sixth shows the maximum and the fourth shows the average. The last column identifies categories where the target exceeds 16 weeks (1) in each of Mr Borg's documents (coloured green), (2) in one or more of Mr Borg's documents (coloured amber) and (3) in none of Mr Borg's documents (coloured red).

GROUP	CAT	CAT DESC	Average TWC	Min TWC	Max TWC	TWC Categories
AVI	C	Audio	20.0	18.0	23.0	All TWC > 16 weeks
	GE	Visual Products	15.9	15.0	18.0	Max TWC > 16 weeks
	GH	Visual Components	17.5	15.0	22.00	Max TWC > 16 weeks
1ACC	CO	Connect PB Accessories	31.8	26.0	52.0	All TWC > 16 weeks
	PO	Power PB Accessories	31.5	20.0	52.0	All TWC > 16 weeks
	PR	Protect PB Accessories	34.5	26.0	52.0	All TWC > 16 weeks
OFF	PA	Print Accessories	18.3	17.0	21.0	All TWC > 16 weeks
	XM	Computer Storage	13.3	12.0	16.0	All TWC = < 16 weeks
	XC	Computer Systems	12.9	9.0	16.0	All TWC = < 16 weeks
	XA	Apple Computers	6.6	5.5	8.0	All TWC = < 16 weeks
	XP	Printing and Office Equipment	16.3	13.0	19.0	Max TWC > 16 weeks
	F	Phones, TAMS, Accessories	15.1	12.0	16.0	All TWC = < 16 weeks
	TA	Tablets	12.8	8.0	16.0	All TWC = < 16 weeks
	XS	Comp	7.3	5.0	13.0	All TWC = < 16 weeks
HMS	XG	Digital Cameras	17.3	15.0	22.0	Max TWC > 16 weeks
	FT	Fitness	20.0	20.0	20.0	All TWC > 16 weeks
	L	Security Products	19.3	16.0	20.0	Max TWC > 16 weeks
	SE	Seasonal	38.0	26.0	44.0	All TWC > 16 weeks
	YG	Gaming & Accessories	19.2	15.0	28.0	Max TWC > 16 weeks
	D	In Car & Navigation	15.8	13.0	20.0	Max TWC > 16 weeks
	HM	Home	24.6	20.0	26.0	All TWC > 16 weeks
MOB	E	Cellular Telephones	9.7	8.0	11.0	All TWC = < 16 weeks
	EB	Broadband	11.1	10.0	15.0	All TWC = < 16 weeks
FCD	AT	Adaptive Tech & Drones	18.0	18.0	18.0	All TWC > 16 weeks

extract from analysis results table - text version (138642, rtf)http://www.caselaw.nsw.gov.au/asset/179f9c824e22a8a0a75b183b.rtf

267 Relying on evidence given by Mr Abboud, it was also suggested that, as the number of stores increased, some increase in the number of weeks covered was also necessary. The evidence given by Mr Abboud was this:

> Q. I think you might have mentioned this in answer to Mr Giles as well. The effect of having lower turnover and more stores had an effect on weeks cover. Is that your understanding?
>
> A. Yes. When I joined Dick Smith it had 320 stores, and based on the turnover, the weeks cover - when I joined I think it was sitting on 370, then we took the $50 million write-down. But it was sitting on approximately 22 weeks cover, and those documents are in the company documents.
>
> Q. I'm asking you specifically about the implications of having a larger number of stores doing less turnover on weeks cover. Do you understand?
>
> A. Yes.
>
> Q. I'm asking you about that calculation?
>
> A. That calculation would say that they would hold a higher weeks cover because of the volume.
>
> Q. So with a store doing a lower turnover, and more of them, it is necessary, isn't it, to balance the weeks cover with the risk of being out of stock in any one store?
>
> A. That's correct, ...

However, this evidence must be understood in context. Mr Abboud was explaining why JB HiFi, with approximately half the number of stores and three times the turnover of Dick Smith, was not a good comparable to Dick Smith in identifying a reasonable number of weeks covered. He was not saying that the mere addition of stores increased the number of weeks covered that was optimal. That, presumably, would only follow if the turnover of the new stores was lower than that of existing stores.

268 On 6 August 2015, Mr Borg sent an email to buyers and merchandise planners which relevantly said:

> We received $8M yesterday.
>
> I am very nervous that we will be over for the month. WE CANNOT BE OVER
>
> …
>
> There will be no more approvals for this month - we need to make our current stock work.

269 According to an inventory aging report as at 23 August 2015, of total stock of $315,445,159, 10.1 percent was more than 12 months old, a further 13.6 percent was more than 6 months old and a further 8.9 percent was more

than 3 months old. The report also records that DSH had bought in round figures $21.5 million worth of end of life stock in the preceding 3 months and had over $92 million worth of stock which was not classified as active. Mr Andrew Powell, of Agile Commerce Consulting Pty Ltd, was provided with a copy of this report in October 2015 by Mr Holtzer. He said that these figures demonstrated a problem and that the $21.5 million demonstrated very poor buying practices.

FAC meeting on 11 August 2015

270 The FAC met on 11 August 2015. DSH's accounts for FY15 were presented to that meeting. The material before the committee included a report dated 6 August 2015 from Deloitte. In relation to inventory obsolescence, the report repeated much of what was said at the time of the half yearly review. It pointed out that the provision for obsolete stock had reduced by $3.2 million from the previous year. It explained that management had adopted a new methodology for calculating the provision which had been further refined in FY15. It stated that "We have assessed the assumptions and methodology applied and concur with the revised methodology". It also explained that:

> The methodology changes contributed $1.8 million to the $3.2 million overall movement, with the remaining movement due to improvement in the aging and condition of stock.

271 In relation to O&A rebates, the Deloitte report states:

> Management continue to maximise the vendor rebates obtained, either through price protection, advertising subsidies or over & above rebates ('O&A Rebates'). The increase in O&A Rebate receivables at 28 June 2015 is due to the increased amount of purchasing for the new stores opened, higher buying activity in the final months of the year as well as promotional launches such as the *Oppo* smartphone.
>
> Where a rebate relates specifically to a product purchase or promotion, the income relating to the rebate received should be deferred so as to match the recognition of the cost of that product or promotion in profit or loss. Generally, O&A rebates are not specifically allocated to a product purchase or promotion, however are often negotiated in parallel to a purchase of inventory or the clearance of an existing product. Consequently these are recognised in the profit or loss in the period to which the marketing or sales activity relates. We have assessed managements treatment of the O&A rebates concur with the treatment.

272 There was also a discussion at the FAC of the final dividend. However, it appears that no paper was presented to the committee on the payment of the

dividend and there is little evidence of what was discussed. Mr Murray's affidavit evidence was that he could not recall precisely what was discussed about the dividend. In cross-examination, he thought he asked his "normal questions of management", which included a question concerning whether cash flows could support the payment of the dividend.

Board meeting on 17 August 2015

273 There was a board meeting on 17 August 2015. All the directors attended that meeting, although Mr Murray attended by telephone from England. It was the day of his father's funeral. At the meeting, the board approved DSH's FY15 financial statements, which were published and lodged with the ASX on the same day. The accounts disclosed NPAT of $37,905,000 compared to $19,826,000 for the previous year, which was at the lower end of forecast. They also showed that the value of inventory had increased from $253,814,000 to $293,044,000.

274 At the board meeting, the board resolved to declare a final dividend of 5 cents a share, which was to be paid on 30 September 2015, although the resolution to declare the dividend is not recorded in the minutes of the meeting.

275 The financial information included in the board papers showed that sales for July were $97.189 million, approximately $2,521,000 behind budget. It also stated that as at July 2015 the working capital was $163,460,000. Working capital was forecast to be $137,831,000 at the end of September 2015. The board papers also indicated that inventory at the end of July 2015 was $315,600,000, which was $22.5 million more than in June 2015. In addition, they showed that net debt was $100,800,000 against a forecast of $98 million and forecast that DSH would have net debt at the end of September 2015 of $70,983,000, a cash surplus of $8,926,000 in January 2016 and a net debt of $10,181,000 at the end of FY16.

276 Mr Murray says that the trading update presented at the meeting was more reassuring to him than at the July 2015 meeting and that his best recollection is that Mr Abboud made the comment that some "excess" inventory had been cleared. However, it is difficult to reconcile this evidence with the fact that inventory had increased by $20 million. Mr Tomlinson's recollection is that at

around the time of the board meeting Mr Potts said words to the effect that DSH had just come through a difficult trading period. He interpreted that comment that management was confident that DSH's sales would improve in the first and second quarters of the 2016 financial year.

277 Also before the board was a dividend discussion paper, which followed the format of the paper for the interim dividend. Based on a payout ratio of 60-70 percent, the paper recommended a dividend of 5.0 cents per share (totalling $11.83 million), taking the total dividend for FY15 to 12.0 cents per share ($28.38 million) for a payout ratio of 65.4 percent. On the question of timing, the paper said:

> It is proposed that the final dividend in relation to FY2015 declared by the Directors of DSH be paid on 30 September 2015. The timing reflects the Company's operational cash flow requirements and has been factored in to the weekly cash flow forecast.
>
> It is also proposed that the record date of the dividend be 31 August 2015, 13 days after the release of the 2015 results and 30 days prior to payment of the dividend.

278 The daily cash flow forecast for the period starting 17 August 2015 paints a substantially different picture from that shown in the board papers. That cash flow provides daily figures up until 16 October 2015 and weekly figures from then until the end of the financial year. It shows that from the week starting 31 August 2015, it was forecast that DSH would exceed its facilities limit of $135 million on multiple occasions up until mid-December 2016 (and by approximately $33 million on 30 September 2015) and that cash at the end of FY16 would be negative $85.290 million. The same excel workbook includes a graph showing net debt on a weekly basis based on the daily cash flows. Not unexpectedly, that graph indicates that DSH would exceed its $135 million facility limit for much of the period from the beginning of September 2015 until mid-December 2015 and that its projected debt at the end of September was approximately $167 million. This forecast is to be contrasted with one produced at the end of FY15, which was referred to by Mr Abboud and Mr Potts in submissions, which suggested that DSH would not exceed its facility limit during the forecast period.

279 By the time of the 17 August 2015 board meeting, Mr Tomlinson had formed the view that Mr Abboud was overly optimistic and that Mr Potts was out of his depth. In an email dated 18 August 2015 to Mr Murray concerning Mr Abboud's performance review, Mr Tomlinson, after expressing the view that Mr Abboud was "doing a great job" and "had delivered another set of solid results this year", said:

> Nick, spurred by Cookie [Mr David Cooke], has fallen into the trap of being overly optimistic all of the time. He will trip up soon.

When cross-examined on that email, Mr Tomlinson gave the following evidence:

> Q. That's a reference to your concern that you had formed by this time that Mr Abboud was overly optimistic?
>
> A. Yes.
>
> Q. It linked into your concern that the forecasts that you were being given about where this company was going were overconfident and ultimately inaccurate?
>
> A. I think that's one aspect of that sentiment.
>
> Q. What are the other aspects?
>
> A. Not being completely open with the board about information. So we've talked about the Westpac facility, that would be an example of that, and probably an over focus on the market as opposed to what we should be reporting as a business.

280 Mr Tomlinson also said in the email "I have questions on Rod [Orrock], MP [Mr Potts] and Cookie. We need to decide and act. Nick needs to lead this". When cross-examined on those statements he explained that he ultimately thought that all three should leave the business. He gave the following evidence in relation to Mr Potts:

> Q. By August 2015, you had completely lost confidence in Mr Potts?
>
> A. I thought he was out of his depth.
>
> Q. And he needed to leave the business?
>
> A. Yes.
>
> Q. And you hadn't formed that view on 18 August, had you?
>
> A. I can't recall specifically when I formed that view, it was developed over time.
>
> Q. But some time before this, though?
>
> A. Yes.

Mr Holtzer engaged in relation to DSH's inventory

281 Prompted by the stock position, Mr Potts suggested to Mr Abboud that Mr Holtzer be engaged to review DSH's buying processes. As I have said, SPI had been engaged by DSH in late 2014 or early 2015 to develop and implement a system for recording and tracking vendor rebates. Following that work, Mr Potts kept in touch with Mr Holtzer. In around July or August 2015, Mr Potts told Mr Holtzer that he was under pressure in relation to Dick Smith's inventory position and that he wished to engage Mr Holtzer to investigate the size of the problem. In some of their previous meetings in 2015 Mr Potts had told Mr Holtzer that Dick Smith had too much inventory and was unable to reduce it. He also told Mr Holtzer that DSH was losing sales because it did not have stock of products that were in demand.

282 Following the conversation in or about August 2015, Mr Potts engaged Mr Holtzer informally to undertake an investigation into Dick Smith's inventory problems pending a formal agreement. Mr Holtzer engaged Agile Commerce Consulting, a company associated with Mr Powell, to assist him with that task.

The Extension Agreement

283 On 2 September 2015, Mr Potts called Mr Kowik at HSBC and said that DSH may need a temporary increase of $20 million in its overdraft between 1 November 2015 to 31 December 2015 and possibly extended to 28 February 2016. Mr Kowik made a note of the conversation in a call report which he sent to Mr Katiforis on 4 September 2015. Mr Potts spoke again to Mr Kowik on 13 October 2015 and initially asked for an increase of $30 million. The likelihood is that he explained that the facility was required to fund the acquisition of additional inventory for sales commencing on Boxing Day. When reporting on the second conversation to Mr Katiforis in an email of the same day, Mr Kowik described the increase as "Boxing Day Financing".

284 On or around 14 October 2015, Mr Kowik submitted a CARM for approval by Mr Allan Byrne, Senior Manager, Wholesale Risk, with HSBC in relation to the increase in the facility.

285 The CARM relevantly stated:

> CARM is raised to seek AUH WMR approval to:

> 1) Increase the existing overdraft by $20m to $80m temporarily from 15Nov15 – 15Jan16 (8 weeks) to fund increased inventory required for anticipated Boxing Day sales. Although the majority of Boxing day sales is expected to occur on the 26Dec15 (and a few days thereafter), HBAU have allowed an additional 2 weeks to accommodate (1) the 3 day merchant clearing period, (2) additional public holidays in between which will delay cleared fund to HBAU acc and (3) additional trading days post-Boxing day to clear the inventory. After 15Jan16, the limit will revert back to the original $60m facility limit.

286 Mr Byrne was assisted by Ms Angelica Yu in relation to his credit analysis. On 19 October 2015, Ms Yu asked Mr Kowik a number of questions in relation to the credit application. One question was whether the increase was a normal seasonal requirement. On the same day, Mr Byrne sent Mr Kowik a follow up email asking a number of additional questions, one of which was "Are you able to confirm the amounts requested by the company in past years?". Mr Kowik replied to that question "Confirmed $20m last year. They requested $30m to anticipate higher sales, but we contained this to $20m due to CMB SYD appetite of risk assessment".

287 On 20 October 2015, Mr Byrne sent Mr Kowik a further email asking some follow-up questions, one of which was "To clarify, I'm trying to get confirmation that the seasonal requirement has been a feature since the business re-listed (inclusive of sizing)". Mr Kowik replied to that question "DSE listed in Dec13. Confirmed that the seasonal requirement started in Dec14 with $20m. Prior to that, in 2013 they were trying to re-shape their inventory (cleaned the old non moving) hence no seasonal requirement needed". Mr Byrne gave his approval the same day. The approval comments included the following:

> Present request is to seek approval for:
>
> - increase the existing overdraft by AUD20m to AUD80m seasonally from 15Nov15 to 15Jan16 (8 weeks) to fund increase inventory required for anticipated Boxing day sales.
>
> As stated in the last approval, the company is displaying sound and improving financial trends. I would ask the covering team to carefully monitor the group's stock levels and continually have discussions regarding obsolete stock levels - in my mind this is currently the key risk in terms of general liquidity and profitability / margins. Any sudden drop in share price should also be investigated and reported to risk promptly.

288 Mr Byrne gives evidence that had he been told one or more of the following:

(a) the increase of $20 million was in fact sought to fund DSH's ongoing cash flow difficulties and these difficulties were unlikely to lessen after January 2016;

(b) DSH did not have in place adequate procedures, practices or systems to detect, value or, where necessary, provision for or write-off obsolete or near end-of-life inventory;

(c) there was a real prospect that DSH would shortly need to announce a profit downgrade of $5 to $8 million;

(d) there was a real prospect that DSH would shortly need to announce a write-off of $60 million of inventory.

he would not have granted credit approval, but instead would have required that an independent external reviewer was given access to DSH's records and that he would not have granted credit approval unless the reviewer reported that DSH would be able to trade for a sufficient period to repay the whole of the debt owed to HSBC.

289 The same day, Mr Kowik sent Mr Potts an email saying that the increase in the facility had been approved.

290 On 22 October 2015, Messrs Murray, Abboud and Potts signed a circular resolution authorising the Finance Director and CFO to execute on behalf of DSH any document required to give effect to the $20 million increase.

291 The likelihood is that Mr Potts was the source of the information about the purpose of the temporary increase in the facility. It is plain from the call reports that Mr Kowik spoke to Mr Potts about the increase. It would have been natural for Mr Kowik to ask about the reason for the increase. There is no reason to think that Mr Kowik mis-recorded that reason in the CARM.

Presentation by Messrs Holtzer and Powell

292 On 21 September 2015, Mr Holtzer and Mr Powell made a presentation to Mr Abboud, Mr Potts and Mr Scott (who by then had replaced Mr Orrock as head of buying). The presentation had been prepared following discussions that Mr Holtzer and Mr Powell had had with members of DSH's staff including Mr Orrock and Mr Borg and after Mr Borg had provided Mr Holtzer with a series of reports. Mr Potts had provided comments on an earlier draft of the presentation. In particular, he had made amendments to a page he titled "Executive Summary". One of the bullet points he inserted on that page read

"over reliance on O&A rebates leading to wrong pricing and purchasing decisions".

293 Following the presentation, Mr Holtzer sent Mr Potts an engagement letter setting out the work that it was proposed that he do. The work was divided into a number of phases. The first phase, to be completed within a month, involved the following:

> ▪ Detailed listing and segmentation of stock with current value and estimated disposal value
>
> ▪ Map of purchasing process with identified weaknesses
>
> ▪ Detailed proposal for next steps with defined realistic hurdles and defined areas that need to be fixed

Events in September and October 2015

294 There is some evidence that by this stage, restrictions were placed on DSH's ability to buy stock that it needed because of its deteriorating financial position. In particular, according to Mr Borg, "in early September 2015 Dick Smith did not have the range of stock which was required for its Sydney International Airport store" and "OTB was not available to buy the product required until the next month" (a view not shared by Mr Abboud). Mr Borg also says that he was told by Mr Potts in September or October that OTB would be cut back by $50 million and that "buyers will shortly be issued with instructions to restrict new purchasing activity as much as possible", although there is no evidence of that instruction actually been given. At the same time, DSH was seeking to delay payment of as many creditors as possible. To that end, on 15 October 2015, Mr Borg wrote to Mr Tony Abdel-Ahad asking him to seek payment extensions from a number of private label suppliers. The email relevantly said:

> We have had a Q2 vendor payments meeting with Nick yesterday and the whole business has been requested to secure extended terms and push out as many payments as possible that would have been due for payment prior to 27/12/2016.

Mr Orrock resigns

295 Mr Orrock resigned in October 2015. Following his resignation, Mr Ishak, Ms Raine and Mr Tomlinson began interviewing candidates to fill his position and possible candidates to replace Mr Abboud. On 21 October 2015, immediately after interviewing one of the candidates (Mr Rob Mesaros, who

worked for Hewlett Packard, one of Dick Smith's suppliers), Mr Ishak and Ms Raine were asked to sign a circular resolution approving the increase in the HSBC facility by $20 million. Later that day, Mr Tomlinson sent an email to Mr Murray reporting on events. The email relevantly said (amending the formatting):

> As you know Robert, Lorna and I met two GM Operations candidates this evening. During these interviews we were also asked to sign the circular resolution for the $20m additional working capital facility.
>
> Unfortunately there was no information provided to Robert and Lorna to justify the increase in debt facility, so they were asking questions which I tried to answer.
>
> Second, Robert Maseros [sic] from HP [one of the candidates] gave an honest assessment of what it's like to deal with Dick Smith from a supplier's perspective, and he gave a frank account of recent pleadings to delay payments on purchases. He also talked about a recent industry gathering where Dick Smith was the talk of the meeting, with people openly pointing to balance sheet weakness. This only served to elevate concerns about cash flow and debt amongst directors.
>
> …
>
> So the three of us agreed that I [must] ask you to convene an informal meeting of the board on Monday or Tuesday to discuss the cash/debt position and the AGM external statement, ahead of the Wednesday AGM.

296 Mr Tomlinson replied saying that Mr Abboud should be involved in the meeting. Mr Murray said in response:

> You should update Nick tomorrow and beware of him gilding the lily. We have all heard about the promises to reduce inventory and now we find ourselves approving an emergency debt line, suppliers in full knowledge of our credit squeeze and procurement driven by O&A not buying the right stuff. It's time to face the music.

297 On 25 October 2015, Mr Algy Pereira, another candidate for Mr Orrock's position, sent Ms Raine, Mr Ishak and Mr Tomlinson a presentation ahead of his interview on 26 October 2015. The presentation set out his thoughts on the Dick Smith business after visiting four stores over two weeks. It appears that he made the visits with Mr Murray. The presentation included the following two bullet points:

> Some stores were cluttered. Customers had trouble moving around. Are we buying too much stock?
>
> …
>
> In a number of categories there is a lot of aged stock. OTB controls? My view is that this is a BIG issue across the business. Unproductive stock

298 Mr Murray gives affidavit evidence that one of the stores he visited with Mr Pereira was the Macquarie Centre store. During that visit, Mr Pereira pointed out to Mr Murray that Dick Smith had some inventory which was not electronics, such as Eskies. A staff member told them that they had sold only one or two in the past year, that they had a substantial number of Eskies in stock in store and that the store had not ordered the stock but that it had been allocated by head office.

Dick Smith announces profit downgrade

299 The board met on 26, 27 and 28 October 2015. On 26 October 2015, there was a discussion of cash flow requirements up to Christmas 2015. Mr Abboud advised that trading in October 2015 was likely to be significantly below budget. The minutes record the following:

> The Board requested management confirm the shortfall indicated for October and undertake further analysis as to how the shortfall would be recovered and the implications to monthly profit and cash flow forecasts. Management advised it would take up to 24 hours to advise the results of the scenario analysis.
>
> MP presented on the accounting treatment of O&A. The Board recognised the prevailing treatment has been audited by Deloittes and deemed appropriate. MP indicated alternatives could provide more flexibility for pricing whilst maintaining margin. MP indicated a change in the procedure for O&A accounting could have a timing impact on profitability, which could be $5million to $10million NPAT (depending on timing and extent put to inventory). Management recommended a commencement date of 1 July 2016, if implemented. The Board concurred with the prevailing treatment and that any change should be considered at a future Board meeting.

300 On 27 October 2015, Mr Holtzer and Mr Powell made a presentation to M Potts. The final version of that presentation is not available. However, according to Mr Holtzer it was in substantially the same form as a draft he did retain. According to that presentation, Dick Smith held $120 million of problem inventory and an appropriate impairment liability was $63,877,544.

301 During that meeting, Mr Potts told Mr Holtzer and Mr Powell that their analysis would not be believed and instructed them to get a second opinion from Mr Borg and agreed to provide further data at the end of the month.

302 The board also met again on 27 October 2015. The minutes of that meeting relevantly record:

> NA and MP advised the Board that the October month trading shortfall to budget was approximately $5 million NPAT. NA and MP presented the Board with the outcomes of management's scenario analysis that indicated a revised FY2016 NPAT range of $33million to $45million, with a most likely range of $37million to $43million. MP indicated these ranges did not include any clearance of over-stocked inventory, nor the impact of any adjustment to O&A accounting treatment.
>
> …
>
> The Board agreed to meet at 7:30am on Wednesday 28 October 2015 to approve the revised forecasts and the Trading Update for lodgement with the ASX.

303 A further board meeting was held at 7.30 am on 28 October 2015. At that meeting, Mr Abboud and Mr Potts presented revised financial forecasts for FY16 which were $5 million to $8 million NPAT below previous guidance of $45 million to $48 million NPAT. Mr Abboud and Mr Potts also told the board that "the drivers of the result including lower sales and adverse gross margin" and that "November had commenced trading consistent with October, with a commensurate concern regarding Christmas trading".

304 The minutes also record that:

> MP reiterated these revised forecasts did not incorporate any impact should clearance of approximately $56 million of over-stock inventory be cleared on an accelerated basis nor any impact of potential O&A accounting treatment transition.

305 At that meeting, the board resolved that a detailed inventory analysis be presented at the November 2015 meeting. The board also approved the issue of a trading update which indicated that NPAT could be $5 million to $8 million below previous guidance of $45 million and $48 million.

306 Mr Abboud and Mr Potts suggest in their submissions that the poor trading performance in October 2015 and the forecast poor performance for the rest of the year was largely due to a decline in sales, particularly in the Office group, which made up 42 percent of Dick Smith's sales in FY15. Mr Abboud attributed the decline largely to the launch of Windows 10 by Microsoft, which adversely impacted computer sales globally and a drop in foot traffic. He gave this evidence:

> Had we known that the Windows 10 - and we read about this a little bit later - that Intel put off 12,000 people because of the delay in Windows 10 and Microsoft - it's well read what took place in the office category in this period. So

> this was probably the most critical part that impacted the business into November.
>
> So Mr Potts's role from there was to say, okay, well, gee, it's now 14 per cent down, I need to think about December. Will December be 20 per cent down or 14 per cent down?
>
> We'd just gone from plus 6, within 30 days. The next month was minus 14. Obviously we weren't to know until later, but definitely in November you could see the office category down, I think it was, like, 30 or 40 per cent, Mr Giles. So it wasn't in other categories.
>
> The other key indicator in November was foot traffic was down double digit. So this is not about a customer coming in and there wasn't stock to buy; they actually didn't come in. It's a fairly important report. They didn't come in because we are an office business, 50 per cent of our business is office, and Windows got pushed out and then we had this absolute - it was probably the worst month in the period I'd been with Dick Smith, and we could only assume that this was going to occur in the month of December. …

307 Mr Abboud's evidence is consistent with a press release issued by International Data Corporation, a market intelligence firm, which attributed the slowdown in demand to, among other things, the launch of Windows 10 which included "a free upgrade program which delay new system purchases in 2015".

308 Mr Abboud's evidence is also supported to some extent by an analysis undertaken by Mr Abboud and Mr Potts's legal representatives which compared sales in the months of January to November 2015 against sales in the comparable months of 2014. The analysis is Annexure 3 to this judgment. It shows that generally product in the Office group performed more poorly in (calendar) 2015 compared to 2014, whereas stock in other groups did better or not as badly. The analysis also suggests that the decline in sales started in March 2015 and became worse in the period June to November 2015. However, the analysis must be treated with some caution. As the plaintiffs point out, there were also declining sales in some categories of stock not included in the Office group; and sales in the Office group began to decline seriously in June 2015.

HSBC enters into Extension Agreement

309 On 28 October 2015, Mr Kowik sent Mr Byrne a CARM in relation to the profit downgrade announced by DSH that day. Mr Byrne asked Mr Kowik to obtain additional information from DSH and report back no later than 15 November 2015. Mr Byrne said in cross-examination that he regarded the profit

downgrade "was quite a cause for alarm". However, he said that by that stage he believed that HSBC was committed to providing the increase in the facility.

310 On 16 November 2015, HSBC entered into the Extension Agreement by which it agreed to increase the total commitment provided by HSBC pursuant to the overdraft finance facility from $60 million to $80 million. The money was advanced that day.

Analysis of Mr Holtzer and Mr Powell

311 Following instructions given to them by Mr Potts, Mr Holtzer and Mr Powell did further work on the inventory with Mr Borg. As a result of that work, different analyses were produced.

312 The starting point for each analysis was the division of stock into six categories:

- Obsolete;
- Aged (over four months) end of life;
- Recent (four months or less) end of life;
- Active no sales (in October);
- Active extreme excess (above one year's cover); and
- Good inventory with less than one year's cover.

313 Stock falling within the first five categories was classified as problem stock.

314 Mr Borg performed separate calculations for Australia and New Zealand. In each case he divided the problem stock into stock aged two months or less and stock aged three months or more. He then calculated a provision based on:

- The existing margins and rebates structure of each category as an average;
- The level of discounting needed over a clearance cycle in which the price was progressively reduced in four stages;
- An assumption that 95 percent of the product in that category would be sold during the clearance process; and
- A 100 percent write-down on the unsold portion.

315 Using that methodology, Mr Borg calculated an impairment of $19.8 million in the value of problem inventory of $189 million.

316 Mr Holtzer used the same methodology but adopted his own assumptions concerning the level of discounting required to sell the stock. In the case of stock aged two months or less, his assumptions concerning the four levels of discount and the levels of sale at those discounts were as follows:

1st Discount Range	2nd Discount Range	3rd Discount Range	4th Discount Range
20-25%	30-50%	40-75%	50-90%
1st Sell Through %	**2nd Sell Through %**	**3rd Sell Through %**	**4th Sell Through %**
20-35%	20-30%	20-35%	5-30%

317 In the case of stock aged three months or more, the corresponding figures were:

1st Discount Range	2nd Discount Range	3rd Discount Range	4th Discount Range
15-25%	25-50%	50-75%	75-90%
1st Sell Through %	**2nd Sell Through %**	**3rd Sell Through %**	**4th Sell Through %**
10-35%	20-35%	10-40%	5-65%

318 In addition, unlike Mr Borg's model, Mr Holtzer's model did not give credit for profits earned on discounted stock in calculating the impairment value.

319 Applying these assumptions, Mr Holtzer calculated an impairment of $58 million.

320 Mr Powell used a different methodology based on the approach he had used for the purpose of preparing the report to Mr Potts in October 2015, which

involved making assumptions about the percentage markdown and expected sales for each category of problem stock. Using that approach, he calculated an impairment of $65.8 million.

321 Mr Abboud and Mr Potts, in particular, were critical in their submissions of the conclusions reached by Mr Holtzer and Mr Powell. They submitted that they had a conflict of interest because Messrs Holtzer and Powell were pitching to have DSH retain SPI to put in place a program for disposing of excess and obsolete stock. As part of that pitch, it was in their interests to establish that DSH had a problem which required their services to solve. In addition, Mr Abboud and Potts point out that Mr Borg had expressed the view that Messrs Holtzer and Powell were incompetent.

322 Messrs Holtzer and Powell were no doubt keen to get additional work from DSH. However, I am not prepared to conclude that that keenness affected their opinions concerning DSH's inventory, particularly in circumstances where none of the defendants chose to cross-examine them. In any event, nothing turns on the issue. Messrs Holtzer and Powell were not called as expert witnesses, and their evidence was only admitted as evidence of their subjective understanding or belief, and not as evidence as to the truth of any fact or opinion asserted. Their evidence helps to explain the circumstances in which the board took the decisions it did. It is not evidence that the impairments they identified were correct.

Board resolves to take a $60 million impairment on stock

323 A board meeting was held on 24 November 2015. At that meeting, the board requested an updated inventory analysis highlighting excess inventory and plans to reduce it.

324 A board meeting was held on 27 November 2015. Prior to that board meeting, Mr Potts gave Mr Abboud two documents. One provided a summary of how the impairment was calculated based on the work that had been done by Mr Holtzer and Mr Powell. The other described a way forward. Both documents were given to the board. The summary provided two calculations, one taking account of scan rebates and the other not. Taking account of scan rebates, the

provision was estimated to be $58 million. Not taking account of scan rebates, the provision was estimated to be $66 million. The note stated:

> From the data that we received at the beginning of November (October data) we have concluded that the provision needed is around $60M. This is the “negative margin” on stock that will be sold at below cost or written off completely. This does not include the lost margin on stock sold at above cost, cannibalisation of full price stock (estimated to be between $10M - $20M), any stock currently sitting in China, changes in O+A treatment ($15M) or any stock sitting in repair (estimated at $9M).

325 Mr Abboud did not agree with the summary, but thought it was necessary to give it to the board.

326 At the meeting on 27 November 2015, the board requested a further analysis of inventory, cash flow and debt implications and asked that a solicitor from Minter Ellison attend the discussions. That meeting was arranged for Sunday, 29 November 2015. At that meeting, the board resolved to take a $60 million non-cash impairment. That impairment was announced to the market at the opening of the ASX on 30 November 2015.

327 Mr Murray gave the following explanation of the board’s decision:

> Q. The decision to take the conservative option was done on legal advice, wasn't it?
>
> A. It was one element of it. It wasn't a legalistic construct; it was more, as I said before, a construct that said, "Let's make sure we go to the market with this issue once and purge ourselves of this issue and don't have to go back again." We had already, if you remember in context, backed off the initial guidance, which had been given to the market, and we had only done that about a month before, and here we were again and I was concerned about how that pattern would look to our investors.
>
> Q. As you have pointed out in your evidence, you were in a very difficult position?
>
> A. Mmm
>
> Q. You have to answer with a word, I think. You agree with me?
>
> A. I'm sorry, I felt it was a difficult position, yes.
>
> Q. On reflection, inadequately briefed by management on that occasion, do you agree?
>
> A. Certainly briefed too late, and if you took the information I think we shared at that meeting at face value, we were briefed there, we had a choice, but it's not the way I would have briefed my board if I had been the CEO of the business.

328 Mr Tomlinson gave evidence to similar effect. He thought that the board had been placed in an impossible position. It was his view that the board had to make an announcement the following day to comply with its continuous disclosure obligations; that it ought to be conservative but that it did not have the final report of the consultants or an adequate time to consider the information that it had been given.

Events following announcement of impairment

329 Following the announcement to the ASX, Mr Potts spoke to representatives of NAB and HSBC about the announcement. During the calls, he requested an extension of the $20 million temporary overdraft facility until 1 April 2016. On 1 December 2015, Mr Potts sent Mr Kowik and Mr Cohen revised monthly profit and loss, balance sheet and cash flow projections.

330 The board met again on 7 December 2015. The minutes of that meeting relevantly record:

> MP advised the Board that discussions with the banks continue and that the forecasts provided to HSBC and NAB (the banking syndicate) incorporated an EBITDA reduction of $30 million, reflecting lower Over and Above rebates from lower forecasts purchases and the estimated impact of Clearance activity cannibalisation. MP indicated there remained some capacity within the banking facility, based on prevailing cash flows and management was accessing options to increase the available capacity.
>
> MP advised the Board that management had requested the $60 million inventory provision be treated as an exclusion to the financial ratio covenants calculation under paragraph (e) of the definition of EBITDA in the Banking Facility Agreement of the facility agreement and that management was seeking, and expected to obtain, a waiver on the anticipated technical breach of the requirement to reduce net debt to below $50 million for five business days in a six month period. The Board concurred with management's position.
>
> MP informed the Board that management were meeting NAB on 8 December 2015 and HSBC on 9 December 2015 to communicate the Company's position and expected a response within two weeks.
>
> The Board requested management formally request an extension through February of the $20 million temporary facility, recognising that MP indicated that informal discussions with the banking syndicate indicated it was unlikely at this stage.

331 There were then further negotiations between the Banks and DSH leading to an agreement by the Banks to extend the overdraft facility on a number of conditions. That agreement was embodied in a letter agreement signed by the parties on 23 December 2015. Under the terms of the letter agreement, NAB,

as agent under the facility agreement, agreed to waive non-compliance with certain terms of the Syndicated Facility on certain conditions and agreed to an extension of the increased overdraft facility of $20 million (which was due to reduce on 15 January 2016) to 16 February 2016. One of the conditions was that:

> the Principal Borrower promises that no Draws under the Overdraft Facility will be used, whether direct or indirectly, to repay or reduce Finance Debt permitted under paragraph (m) of the definition of Permitted Finance Debt, including but not limited to the unsecured lines of credit provided by Macquarie Bank".

332 Mr Abboud did not believe that the varied arrangements prevented DSH from using funds to repay Macquarie prior to the commencement of the extended facility period (a view shared by Mr Murray) and on 24 December 2015, DSH drew down the HSBC overdraft facility to pay $9.961 million to Macquarie. On 30 December 2015, it drew down a further $1.195 million to pay Macquarie.

333 On 31 December 2015, NAB wrote to DSH notifying that it had breached the terms of the Syndicated Facility by making the payments to Macquarie and requiring the breach to be remedied within 10 business days.

334 Unable to remedy the alleged breach or reach agreement with the Banks to waive it or to accept DSH's interpretation of the condition in question, on 4 January 2016, the board resolved to put DSH and its subsidiaries into voluntary administration. Following that resolution, the Banks appointed the receivers.

The receivership

335 The receivers elected to continue to trade with a view to selling the business in mid-March. However, in their report dated 14 January 2016, they observed that:

> ■ It is clearly apparent that the business is in a **very distressed state** impacted by:
>
> > □ The aggressive stock clearance in December 2015 which significantly reduced stock flow volumes in the business (c. $90-$120m);
> >
> > □ A reduction in stock flow by suppliers pre receivership where credit terms were reduced or switched off entirely (e.g. Apple);
> >
> > □ Normal disruption to supply arrangements consequent upon the receivership; and

- Adverse media impacted by gift vouchers.

- As a result of the above the business is suffering from significant 'out of stocks' primarily in best seller categories. This is leading to **very large declines** in sales (e.g. i 50%) and foot traffic which means that at **current levels of trading the business is unsustainable and will incur significant trading losses**.

336 The sales process was unsuccessful and on 24 February 2016 the receivers decided to close the business. For that purpose, they appointed Hilco Merchant Australia Pty Ltd to close the stores and sell the remaining stock. In their report dated 5 May 2016, the receivers observed that all 62 New Zealand stores were vacated by 30 April 2016 and that the remaining 21 stores in Australia were due to be vacated by 5 May 2016. The report also indicated that the Hillco had sold $137.0 million in stock in Australia and NZD22.4 million in New Zealand and that the current book value of the inventory in Australia was $18.7 million and in New Zealand NZD3.0 million. In relation to that, the report stated that:

- With respect to the remaining book value of inventory on hand, approx.. $8m is faulty inventory being held by TIC, $1.2m relates to accessories which are in the process of being sold for $348k and the remaining amounts represent shrinkage.

The report estimated that there would be a deficit in the return to the Banks of between $73.23 million and $101.03 million.

337 The most recent report of the receivers in evidence is Update No 25 dated 7 November 2018. The report estimated that there would be a deficit of between $72.70 million and $75.52 million in the return to the Banks. It is apparent from earlier reports the receivers have funded a number of preference claims brought by the liquidator, including preference claim against Macquarie, which settled for $6.5 million.

The "bad stock" case

Introduction

338 It is convenient to begin with the claim that the directors breached their duties as directors by failing to cause DSH to implement any adequate procedures, practices or systems to manage the obvious risks created by the alleged adoption of a scheme to maximise rebates, particularly O&A rebates.

339 The Third Amended Commercial List Statement in the Company Proceeding (***C3ACLS***) pleads that the directors breached both their duties under s 180 of

the Corporations Act and their duties at common law by adopting the scheme without putting into place adequate procedures etc to manage the risks said to be associated with such a scheme.

340 Section 180 of the Corporations Act provides:

> Care and diligence—directors and other officers
>
> (1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
>
> > (a) were a director or officer of a corporation in the corporation's circumstances; and
> >
> > (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.
>
> Business judgment rule
>
> (2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
>
> > (a) make the judgment in good faith for a proper purpose; and
> >
> > (b) do not have a material personal interest in the subject matter of the judgment; and
> >
> > (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
> >
> > (d) rationally believe that the judgment is in the best interests of the corporation.
>
> The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.
>
> (3) In this section:
>
> > ***"business judgment"*** means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

341 It is not alleged that the common law relevantly imposes a broader duty on the directors of DSH than s 180. Moreover, s 180(2) makes it clear that the business judgment defence provided by that section is available in respect of an alleged breach of a duty owed at common law. Consequently, the case based on the common law adds nothing to the case based on s 180.

342 It is common ground that, in answering the question whether a director or officer has complied with the obligations imposed by s 180, the Court must

apply a standard of care and diligence that a reasonable person would exercise, taking into account the corporation's circumstances, the offices occupied by the defendants and their responsibilities within the corporation: *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1 at [7242].

343 The claim has a number of steps or components:

(a) First, it is said that from at least May 2014, DSH implemented a policy across the Dick Smith group of maximising the vendor rebates obtained from its suppliers, including O&A rebates (defined in the C3ACLS as "the Rebate Maximisation Policy");

(b) Second, it is alleged that the Rebate Maximisation Policy led to buyers (1) "engaging in buying practices which focused on and prioritised maximising rebates, at the expense of focusing on current or likely future customer demand and whether the inventory purchased would be saleable for an appropriate margin within an appropriate timeframe", and (2) entering into or extending contracts "based on whether rebates would be maximised, at the expense of focusing on whether entering into or extending the contracts was in the best interests of DSH or the DSE Group" (defined in para 34 of the C3ACLS as the "Rebate Driven Buying Practices");

(c) Third, it is alleged that the Rebate Driven Buying Practices resulted in Dick Smith, from at least May 2014, acquiring stock that "was unsaleable at all or for an appropriate margin within an appropriate timeframe because there was no or inadequate customer demand" (defined in the C3ACLS para A5 as "Bad Stock");

(d) Fourth, it is alleged that DSH did not have in place or implement any adequate procedures, practices or systems "to detect, value or (where necessary) provision for or write-off (in whole or in part) obsolete or near end-of-life inventory, or perform stock takes" (C3ACLS para C41);

(e) Fifth, it is alleged that the directors breached their duties by implementing and maintaining the Rebate Maximisation Policy without appropriate systems to prevent the consequences referred to in (c);

(f) Sixth, relying on an expert report obtained from Ms Holly Etlin, the plaintiffs seek to identify Bad Stock which would not have been acquired if appropriate procedures had been put in place;

(g) Seventh, relying on a report prepared by Ms Christine Oliver, a partner of the receivers, the plaintiffs seek to calculate the difference between DSH's financial position as a consequence of buying the stock identified by Ms Etlin as Bad Stock and its financial position in the counter-factual world in which it did not acquire that stock.

344 In their pleaded case and in their final written submissions, the plaintiffs also sought to advance a case that (1) the practice of increasing the price of private label stock and seeking rebates equivalent to the increase from the private label suppliers (described as the "Rebate Uplift Practice") and (2) the way in which O&A rebates (including O&A rebates "paid" by private label suppliers) were accounted for (described as the "Rebate Accounting Approach") did not comply with the law (in particular, AASB 102), which is said to have created skewed incentives to buy more stock and to buy stock from suppliers who were willing to pay O&A rebates. However, in final oral submissions Mr Giles SC, who appeared for the plaintiffs, rightly abandoned the claim that the Rebate Accounting Approach did not comply with the law. That claim could not be maintained in the light of Deloitte's successful application on the 54th day of the trial to strikeout allegations in the C3ACLS to the effect that the HY15 financial report and FY15 accounts were materially misstated because they accounted for rebates in accordance with the Rebate Accounting Approach. Those claims were struck out following the rejection of expert evidence filed by the plaintiffs in support of those allegations. However, the abandonment of that claim did not alter the nature of the plaintiffs' case. The Rebate Accounting Approach and the way it was dealt with was still said to be relevant to what steps the directors should have taken when faced with the Rebate Maximisation Policy. And the plaintiffs' case remains that, for whatever reason, DSH sought to maximise O&A rebates and its policy of seeking to do so created skewed incentives in relation to the stock that it bought.

Some preliminary points

345 Before addressing the claim directly, there are a number of points to be made about it.

346 First, an important issue in relation to the claim is what precisely the Rebate Maximisation Policy is alleged to be – that is, what precisely is meant by the allegation that DSH adopted a policy of "maximising" rebates. That is obviously relevant to the question whether DSH adopted the policy. But it is also relevant to the question whether the directors knew or ought to have appreciated that

DSH had adopted the policy and the consequences or likely consequences of the policy and the steps that ought to have been taken to eliminate or mitigate its adverse effects, whatever they were.

347 Although the policy is described in the C3FACLS as one involving the maximisation of rebates, the focus of the case was on O&A rebates. It seems clear that DSH had a policy of seeking to obtain the greatest level of O&A rebates it reasonably could. Initially, at least, it appears that that policy was driven by the value of the rebates themselves, but from early 2014 it also appears to have been driven by what was thought to be the favourable accounting treatment attaching to them and, in particular, when they could be brought to account as a contribution to profit. However, the question remains whether the policy itself is said to be one that focused on the collection of O&A rebates to the exclusion of all other considerations or only some and, if only some, to what extent.

348 In Deloitte's report to the meeting of the FAC held on 12 August 2014, Deloitte refer to the fact that "Management have undertaken a program of maximising the vendor rebates obtained, either through price protection, advertising subsidies or over & above rebates"; and it is possible that that is the genesis of the allegation in the C3ACLS. But that only begs the question of what Deloitte meant, and what Deloitte might reasonably have been understood to mean, by their reference to "a program of maximising the vendor rebates obtained …". Whatever precisely Deloitte meant, there was no suggestion in their report that the program undertaken by DSH was an unorthodox one for a retailer to undertake. And the fact that Deloitte chose to use an imprecise expression to describe some program undertaken by management is of little assistance in giving content to the allegation in the C3ACLS.

349 It is pleaded that the Rebate Maximisation Policy led to the Rebate Driven Buying Practices. One way of giving some precision to the Rebate Maximisation Policy is to say that it was a policy in relation to O&A rebates that had or was likely to have that consequence. That appears to be the most satisfactory way of interpreting the plaintiffs' claim. It means that the alleged consequences become an integral part of the practice complained about. What

is alleged is that DSH implemented a policy of placing such an emphasis on the collection of O&A rebates that it was likely that buyers would seek, and in fact did seek, to acquire those rebates at the expense of focusing on current or likely future customer demand and whether the inventory purchased would be saleable for an appropriate margin within an appropriate timeframe.

350 Second, in the C3ACLS, "Bad Stock" is defined in the terms set out in para [343_Ref65051882] above. That definition has two elements. First, the stock must be (1) unsaleable at all or (2) unsaleable for an appropriate margin within an appropriate timeframe. Second, that state of affairs must be because there was no or inadequate customer demand. The second limb of the first element itself has two components – namely, the stock must be unsaleable (1) for an appropriate margin and (2) within an appropriate timeframe. That is, to avoid being Bad Stock, the stock must both be saleable for an appropriate margin and saleable within an appropriate timeframe.

351 The definition of "Bad Stock" is supplemented by the Consolidated Particulars which state that "Bad Stock" is distinguished from other stock "by reference to whether the stock was (a) purchased from a vendor who supplied O&A; and (b) saleable at all or for an appropriate margin within an appropriate time frame because there was no or inadequate customer demand" (para 35). The Consolidated Particulars also state that "Any stock that had greater than 16 weeks cover is considered stock which was not able to be sold within an appropriate timeframe" (para 37) and "Any stock which was sold below the cost at which DSH carried that stock was not able to be sold for an appropriate margin" (para 38).

352 No attempt was made to identify stock that was sold within 16 weeks after it was acquired for less than the cost at which DSH carried the stock. Consequently, that limb of the definition of "Bad Stock" appears to be otiose. Moreover, there was no suggestion that stock was not sold or not sold at an appropriate margin within an appropriate timeframe for reasons other than an absence of customer demand. Consequently, that limb of the definition also appears to be otiose. What seems to be alleged is that the Rebate

Maximisation Policy lead to a situation where DSH acquired stock that could not be sold at all or could not be sold within 16 weeks after it was acquired.

353 Third, in submissions, particularly oral submissions, the plaintiffs sought to recast the alleged consequences of the Rebate Maximisation Policy somewhat. As recast, the allegation was that the Rebate Maximisation Policy (understood as an emphasis or over-emphasis on the collection of O&A rebates) created an incentive to buy more stock than was needed and stock from suppliers who were prepared to provide O&A rebates (and not from those who were not), with the consequence that DSH acquired an excessive amount of stock, some at least of which could not be sold at an appropriate margin within an appropriate timeframe (that is, 16 weeks). The defendants objected to this reformulation of the case. They contended that it was outside the pleaded case and that they would be prejudiced if the plaintiffs were entitled to run it now, not least because they cross-examined the plaintiffs' witnesses on the pleaded case, not the reformulated one. As pleaded, they contended that an essential element of the plaintiffs' case was that buyers were prioritising the obtaining of O&A rebates over customer demand and without attention to whether the stock could be sold profitably (at any time). The plaintiffs' witnesses were cross-examined on that basis and it might be thought that the defendants obtained significant concessions from them, as explained earlier (see [122_Ref65227966]ff).

354 In my opinion, the reformulated case does not go beyond the pleading. It is true that "Rebate Driven Buying Practices" is defined in a way that suggests that an essential element of the practices is that buyers focused on O&A rebates at the expense of focusing on *current or likely future customer demand* and whether the inventory purchased would be saleable for an appropriate margin within an appropriate timeframe. That is, the absence of a focus on current or likely future customer demand appears to be an essential feature of the practice, and no timeframe is specified over which the absence of current or likely future customer demand is to be measured. However, the case as pleaded is that the Rebate Maximisation Policy led to the Rebate Driven Buying Practices which in turn led to the acquisition of Bad Stock. As I have explained, "Bad Stock" includes stock that could be sold for an appropriate margin but only outside 16

weeks. Consequently, on the plaintiffs' case, the Rebate Driven Buying Practices include as one of their undesirable consequences the acquisition of stock meeting that description. If that is right, the reference to the absence of a focus on current or likely future customer demand must be interpreted to extend to a case where the absence of focus includes an absence of focus on current and likely future demand in that sense – that is, demand for the stock in the 16 weeks after it was acquired. Unless the absence of customer demand is interpreted in that way, there is a disconnect between the undesirable practices (the Rebate Driven Buying Practices) and the result (the acquisition of Bad Stock), since the practices require the absence of focus on customer demand at any time whereas the result can include stock for which there is customer demand but not sufficient demand for all the stock to be sold within 16 weeks of its acquisition. The C3ACLS should not be read in that way.

355 Fourth, a critical plank in the plaintiffs' case is the contention that any stock is "Bad Stock" if it was acquired from a supplier who provided O&A rebates and DSH held more than 16 weeks cover in respect of that stock. The choice of 16 weeks depends largely on evidence given by Ms Etlin. Ms Etlin has worked as a partner or principal with Deloitte, XRoads Solutions Group and AlixPartners providing turnaround services to companies in the retail, distribution, consumer products, financial services and media industries. Her experience includes working as interim CFO for RadioShack, a United States electronics retailer with USD5 billion in revenue and over 4,500 stores, during 2013 and 2014 and as chief restructuring officer and CEO of Borders, a United States specialty books retailer.

356 Ms Etlin gives evidence that 10 weeks cover for electronics retailers, such as DSH, is best practice in inventory management. She accepts that it would not be uncommon for an electronics retailer to have certain SKUs with more than 10 weeks cover from time to time, although she says in that case that would be for specific operational reasons, such as in cases where there are lag times in delivery or price advantages in placing a larger order for stock. However, according to her "greater than 16 weeks implies that there is excess inventory for those SKUs and a higher risk that some proportion of the inventory on hand will become obsolete and/or require extensive markdowns to be sold".

357 Ms Etlin's evidence is supported to some extent by the policies actually adopted by DSH. As I have explained, it appears that DSH originally aimed to achieve a level of stock that equated to approximately 10 weeks cover. However, in mid-2014, Mr Abboud and Mr Wavish agreed the level of stock should increase from $200 million to $250 million. That represented approximately 13 to 14 weeks cover. That level of stock was accepted by the board. There is no evidence that there was a further change in policy on the quantity of stock DSH should hold. The figure is also consistent with other evidence, which suggests that some retailers, such as JB Hi-Fi, operated on substantially fewer than 16 weeks cover of stock.

358 There is, however, an important difference between the evidence of Ms Etlin and the actual policy adopted by DSH. According to Ms Etlin, it would be bad inventory management for an electronics retailer to acquire more than 16 weeks cover in respect of any SKU. On the other hand, the actual practice adopted by DSH related to inventory as a whole. There is no evidence that DSH adopted a practice or benchmark that required DSH to hold no more than 16 weeks cover in respect of each SKU.

359 Relying on the evidence of Ms Etlin, the plaintiffs submit that 16 weeks cover is a conservative and reasonable measure of whether DSH has excessive stock generally or of particular SKUs. In final submissions, the plaintiffs accepted that "there are certain limited circumstances that could lead an electronics retailer to build inventory levels to slightly above 16 weeks cover, such as ahead of the Christmas shopping season". However, in their submission, that was not enough to undermine the appropriateness of defining "Bad Stock" by reference to 16 weeks cover both for the purpose of identifying whether the directors had breached their duties and for the purpose of calculating damages.

360 Fifth, an essential element in the plaintiffs' case is that the directors should have put into place appropriate systems which would have had the consequence of preventing or minimising the acquisition of Bad Stock. Those systems are described in the C3ACLS as:

> (i) Adequate internal controls … to prevent or minimise the purchase of inventory which was not likely to be saleable for an appropriate margin within an appropriate timeframe;

(ii) [receipt by the directors of] regular and comprehensive reporting of inventory;

(iii) regular and comprehensive stocktakes;

(iv) [the prompt writing off of] inventory which was obsolete or near end-of-life … in DSH's accounts …

361 So far as the NEDs are concerned, that list was replaced by particulars listing a catalogue of things it is said the NEDs should have done. In final submissions, the plaintiffs relied on a subset of those things, which it is said (all) the directors should have done. Those things are:

(a) If O&A rebates were to be prioritised, ensuring that systems were in place to ensure that reports were made to the board on the type and quantity of O&A rebates obtained by the Company;

(b) Putting in place systems to prevent buyers from purchasing excess inventory;

(c) Ensuring that systems were put in place so that if a buyer wanted to make promotional or opportunistic purchases in excess of their OTB then a business case was prepared and reports were submitted to the board of the circumstances and why this occurred and follow-on reports to monitor the effectiveness of such purchases;

(d) Ensuring that a compliance team independent of the buyers was assigned to review and check the purchasing practices of buyers;

(e) Ensuring that DSH had an internal audit function which reviewed how rebates were accounted for;

(f) Putting in place systems to obtain data and reports from key members of the buying team in order to understand the strategy, rationale and methodology sitting behind inventory purchasing decisions and how O&A rebates were being achieved and recorded;

(g) Ensuring that systems were put in place to communicate to all buyers the expectation of the board that inventory should not be purchased to obtain O&A rebates unless there was a realistic business case for purchasing the inventory, DSH did not already hold more than 8 to 10 weeks cover and a realistic expectation existed that the inventory to be purchased would be sold for an appropriate margin within an appropriate timeframe;

(h) Depending on the effectiveness of the systems that had been put in place, considering and possibly implementing systems to review inventory purchases taking place in the period before balance dates;

(i) Obtaining reports which identified and provided an explanation from any significant divergence from budget and reports on the performance of individual buyers;

(j) Ensuring that systems were put in place to ensure that the inventory was regularly reviewed for obsolescence by reference to the number of weeks covered held and the health and age of the stock;

(k) Ensuring that systems were in place to identify aged or obsolete stock and for reports on this process to be given to the board or to a subcommittee of the board.

All of the parties made submissions on the basis of this list.

362 Sixth, it is helpful to say something more at the outset about the way in which the plaintiffs put their damages claim.

363 As I have said, the damages claim has two components. The first is Ms Etlin's analysis which identifies Bad Stock. The second is Ms Oliver's analysis of the loss said to arise from the Bad Stock identified by Ms Etlin.

364 The starting point of Ms Etlin's analysis is the view she expressed that greater than 16 weeks cover implies that there is excess inventory. Consistently with that opinion, Ms Etlin was provided with purchase and sales data for 3938 SKUs in Australia and 2129 SKUs in New Zealand which:

(1) Were acquired from a vendor that provided O&A rebates to DSH;

(2) Had greater than 16 weeks cover as at 29 September 2015; and

(3) Had at least one purchase between 1 May 2014 and 27 December 2015.

365 Using that information, Ms Etlin calculated for the end of each financial month during the period 1 May 2014 to 27 December 2015 the weeks covered for each such SKU. In each case, the calculation was performed by reference to data for the previous 3, 6, 9 and 12 months in order to make allowance for variables such as whether the SKU was a new product and the effects of seasonal demand. That involved taking the stock on hand at the end of the relevant month, dividing it by the average stock sold each week in the preceding 3, 6, 9 and 12 months. Ms Etlin's analysis then examined each purchase of the relevant SKU. If the SKU was purchased at a time when calculations of weeks covered for the immediately preceding month exceeded 16 weeks on all four bases, the purchase was one that in her opinion did not

accord with appropriate inventory practices. She refers to those purchases as "Excess Inventory Purchases". The plaintiffs submit that it is to be inferred that the excess inventory purchases would not have occurred if appropriate procedures, practices and systems had been in place to manage the risks associated with the scheme to maximise rebates. Applying that methodology, Ms Etlin concludes that the total amount of excess inventory purchases made by DSH in Australia and New Zealand between 1 May 2014 and 27 December 2015 was $158,392,152.

366 To introduce an additional degree of conservatism, Ms Etlin makes two adjustments to her initial conclusions. One adjustment was designed to allow time for the weeks cover calculation to settle after a new product launch. As Ms Etlin points out, at the time of the new product launch inventory is likely to be high at the end of the month in which the product is launched with very few if any sales in the prior month, with the result that the weeks cover calculation will be artificially high. In order to deal with that issue, Ms Etlin excludes excess inventory purchases for any given SKU made in the first two months of sale of that SKU. That had the effect of reducing excess inventory purchases by $39.8 million.

367 The second adjustment was to allow for cases where the weeks covered for a particular SKU fell below 16 weeks during the course of a month, but were greater than 16 weeks at the beginning of the month. Ms Etlin only had data for the end of each financial month. Consequently, to cater for cases where purchases were made later in the month after stock had fallen below 16 weeks' cover, her analysis excluded as cases of excess inventory purchases all cases where the weeks covered was less than 16 at the end of the month in which the purchase occurred, even if there were more than 16 weeks' cover at the beginning of the month. That resulted in a further reduction of $7,150,098 in the value of excess inventory purchases.

368 As an alternative to those two adjustments, Ms Etlin adopts what she describes as a "highly conservative measure" of excess purchases by calculating the value of excess inventory purchases using a threshold of 26 weeks cover rather than 16 weeks cover (or 16 weeks cover with adjustments). On that

basis, she concludes that the total value of excess inventory purchases was $113,358,091.

369 Ms Oliver's calculation of the loss arising from the alleged breach takes as a starting point the purchases identified by Ms Etlin as excess inventory purchases using each of the three criteria identified by Ms Etlin – that is, more than 16 weeks cover (scenario 1), more than 16 weeks cover with adjustments (scenario 2) and more than 26 weeks cover (scenario 3) to arrive at three different conclusions of the loss said to have been suffered by DSH.

370 In each case, in order to calculate the loss, Ms Oliver creates a running account of purchases and sales for each SKU where Ms Etlin has identified one or more excess inventory purchases. The purchases are divided into two columns or "buckets". One column contains purchases (expressed in numbers of units) classified by Ms Etlin as excess inventory purchases. The other column contains other purchases (that is, those purchases that it is said would have been made if Dick Smith had complied with proper buying practices). It will be convenient to refer to stock falling into this second category as "good stock". The sales which occurred during each month are assumed to reduce inventory in the good stock column until the running total of the inventory in that column is reduced to zero. Any further sales are then assumed to reduce inventory allocated to the excess inventory column until the good stock column is replenished by a purchase that is not classified by Ms Etlin as an excess inventory purchase. The running list continues – deducting sales from the good stock column where that is possible and from the excess inventory column where it is not – until sales stop after the receivership. At that point, the value of any remaining stock is written off. Ms Oliver explains that the combined list represents the actual world. It records all purchases and sales of the relevant SKU. The column showing purchases of good stock and reduction in that stock arising from sales records what would have happened in the counter-factual world.

371 In order to calculate the loss arising from excess inventory purchases, Ms Oliver takes the cost of the excess inventory and deducts the revenue earned from any sales attributed to the excess inventory purchases (because good

stock has been exhausted at the time of those sales). The resulting figures for each SKU are totalled to arrive at a loss. Adopting that approach, Ms Oliver's conclusions can be summarised in the following table (which makes corrections to her original figures for duplicate sales data):

Table 1: Alternative Loss Methodology calculations

	Australia $'000	**New Zealand $'000**	**Total $'000**
Scenario 1	(24.573)	(2.899)	(27.472)
Scenario 2	(18.004)	(2.057)	(20.061)
Scenario 3	(21.922)	(2.402)	(24.324)

372 One feature of Ms Oliver's approach is that she takes no account of the profit earned on the sale of non-excess inventory stock. A second feature is that she makes no attempt to analyse what profit Dick Smith would have made if instead of purchasing Bad Stock, Dick Smith purchased other stock from which it would have made a profit. To that extent, the calculation is said to be conservative. A third feature is that the approach does not give any credit for O&A rebates, ad sub and scan rebates obtained by Dick Smith.

373 In her original report, Ms Oliver adopted as her primary method of calculating the loss a different methodology which involved identifying all sales that recorded a loss at second margin level during the period May 2014 to June 2016. That method was abandoned by the plaintiffs and nothing more needs to be said about it. But it explains why the method now relied on by the plaintiffs is described as an "Alternative Loss Methodology".

Did DSH engage in the conduct complained of?

374 This question raises three issues. One is whether DSH engaged in the Rebate Maximisation Policy. Another is whether that led to the Rebate Driven Buying Practices. A third is whether that resulted in the acquisition of Bad Stock. As I have explained, the best way of understanding these questions is to treat them

as asking whether DSH engaged in a policy of placing such an emphasis on the collection of O&A rebates that it was likely that buyers would engage in conduct that led to the acquisition of stock that could not be sold at all or within 16 weeks or (on the reformulated case) led to the acquisition of an excessive amount of stock, some at least of which was more difficult to sell at an appropriate margin within an appropriate timeframe (that is, 16 weeks). Understood in that way, the three questions are closely connected. For that reason, it is convenient to deal with them together.

375 In my opinion, the answer to the three questions is not an unequivocal yes or no. I am not satisfied that the plaintiffs have established that DSH adopted a policy that made it likely that buyers would seek to obtain O&A rebates at the expense of obtaining stock that they believed was saleable at a reasonable margin. Buyers were obviously encouraged to obtain O&A rebates. The degree of encouragement they received and the targets they were set increased over time. In about May 2014, those targets became part of their KPIs. But they had other KPIs which gave them incentives to acquire stock that was attractive to consumers and saleable at an appropriate margin, including KPIs in relation to sales and gross profit. There is evidence that emphasis was placed on meeting the KPI in relation to O&A rebates, but there is no evidence that the other KPIs were ignored. In cross-examination, each of Mr Bonham and Mr Freeman accepted that, for their own part, the policy of seeking to “maximise” O&A rebates was not pursued at the expense of meeting other KPIs. Mr Borg accepted that competent buyers complying with DSH’s requirements ought to have considered saleability of the product and the margin that they thought they could achieve as well as O&A rebates; and he did not suggest that he was aware of buyers who did not consider those matters.

376 On the other hand, I accept that buyers were encouraged to buy stock that they otherwise would not have in order to obtain O&A rebates. There is ample evidence that buyers were encouraged to give preference to suppliers who provided O&A rebates. They were given that encouragement by the introduction of targets in relation to O&A rebates. But I also accept that considerable pressure was put on, and inducements were given to, buyers to

meet those targets. That pressure and those inducements are described earlier in this judgment.

377 The plaintiffs say that the encouragement given to buyers to obtain O&A rebates created skewed incentives in relation to the stock that they bought. However, that allegation must be treated with some caution. It is to be expected that the emphasis on O&A rebates would have a significant impact on the buying patterns of buyers compared to the buying patterns they would have adopted if there was no expectation in relation to the collection of O&A rebates. In that sense, the buying patterns were "skewed". But that does not necessarily mean that the stock by its nature was less attractive to consumers at the time that it was bought. And even if some of the stock that DSH bought was less attractive to consumers in that sense, it would be necessary to bring to account the O&A rebates before it could be said that overall the stock that was bought was inferior (in terms of profitability) to the stock that could have been bought. The plaintiffs have not undertaken any analysis, or led evidence of any analysis, of the stock actually bought compared to the stock that could have been bought from which it could be concluded that the emphasis on O&A rebates created skewed incentives in this sense.

378 The plaintiffs seek to answer the point made in the previous paragraph in two ways. First, they point to the opinion expressed by Ms Etlin. Second, and more significantly, they point to evidence that they submit establishes that DSH did buy what might be described as the "wrong" stock.

379 Ms Etlin expressed the following opinion in relation to vendor rebates:

> They are common and I would characterise them as relatively insidious practice, because they result in people sometimes not making the best economic decisions, and most major US retailers are now currently moving to more fair price relationships with their vendors because of these kinds of strange incentives and the back and forth that it creates.

However, this evidence is expressed at such a high level of generality about what sometimes happens in the United States market that it cannot shed any light on what happened at Dick Smith.

380 The plaintiffs do not specifically identify all the evidence they rely on for the assertion that DSH bought the wrong stock. I take the evidence to include

Mr Borg's email dated 25 September 2014 to Mr Anthony Liberto saying that they were stuck between a rock and a hard place trying to balance the mix between margin and O&A, the presentation prepared by Mr Pereira in October 2015, Mr Murray's evidence of his visit to the Macquarie Centre store with Mr Pereira and the reference in his email to Mr Tomlinson on 21 October 2015 to "procurement driven by O&A not buying the right stuff". It also includes the evidence of Mr Holtzer and Mr Powell and their reports that were presented to the board which led to the board resolving to take a $60 million impairment on stock and the decision apparently taken by the receivers to write off a substantial amount of stock.

381 This evidence certainly raises a suspicion that the emphasis on O&A rebates caused Dick Smith, on occasions, to buy the wrong stock – that is, stock that was unlikely to be sold profitably because it was not attractive to consumers. However, the evidence is not sufficient to prove that that is what happened to any significant degree. Some of the evidence is anecdotal or speculative – such as Mr Pereira's presentation and Mr Murray's comment to Mr Tomlinson. Mr Borg's email suggests that the position of buyers was difficult, but it does not go so far as to suggest that the emphasis on O&A rebates caused DSH to buy stock that could not be sold for an appropriate margin. The evidence given by Mr Holtzer and Mr Powell was not admitted as evidence of the truth of what they asserted, not least because there was no reasoning which would justify its admission as opinion evidence. It was at odds with the views expressed by Mr Borg, who thought that an impairment of $20 million was appropriate. The fact that the board decided to take an impairment of $60 million is significant. But its significance is reduced by the circumstances in which it occurred. As both Mr Murray and Mr Tomlinson said, the board was placed in a very difficult position. It had conflicting opinions before it on the amount of the appropriate provision. Understandably, it felt compelled to make some announcement before the market opened the following day. Also understandably, it thought that it had to take a conservative approach and that it could not take further impairments without causing even more damage to Dick Smith's reputation. The decision it took was based on practical considerations rather than a proper understanding of the actual position in respect of stock. More importantly, the fact that the

board resolved to take the impairment itself says nothing about the reasons for the impairment and, in particular, whether it was necessary because Dick Smith bought the wrong stock because of the emphasis placed on the collection of O&A rebates, rather than, for example, changes in consumer tastes. There is no attempt to connect what is said to be Bad Stock in this sense with the emphasis on O&A rebates.

382 The same point applies to the decision of the receivers to write off stock. It is not entirely correct to say that the receivers wrote off the stock. Rather, they engaged Hilco Merchant Australia Pty Ltd to sell the stock. It may be inferred that a substantial amount of the remaining stock was sold for substantially less than its cost and in some cases for close to nothing. No evidence was led concerning the nature of that stock or, for example, when it was bought. It may be that some of that information can be found in one or more of the many spreadsheets that were admitted into evidence. But it is not for the Court to struggle to identify those spreadsheets and try to make sense of the information they contain absent submissions from the plaintiffs which seek to undertake that task. The plaintiffs submitted that it could be inferred that the receivers complied with their duties, which included a duty to realise the assets in respect of which they were appointed receivers for a fair price. Consequently, it was said that it could be inferred that the receivers obtained a reasonable price for the stock that remained. That much can be accepted. But it still does not establish that the stock that was effectively written off by the receivers was Bad Stock in the relevant sense at the time that it was acquired or that it was acquired in order to obtain O&A rebates rather than meet customer demand.

383 One other point to make in this context is that the stock that was written off and included in the plaintiffs' damages claim presumably includes private label stock in respect of which O&A rebates were paid as a consequence of the Rebate Uplift Practice. It was not suggested and there is no reason to think that the types of SKU (as opposed to their quantity) falling into this category were acquired as a result of the Rebate Maximisation Policy. There is no evidence that different stock was sourced from private label suppliers based on the willingness of those suppliers to provide O&A rebates, and it seems unlikely

that that would have happened. Under the Rebate Uplift Practice, DSH agreed to pay an increased price for its private label stock and received O&A rebates equivalent to the increased price. It is difficult to see why private label suppliers would not agree to the practice since the economic effect for them was the same. Consequently, it is difficult to see why the desire to obtain O&A rebates would encourage buyers to acquire stock from some private label suppliers and not others.

384 On the other hand, there is ample evidence that DSH bought more stock, and more stock falling into particular categories, than it needed. It is apparent from what has already been said that on occasions Mr Abboud released additional OTB as a means of obtaining O&A rebates in order to meet profit projections. The release of $23 million in OTB in about July 2014 as part of a plan to meet budgeted EBITDA for FY14 is an example. What happened in late 2014 and early 2015 is another. There was a large build up stock towards the end of 2014. Part of that build up may be explained by an increase in stock in anticipation of the Christmas period. And part of the build-up may be explained by the fact that delivery of several containers of private label stock was delayed until after Christmas. However, on 30 October 2014 Mr Abboud authorised the release of an extra $15 million in OTB notwithstanding the fact that throughout the last quarter of the year, Mr Borg was expressing concerns about DSH being overstocked, which he attributed at least in part to the fact that DSH was seeking "to maximise Dec O&A".

385 Mr Abboud says in his affidavit evidence that he released the extra OTB in October 2014 to increase the stock available to be sold in the Christmas sale period and to generate more sales and GP (gross profit). Although that might be literally true, the likelihood is that the real reason it was released was to obtain additional O&A rebates in order to make budget for the half year. Mr Abboud was inclined to give self-serving and somewhat rehearsed evidence concerning his desire to drive sales and the important role O&A rebates played in funding promotional activities directed at that goal. In my opinion, the contemporaneous correspondence of Mr Borg provides a more reliable guide to what was happening. Those emails indicate that DSH was overstocked and part of the reason for that was to obtain O&A rebates. That conclusion is

reinforced by the fact that DSH was seriously overstocked in February 2015, which was a time when, as NAB recognised, it was to be expected that stock levels would have decreased following the Christmas sales.

386 The same is true of the period later in 2015. In particular, Mr Borg's analysis of the stock position in his emails to Mr Abboud and others dated 28 July 2015 and 30 July 2015 should be accepted. Those emails establish that DSH was overstocked in the accessories category, which was limiting OTB in categories where it was understocked.

387 The conclusion of the previous paragraphs is also supported by DSH's stock position generally. I accept that the board agreed to, or at least accepted, an increase in stock from $200 million to $250 million, when it approved the FY14 Annual Report at the board meeting on 18 August 2014. The Annual Report explained that the increase reflected the opening of 54 new stores and what was described as a "healthier stock position". However, as is apparent from Annexure 2 the net inventory position increased dramatically in November 2014 (to $353.956 million). It reduced significantly in the first half of 2015, but still remained well above the $250 million target and by October 2015 it was only slightly less than $340 million, approximately $90 million above target. In my opinion, an important contributing factor to that state of affairs was that DSH had bought too much stock in order to obtain O&A rebates. That fact carried with it an increased risk of obsolescence, not necessarily because it was unattractive to consumers at the time it was bought but because over time there was a risk that it would be superseded by newer models or consumer tastes would change. However, as I have explained, it is not possible on the evidence to say to what extent that risk came to fruition. In particular, it cannot be said that the purchase of too much stock resulted in the provision of $60 million or in a substantial amount of stock effectively being written off by the receivers.

Did the directors breach their duties in relation to the Rebate Maximisation Policy?

388 The pleaded case is that the directors breached their duties because they adopted the Rebate Maximisation Policy without putting in place adequate internal controls to prevent Bad Stock from being bought. An express premise

of this claim is that adequate controls were not in place. An implied premise is that the directors acting with reasonable care and diligence ought to have appreciated that the acquisition of Bad Stock would be a consequence of the Rebate Maximisation Policy absent appropriate controls. That implied premise is said to be true because the risks were "obvious". However, that way of putting the case is an over-simplification and does not adequately account for the different position of different directors and, in particular, the different positions of the executive and non-executive directors.

389 The context in which the issue arises is important. Dick Smith was a large retailer of electronic goods which had been operating for a number of years before it was acquired by Anchorage and subsequently floated. It is to be expected that it would have, and it did have, systems in place for ordering stock, reviewing that stock and monitoring how well or poorly it was selling. Those processes changed somewhat over time. They are described broadly earlier in this judgment. Mr Wavish, who had extensive retail experience, was closely involved in Dick Smith's management prior to the float and obtained a detailed knowledge of its processes during that period and was instrumental in improving a number of them. In that capacity, he worked closely with senior management and gave unchallenged evidence that he formed the view that they were competent. Following the float, he became a non-executive director.

390 In addition, it is apparent in this case that, to the extent that there was a problem at Dick Smith with an over-emphasis on the collection of O&A rebates, the problem arose not because of a lack of supervision or control over buyers but because of the willingness of more senior managers including Mr Abboud to approve purchases, or to approve increases in OTB, with a view to increasing the amount of O&A rebates collected by Dick Smith. One consequence of that fact is that it means that the position of the NEDs is very different from the position of Mr Abboud and Mr Potts. The question in relation to the NEDs is whether they knew, or acting with care and diligence they ought to have known, that Dick Smith was buying too much stock, or too much stock of particular types, as a consequence of the emphasis that management (including Mr Abboud) was placing on the collection of O&A rebates. On the other hand, the question in relation to Mr Abboud and Mr Potts is whether

acting with care and diligence they ought to have appreciated that their conduct, or conduct they were aware of, was having that consequence.

The position of the NEDs

391 The question whether the NEDs breached their duties in relation to the Rebate Maximisation Policy raises two questions. The first is whether they knew of the policy and knew or ought to have known of its likely consequences. The second is whether they took adequate steps to guard against those consequences.

392 It is apparent that each of the NEDs was aware that DSH had a policy of seeking to obtain O&A rebates. Quite how they understood that policy, and whether they thought about it sufficiently to form a precise understanding of it, is less clear. The members of the FAC at least had been told by Deloitte that the policy was to “maximise” rebates. But as I have explained, that itself says very little. The real question is whether the NEDs knew or ought to have appreciated that the policy in relation to O&A rebates that had been adopted by DSH was likely to have the effect of causing DSH to buy more stock than it needed, with the consequent increase in risk that some of that stock would become obsolete. Although the plaintiffs provided extensive written submissions on the knowledge of the NEDs of the Rebate Maximisation Policy, their submissions do not address this question specifically. The plaintiffs do, however, submit that the risks associated with the Rebate Maximisation Policy were obvious. They also submit that the NEDs were aware that DSH was overstocked and ought to have appreciated that at least one of the causes of that was the emphasis placed on O&A rebates.

393 To a substantial extent that submission depends on a misunderstanding of the facts.

394 There can be no doubt that each of the NEDs was aware of the significance of O&A rebates to Dick Smith’s business. Prior to the float, it was agreed between Mr Abboud, Mr Cave and Mr Wavish that Dick Smith would seek to increase its profitability by seeking to increase supplier support, which included support in the form of O&A rebates. It was Mr Wavish’s evidence, which was supported by evidence given by Mr Murray and which I accept, that retailers in Australia

and around the world look to improve their profitability by obtaining as much supplier support as possible, and that one of the problems at Dick Smith while it was under the ownership of Woolworths was that management had not sought to do that. Neither Ms Raine nor Mr Ishak gave evidence, but the likelihood is that they were both aware of that policy. Mr Murray, who joined the board on 12 August 2014, gave evidence, which I accept, that "Based on discussions I had with Mr Cave, Mr Abboud and Mr Wavish in around July 2014 and August 2014, I was aware that management and the board had a view that the business needed to obtain rebates from suppliers at a level that was commensurate with the level of rebates being obtained by Dick Smith's competitors". The likelihood is that Ms Raine and Mr Ishak were involved in similar discussions when they joined the board of DSH on 25 October 2013. An increase in supplier support was a significant part of Dick Smith's turnaround strategy. The collection of O&A rebates was referred to in the monthly board reports. It would be surprising if Ms Raine and Mr Ishak were unaware of the significance of O&A rebates to DSH's business. Mr Tomlinson gives evidence that before he joined the board, he became aware of O&A rebates and one of the issues he raised in an email sent on 31 March 2015 with Mr Murray before agreeing to join the board was the "Sustainability of O&A supplier contributions".

395 However, I do not think that it could be said that the risk in respect of O&A rebates that came to fruition was one that ought to have been so obvious to the NEDs that they should have taken steps to mitigate it without evidence that it existed or had come to fruition. The collection of O&A rebates was a normal incidence of a retail business. Dick Smith had been operating for a period of time under the direction of Mr Abboud and during that period had kept a tight control on stock. Against that background, there was no reason for the NEDs to think that because DSH was earning substantial revenue from O&A rebates, there was a risk that it would buy too much or inappropriate stock.

396 Moreover, the relevant risk in this case was that senior management would adopt policies in relation to the collection of O&A rebates that would cause DSH to acquire too much stock or too much stock falling into particular categories. There was no reason for the NEDs to believe that that risk existed

without evidence. The senior managers working at Dick Smith, including Mr Abboud and Mr Potts, all had extensive retail experience. Mr Wavish had worked with them closely and formed the view that they were competent. Dick Smith under the control of Mr Abboud had been successful in reducing its inventory and disposing of under-performing stock. By the end of FY13, the value of inventory in DSSH's accounts had reduced from $370.55 million to $192.7 million. Mr Wavish and Mr Cave would have known of that change and the likelihood is that Ms Raine and Mr Ishak did as well. It was reasonable for each of Mr Cave, Mr Wavish, Ms Raine and Mr Ishak to conclude that Mr Abboud understood the importance of keeping a tight control on stock. And it was reasonable of Mr Murray and Mr Tomlinson to expect to be told if there was an issue concerning the management of stock if there was one.

397 As I have explained, by about mid-2014 Mr Wavish agreed with Mr Abboud's proposal to increase the level of stock to $250 million and that appears to have been accepted subsequently by the board. That acceptance had come about in a context where DSH had opened 54 new stores during the year. The board papers for August 2014 and October 2014 (there was no board meeting in September 2014) show that stock was at about $250 million. The report prepared by Deloitte and distributed to members of the FAC in advance of the meeting on 12 August 2014 pointed out that "Whilst the gross inventory balance has increased, the inventory provision has decreased mainly due to an improvement in the quality and ageing of inventory". Consequently, from the point of view of the NEDs, there was no reason to think at that time that the emphasis on O&A rebates had caused DSH to buy more stock than it needed.

398 The position changed very substantially starting in November 2014. However, that would only have become apparent to the NEDs when they received the board papers for the meeting held on 16 February 2015 (or a few days earlier in the case of members of the FAC). Mr Wavish explained in his affidavit evidence that he observed that inventory was "significantly above the Benchmark [of $250 million]" and that it was "too high" and "an orange light". However, his evidence was that management had a plan for reducing the inventory and that Mr Abboud had a good track record of doing so. Mr Murray gave evidence to similar effect. In addition, there was no suggestion that the

inventory would not be able to be sold for a reasonable margin. The accounts for HY15, which showed the increase in inventory, had recently been reviewed by Deloitte. Deloitte had raised no issue in relation to the provision included in those accounts and it is no longer part of the plaintiffs' case that the accounts were wrong in that respect. Similarly, the financial information included with the board papers for January 2015 stated that $367.9 million of stock was classified as "Active". There is no evidence that any of the NEDs appreciated by that stage that the emphasis on O&A rebates was a substantial cause of DSH's excessive stock position. Nor do I think that their failure to make that connection at that time showed a lack of care or diligence on their part. The excessive stock position only became apparent to them in February 2015. They asked questions about it and received explanations from Mr Abboud and Mr Potts at the February 2015 board meeting which were plausible. There was no reason for them to doubt what they were told at that stage and nothing that was said to them would have suggested to a director in their positions acting with care and diligence that one of the causes of the problem was the emphasis on O&A rebates.

399 Mr Cave retired from the board on 28 February 2015 and Mr Wavish retired on 25 March 2015. Realistically, they could not have been expected to do anything more prior to their retirement.

400 In my opinion, the position did not change substantially for the other NEDs during the period from March to August 2015. Mr Tomlinson only joined the board on 10 April 2015 and it is to be expected that, absent some crisis, it would take him several months to understand the business sufficiently well to reach his own conclusions about the reasons that DSH was carrying an excessive amount of stock which were different from what he was told by management. Mr Tomlinson plainly approached the task of learning about the business and asking questions with diligence. It was not seriously suggested otherwise.

401 The position of the other directors is somewhat different. However, the evidence of both Mr Murray and Mr Tomlinson is that the NEDs questioned Mr Abboud and Mr Potts at each of the board meetings about the stock position.

They were given answers that appeared to be plausible. Up until and including the July 2015 board meeting it was apparent that excess stock was being sold, although not as quickly as forecast. The position worsened in August 2015, but not dramatically. At the same time, they had the benefit of Deloitte's audit and advice from Deloitte to the effect that management had adopted a new provisioning methodology with which Deloitte agreed. That methodology resulted in a relatively small provision, which would have indicated to a diligent director that over time the inventory could be sold at a reasonable margin. Accordingly, I do not think it was unreasonable for the NEDs to continue to accept what they were told by Mr Abboud and Mr Potts, although it is to be expected that they would subject what they were told to an increasing degree of scrutiny. Nothing that they were told suggested that a substantial cause of the excessive stock position was the emphasis on obtaining O&A rebates.

402 There was no board meeting in September 2015. The position obviously changed radically in October 2015. However, there is no suggestion that the NEDs failed to act with the care and diligence that would be expected of a director in their position after that time.

403 The conclusions I have reached dispose of the case that the NEDs breached their duties as directors by failing to take steps to guard against the risks said to be associated with the Rebate Maximisation Policy. I should, however, say something about the steps it is said that the NEDs ought to have taken. As I have said, the plaintiffs now rely on a substantial list of steps they say that the NEDs ought to have put in place to address the risks they say existed. But there are a number of difficulties with the plaintiffs' submissions in this respect.

404 First, the steps appear to be designed to address a particular form of the Rebate Maximisation Policy that I have found did not exist (that is, a policy that prioritised O&A rebates to the exclusion of everything else).

405 Second, the steps that it is said the board should have taken appear to be ones that would have ensured that certain conduct did not occur. There are two difficulties with that contention. First, particularly in the circumstances I have described, it was not for the board to put in place systems of control. There were systems of control already in place. The task of the board relevantly was

to monitor the financial performance of the company, to ask questions of management where the company was not meeting its expected financial performance to identify why that was happening, to require management to address any deficiencies that were identified and to replace management if it concluded that they were incapable of addressing those deficiencies. Second, it was not the obligation of the board or indeed management to put in place systems that ensured a particular outcome. Rather, any obligation to put in place systems of control was an obligation to put in place systems that could reasonably be expected to have the desired outcome.

406 Third, and related to the second point, a number of the systems of control proposed by the plaintiff would involve the board performing the functions of management. For example, it was not for the board to receive detailed reports on promotional or opportunistic purchases in excess of OTB or to make assessments of whether a business case could be made for those purchases or to assess detailed strategies sitting behind decisions in relation to inventory or to monitor the performance of individual buyers. On the face of it, it appears that it would be impractical for any board to undertake those activities. Any case that those activities are ones that would normally be undertaken by the board of a publicly listed retailer would need to be supported by evidence.

407 Fourth, it is for the plaintiffs to prove that the systems of control they propose would have been a reasonable response to the risk of harm that existed. The plaintiffs have not discharged that onus. There is no evidence concerning the costs of the systems proposed by the plaintiffs. But it is to be expected that the costs of some of those systems would be substantial, such as an internal audit function and possibly the costs of a compliance team independently of the buyers. I say “possibly” because it is not clear what the difference is between that compliance team and the system of supervised merchandise managers which Dick Smith did have in place. The FAC itself considered at its meeting on 25 November 2014 whether having an internal audit function in a company the size of DSH was warranted and concluded that the costs of such a function would outweigh the benefits. No attack was made on that decision.

408 It is unclear how the systems of control proposed by the plaintiffs would have made a difference. As I have explained, from no later than about October 2014, Mr Borg was warning senior management, including Mr Abboud and Mr Potts, that DSH's policy in relation to O&A rebates was causing DSH to become overstocked. The difficulty is that Mr Abboud and Mr Potts either did not accept those warnings or took inadequate steps to address them. It is unclear how many of the systems of control identified by the plaintiffs would have addressed that problem.

The position of Mr Abboud and Mr Potts

409 In my opinion, the position of Mr Abboud and Mr Potts is different. Mr Abboud was the driving force behind the emphasis on the collection of O&A rebates as a means of increasing DSH's reported profits at least from the second quarter of 2014. Mr Potts knew that that was the case and himself was involved in formulating the plan in April 2014 to increase O&A rebates in order to meet budgeted profit for FY14. That plan involved an increase in OTB initially by $20 million.

410 However, prior to about October 2014, there is limited evidence that the emphasis on O&A rebates was causing DSH to buy too much stock or too much stock in some categories. As I have explained, the level of stock increased in mid-2014, but that increase was the result of a deliberate decision to increase stock and was agreed between Mr Abboud and Mr Wavish and appears to have been accepted by the board. As a result of the increase in stock, weeks covered increased to about 13 or 14 weeks. There is no evidence that that was excessive. Ms Etlin expresses the view that it was substantially greater than ideal. However, that opinion was expressed without a detailed analysis or understanding of DSH's business. There is some evidence that weeks covered was well in excess of 13 weeks for a number of SKUs. But it is unclear whether that was a result of the policy in relation to O&A rebates. And it is unclear how significant that fact was in the context of DSH's business as a whole.

411 The position changed substantially by about October 2014. From that time, Mr Borg wrote a number of emails referring to the fact that DSH was becoming

increasingly overstocked. Some of those emails were either sent to or copied to Mr Abboud and Mr Potts. A number of those emails (in particular, his email dated 19 December 2014 to buyers and Mr Abboud, which was copied to Mr Potts) attributed the fact that DSH was overstocked to the emphasis on O&A rebates. The likelihood is that those emails reflect discussions within DSH. Mr Abboud, for example, accepts that he spoke to Mr Borg regularly and sometimes more than once a day, and it seems probable that they would have discussed what Mr Borg was saying in his emails.

412 The views expressed in Mr Borg's emails seem plausible. The evidence clearly suggests that a great deal of emphasis was placed on the collection of O&A rebates. Mr Abboud released additional OTB in order to collect O&A rebates and to improve DSH's reported profits. There can be no doubt that DSH did become overstocked. It seems plausible that the emphasis on obtaining O&A rebates, and the buying practices that emphasis created, was a substantial cause of DSH becoming overstocked.

413 Mr Abboud gives detailed affidavit evidence of the steps he took to monitor margins and rebates, including O&A rebates. He also offers explanations of why he agreed to increases in OTB and examples of where he restricted OTB. He repeats the explanation of an increase in stock in January 2015 which was given in the HY15 Results Announcement – namely, the purchase of stock to provide inventory for new stores, an increase in the purchase of private label inventory, the purchase of stock to support increased sales in the second half of the year and the purchase of stock for the Christmas and January sales period. In relation to Mr Borg's email dated 19 December 2014, he says that each of the suppliers recorded in the email manufactured leading brands.

414 In my opinion, this evidence fails to address the real issue. By about October 2014, it had become apparent that the emphasis on O&A rebates was causing DSH to buy too much stock, particularly in certain categories. If Mr Abboud had acted with reasonable diligence and care he would have appreciated by no later than January 2015 that that was the case. He was told by Mr Borg that DSH was overstocked and that one of the principal causes was the emphasis on the collection of O&A rebates. Nothing Mr Abboud says in evidence

explains why Mr Borg's assessment was not correct. Mr Borg's views appeared to be reasonable and were confirmed by the stock position in January 2015. When the stock position became apparent in January 2015, Mr Abboud restricted OTB for a period of time. However, he did nothing to change the emphasis on the collection of O&A rebates and the problems with stock continued. In my opinion, faced with the mounting evidence that there were problems with the approach DSH was taking to the acquisition of stock, a person acting with care and diligence in the position of Mr Abboud would have ensured that a review was undertaken to determine the categories of stock where DSH had too much stock and those where it did not and would have put in place a system designed to ensure that buyers bought stock falling into the latter category. That presumably could have been achieved by instructing buyers to reduce the priority they gave to obtaining O&A rebates and changing the incentives they were given. However, Mr Abboud did not do that. To that extent he fell short of the obligations imposed on him by s 180 of the Corporations Act.

415 Mr Potts's position is similar. Like Mr Abboud, he was aware by no later than December 2014 that the emphasis that DSH was placing on the collection of O&A rebates was causing it to buy too much stock. He was told as much by Mr Borg in December 2014. He was a senior person in the company who must have had personal knowledge of the steps that DSH was taking to increase its reported profits. Although many of the emails concerned with the effect that the emphasis on O&A rebates was having on the purchase of stock were not copied to him, it is not plausible that someone in his position would be oblivious to what was happening and to the fact that over a period of time Mr Borg had expressed concerns about the build-up of stock and the fact that it was being driven, at least in part, by the emphasis on O&A rebates. It was open to Mr Potts to explain in evidence why he did not accept Mr Borg's assessment. However, he chose not to give evidence. That Mr Potts appreciated that there was a problem with DSH's approach to O&A rebates is supported by his decision to retain Mr Holtzer in August 2015 to investigate the stock position and by his insertion in Mr Holtzer's September 2015 draft presentation of a bullet point saying "Over reliance on O&A rebates leading to wrong pricing and

purchasing decisions". The closing written submissions made by Mr Abboud and Mr Potts say that precisely what Mr Potts meant by the insertion of this bullet point is unclear. I do not accept that submission. In my opinion, a fair interpretation of what happened is that Mr Potts wanted Mr Holtzer to make the point in his presentation that DSH had placed too much emphasis on the collection of O&A rebates and that had caused DSH to make the wrong pricing and purchasing decisions, including buying too much stock or too much stock falling into particular categories. Although Mr Potts made that comment in August 2015, the likelihood is that it reflected a view that he had held for some time. As I have said, it was open to Mr Potts to give evidence to explain his suggested change to the draft presentation or to explain when it first became apparent to him that the emphasis on O&A rebates was causing DSH to buy took much stock and too much stock in particular categories. The fact that he did not do so supports the inferences to be drawn from the documents. In any event, like Mr Abboud, Mr Potts had been told prior to January 2015 that DSH was overstocked and one of the major causes of that was the emphasis placed on O&A rebates. It was apparent by January 2015 if not before that DSH was overstocked. Any person in the position of Mr Potts would have appreciated that fact and the fact that a likely cause was the emphasis placed on the collection of O&A rebates.

416 Mr Potts was a director of DSH. In my opinion, a director in his position acting with care and diligence would, at a minimum, have raised his concerns with Mr Abboud and if Mr Abboud did not agree to take appropriate steps to address the issue would have raised the matter at the February 2015 board meeting so that the board could consider what steps should be taken to address the problem. Mr Potts did neither of those things. As a consequence, in my opinion, he also breached his duties under s 180 of the Corporations Act.

Damages

417 It is the plaintiffs' case that, if the directors had complied with their duties, DSH would not have bought stock where it already had 16 weeks cover and that consequently any loss it suffered as a consequence of buying that stock is a loss that can be recovered from the directors under s 1317H of the Corporations Act. That section relevantly provides:

> Compensation for damage suffered
>
> (1) A Court may order a person to compensate a corporation … for damage suffered by the corporation … if:
>
> > (a) the person has contravened a corporation/scheme civil penalty provision in relation to the corporation, scheme or fund; and
> >
> > (b) the damage resulted from the contravention.
>
> The order must specify the amount of the compensation.

Alternatively, the plaintiffs claim damages under the general law. In each case, they submit that those damages are to be calculated in the way described earlier.

418 As I have explained, the plaintiffs' contention that greater than 16 weeks cover in respect of particular SKUs implies that there is excess inventory for those SKUs relies heavily on evidence given by Ms Etlin. The defendants take issue with that evidence. They submit that Ms Etlin has limited experience of electronics retailers, no experience of electronics retailing in Australia and had no information concerning the particular business of DSH. In addition, Ms Etlin's evidence is said to be inconsistent with contemporaneous emails of Mr Borg, who proposed weeks covered targets for particular SKUs of well in excess of 16 weeks. The defendants also rely on concessions said to have been made by Mr Borg in cross-examination and on evidence given by Mr Abboud. Mr Borg, for example, gave the following evidence in cross-examination:

> Q. So you wouldn't agree with the proposition that you should have a fixed 16 weeks cover for any SKU in the business; is that right?
>
> A. That's correct. Definitely not a flat 16 for everything. That's - no. Specific to the category.
>
> Q. The business couldn't function if that were the rule; do you agree?
>
> A. Correct.
>
> Q. Because some of these products, particularly those purchased from China, had substantial lead times which meant that it could take a substantial time in excess of 16 weeks between an order placed and when product is delivered?
>
> A. It could, correct. Depending on the time of the year, that's correct.

419 Mr Abboud gave this evidence:

> I disagree with Ms Etlin's statement that an electronics retailer would not ordinarily make additional purchases of a particular SKU if it already had 16 weeks cover. This does not take into account the lead time for PL stock

> ordered from China. The lead time from ordering PL stock to receipt of stock was at least 4 months (see paragraph 196). It was necessary that DSH held PL inventory in quantities exceeding 16 weeks cover to avoid out of stocks, such as those referred to in paragraph 202. Another reason for my disagreement is that a category such as Accessories has a high number of ranges of products compared to other categories. For example, a phone case can come in ten different colours. A television set can come in one colour. Where the category includes a high number of ranges, it is necessary to carry more stock to ensure there is sufficient stock to meet demand for the SKUs which constitute the range.

420 There is some force in the defendants' criticism of the evidence given by Ms Etlin. She appears to have had limited experience of the electronics retail market and no experience of that market in Australia or of the particular issues confronting DSH. For example, DSH managed its stock from a central warehouse. It had a large number of stores having regard to its turnover compared to JB HiFi. There are good reasons for thinking that both those matters required DSH to hold more stock than it would have if stock was delivered directly to stores (as is the case with JB HiFi) or if its per store turnover had been higher than it was. Ms Etlin addresses none of these points.

421 On the other hand, the evidence given by Mr Borg was not as favourable to the defendants' case as they suggest. Prior to the evidence quoted above (and relied on by the defendants), Mr Borg gave this evidence:

> Q. Do you agree that there would be purchase orders for SKUs forecast to end the month on weeks cover figures less than 30 weeks which you would approve?
>
> A. Generally speaking, yes.
>
> Q. There were many categories in the business which during 2014 and 2015 had weeks cover targets which you fixed which exceeded 16 weeks; do you agree?
>
> A. Yes.
>
> Q. What was the target for accessories?
>
> A. I vaguely recall at some point in time 22, 24, it could have gone to 26. It changed over time, Mr Smith.
>
> Q. Yes. But you wouldn't subscribe to the view, would you, that the company should not purchase any SKUs in categories where existing cover was 16 weeks; do you agree with that?
>
> A. Are you asking my personal opinion?
>
> Q. Yes. That's all I can ask.
>
> A. I would not - my personal opinion is not to buy anything where you're sitting on more than 16 weeks.

Q. That's not what you said here; do you agree?

A. It doesn't say anything about 16 weeks.

Q. No. In fact, you had targets, approved targets, for various categories of SKUs well in excess of 16 weeks during 2014 and 2015; do you agree?

A. The target was set at above those, yes. It doesn't mean I agree with them.

Q. You set the target, Mr Borg, didn't you?

A. In consultation with merchandise managers, yes.

Q. And you agreed with a target in some categories exceeding 16 weeks, didn't you?

A. I did not agree with the target, but the target was still set.

Q. So you disagreed with the target but allowed the business to operate on weeks cover exceeding 16 weeks; is that right?

A. Yes.

Q. Is this right: are you telling his Honour that you agreed to target weeks cover in excess of 16 weeks where you personally disagreed with that? Is that right?

A. Yes.

Q. What, for every SKU; is that right?

A. No.

Q. So there were cases where you would agree that a SKU should have more than 16 weeks cover; is that right?

A. Agree? No. Targeted, yes. That doesn't mean I agreed with them.

Q. But it's a target that you formulated for the business; correct?

A. In consultation with the business, correct.

Q. Did you tell anyone, "Look, this is a target which the business should work to to purchase stock exceeding 16 weeks cover, but I don't agree with it"?

A. Yes.

Q. Did you say that to anyone?

A. Yes.

Q. Who did you tell?

A. Mr Potts. It was written on my notice board for two years - "eight weeks cover", underlined.

Q. What, for every SKU?

A. No, not every SKU, but to get to eight, some can, you know - talking general terms, some categories can be under eight, some categories can be over eight, but to get to eight you need to have as many categories under as over. But it was all set at a category level in consultation with the merchandise manager specific to each category. In some cases I didn't agree, and in many cases I expressly disagreed.

422 Mr Borg also made the point in cross-examination that that the targets he proposed were not necessarily intended to represent the ideal levels of stock that DSH should hold. Rather, they were intended to represent realistic goals given the amount of stock that was actually held.

423 I accept the evidence given by Mr Borg. It is plausible and is consistent with the target stock levels agreed between Mr Abboud and Mr Wavish and accepted by the board. Mr Abboud's evidence is consistent with the evidence given by Mr Borg. At most, Mr Abboud's evidence is that there may be circumstances where it was appropriate for DSH to buy additional quantities of a particular SKU even though it already had 16 weeks cover of that SKU. Mr Borg accepts that proposition. But that proposition does not undermine the point that generally stock should not exceed more than 16 weeks cover.

424 In response to the point made in the previous paragraph, the defendants point to the fact that the plaintiffs' damages claim depends on establishing that Bad Stock comprised stock of each SKU where the amount of the stock held exceeded 16 weeks cover. They also point to the following principles stated by Hayne J (with whom Gleeson CJ, McHugh and Kirby JJ agreed) in *Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd* (2003) 196 ALR 257 at [37]f [2003] HCA 10 (footnotes omitted):

> [37] Placer undoubtedly bore the burden of proving not only that it had suffered damage as a result of Thiess Contractors' breach of contract, but also the amount of the loss it had sustained. It goes without saying that it had to prove these matters on the balance of probabilities and with as much precision as the subject matter reasonably permitted.
>
> [38] It may be that, in at least some cases, it is necessary or desirable to distinguish between a case where a plaintiff *cannot* adduce precise evidence of what has been lost and a case where, although apparently able to do so, the plaintiff *has not* adduced such evidence. In the former kind of case it may be that estimation, if not guesswork, may be necessary in assessing the damages to be allowed. References to mere difficulty in estimating damages not relieving a court from the responsibility of estimating them as best it can may find their most apt application in cases of the former rather than the latter kind. This case did not invite attention to such questions. … [Footnotes omitted]

The defendants contend that, in this case, it was open to the plaintiffs to call expert evidence on the appropriate level of stock for DSH to hold in each category of product or each SKU. They chose not to do so. The Court should not fill the gap in the plaintiffs' evidence by seeking to estimate the plaintiffs' loss by reference to assumption that is at best an approximation and would capture stock that on any view could not be regarded as excessive.

425 I do not accept the defendants' submission. It would have been difficult for the plaintiffs to lead expert evidence directed at establishing that a reasonable director in the position of Mr Abboud or Mr Potts would have appreciated that, at the time DSH placed orders for particular SKUs where it already had more than 16 weeks cover, the order would have resulted in an excessive quantity of stock of that SKU. Whether that was so or not would depend on all the circumstances at the particular time. It would not have been possible to give an expert appropriate assumptions on those matters. However, that does not alter the fact that on the conclusions I have reached more than 16 weeks cover calculated across all of DSH's stock was excessive. Accepting that, a reasonable albeit imprecise way of identifying "Bad Stock" is by reference to whether or not DSH held 16 weeks cover in respect of each SKU. It is true that that approach will catch some orders of stock which could not properly be regarded as excessive. But it will also fail to catch some orders of stock that were. There is no reason to think that the former category is substantially larger than the latter. Accordingly, a calculation based on the application of a 16 week limit to all SKUs appears to be a reasonable approximation of the same calculation based on an assessment of the appropriate number of weeks covered for each SKU or each category.

426 There are, however, other difficulties with the plaintiffs' claim. As originally formulated, the plaintiffs' case was that Rebate Maximisation Policy led to the Rebate Driven Buying Practices. The Rebate Driven Buying Practices had as one of their elements the purchase of stock which focused on and prioritised maximising rebates, at the expense of focusing on current or likely future customer demand. As I have said, implicit in that case is the idea that stock that was bought as a consequence of the Rebate Maximisation Policy was stock that was unappealing to consumers and therefore could not be sold for a reasonable margin within a reasonable timeframe. However, the plaintiffs did not seek to make out that implicit assumption. That is, the plaintiffs did not seek to make out a case that the nature of the stock in respect of which they make a claim was unattractive to consumers. Instead, as I have explained, they sought

to make out a different case – namely, that as a consequence of the directors' breaches of duty, DSH bought too much stock. The obvious losses flowing from that conduct was that an excessive amount of capital was tied up in stock and DSH was exposed to an increased risk that the stock would become obsolete. But the plaintiffs' method of calculating damages makes no attempt to quantify those losses. Plainly, it makes no attempt to quantify the losses arising from the fact that too much capital was tied up in stock. Nor does it seek to value the risk associated with obsolescence.

427 It might be suggested that the methodology the plaintiffs employ is a reasonable proxy for the second type of loss. In my opinion, that suggestion cannot be accepted. There is a question whether it is appropriate to use actual results as a proxy for the value of a risk that might come to fruition. The defendants contend with some justification that it involves an impermissible use of hindsight. Leaving that point aside, the methodology adopted by the plaintiffs seeks to identify the actual losses made by DSH as a consequence of buying an excessive amount of stock. But in doing so it seeks to identify only those purchases where DSH already held 16 or more weeks cover that resulted in a loss. It does not take account of those purchases where DSH already held 16 or more weeks cover that resulted in a profit. According to Mr Tony Samuel, an expert engaged by the defendants, once those profits are taken into account, DSH actually made a profit on the purchase of excess stock. The following table summarises his conclusions:

Table 2: Adjustment to Alternative Loss Methodology calculations

	Australia $'000	**New Zealand9 $'000**	**Total $'000**
Scenario 1 per Oliver	(24.573)	(2.899)	(27.472)
Profits on sale of Bad Purchases	32.159	2.951	35.110

Adjusted Profit / (Loss)	**7.585**	**0.052**	**7.637**
Scenario 2 per Oliver	(18.004)	(2.057)	(20.061)
Profits on sale of Bad Purchases	29.157	2.640	31.797
Adjusted Profit / (Loss)	**11.153**	**0.583**	**11.736**
Scenario 3 per Oliver	(21.922)	(2.402)	(24.324)
Profits on sale of Bad Purchases	20.642	1.507	22.149
Adjusted Profit / (Loss)	**(1.280)**	**(0.895)**	**(2.175)**

9 Converted from NZD to AUD at AUD/NZD = 1.065 per First Oliver Affidavit, paragraph 8

These figures do not take account of data anomalies identified by Mr Samuel and Ms Oliver in a joint report prepared by them. Nor do they attribute any value to unsold stock, contrary to Mr Samuel's view that they should.

428 Ms Oliver accepts that Mr Samuel's calculation of the net profit from Excess Inventory Purchases is a mathematically accurate calculation. However, she does not accept that credit should be given for purchases that made a profit. According to her, a proper calculation of the loss would have taken into account profit that would have been earned on stock that would have been bought in place of the stock treated as Bad Stock. That was a matter of retail expertise, not accounting expertise on which she and Mr Samuel had no information. Ignoring the profit that was actually earned on Bad Stock and the profit that could have been earned on alternative stock reflected the best that could be done with the imperfect information available.

429 The difficulty with Ms Oliver's response is that it assumes that DSH would have bought other stock if it had not bought Bad Stock. But that assumption is inconsistent with the plaintiffs' case that the consequence of the Rebate

Maximisation Policy and the failure relevantly of Mr Abboud and Mr Potts to do anything about it was that DSH bought too much stock. It assumes incorrectly that the plaintiffs' case as ultimately put was that the consequence of the Rebate Maximisation Policy was that DSH bought the wrong stock (in the sense of stock that was unattractive to consumers). That, it seems to me, is a fatal error with the way in which the plaintiffs put their damages claim.

430 A second difficulty with Ms Oliver's Alternative Loss Methodology is that it purports to include losses incurred on all stock bought after 1 May 2014. However, I have concluded that Mr Abboud and Mr Potts did not breach their duties as directors until the end of January 2015. Consequently, it would be necessary to identify excessive stock acquired after that date. The plaintiffs have not undertaken that task, although the data is available to allow that task to be undertaken. It is noteworthy that the plaintiffs do calculate the losses arising from inventory purchased from October 2014 (when Mr Murray became a director) and June 2015 (when Mr Tomlinson became a director) by reference to the proportion of Excess Inventory Purchases made after those dates. In the case of October 2014, the proportion is 73.58 percent. In the case of June 2015, it is 38.62 percent. If the date from when the calculation was to be performed had been the only difficulty with the plaintiffs' claim, it would have been appropriate to give them an opportunity to calculate damages from the correct date. However, that would be pointless given the conclusion I have reached.

431 A third difficulty with Ms Oliver's Alternative Loss Methodology is that it does not give credit for volume, ad sub, scan and O&A rebates earned by DSH. Ms Oliver accepts that in principle credit should be given for any rebates received by DSH. However, she explains this omission on the basis that it was not possible on the available evidence to determine the rebates received as a result of Bad Stock purchases. She also expressed the view that it was unlikely that the O&A rebates would exceed the hypothetical profit that DSH would have earned on alternative purchases. In the joint report prepared by her and Mr Samuel, she says that she understood "this is consistent with the Plaintiff's assertions and the basis for this assertion will be addressed through lay evidence".

432 There are a number of difficulties with the position taken by Ms Oliver. First, the point that Ms Oliver said would be addressed through lay evidence was not. Second, as I have explained, on the way the plaintiffs ultimately put their case, there would have been no alternative purchases and therefore no hypothetical profit. Moreover, the point Ms Oliver makes involves a degree of double counting, since, on her approach, the hypothetical profits are also supposed to be set off against the actual profits earned on Bad Stock Purchases. Third, Ms Oliver accepts that in principle credit should be given for the rebates. In the absence of material that would permit the precise calculation by the Court of those amounts, the Court would need to do the best that it could to make allowance for them. The approach taken by Mr Samuel at least provides a starting point for making an appropriate adjustment. The plaintiffs advance various criticisms of Mr Samuel's calculations. There is, however, no utility in trying to reach a concluded view based on Mr Samuel's calculations and the criticisms made of them, since the calculations proceed on the assumption that Bad Stock included stock bought from 1 May 2014 and the damages claim depends on a methodology that cannot be accepted.

433 A fourth difficulty with Ms Oliver's Alternative Loss Methodology is that it does not give any credit for stock not sold by the receivers and written off at the time the receivers closed the Dick Smith stores, which appears to account for $10,546,000 or 53 percent of the plaintiffs' claim on Scenario 2. As I have explained, the plaintiffs justify that approach on the basis that the Court can infer that the receivers complied with their duties and took reasonable steps to sell the stock and to obtain a reasonable price for it. The difficulty with that submission is that without knowing more, it is not possible to know whether the stock was unsaleable because it was Bad Stock or for some other reason. The report of the receivers dated 5 May 2016 suggests that most of the remaining stock was faulty inventory and accessories valued at $1.2 million which were sold for $348,000, with the balance being explained as "shrinkage" (that is, stock that could not be located). That may not be an issue if the plaintiffs were able to prove that DSH went into receivership because it bought Bad Stock. However, that case has not been made out. The plaintiffs have not proved that the write-down in stock was necessitated by the purchase of Bad Stock. The

write-down occurred because the board accepted the opinion of Mr Holtzer and Mr Powell. However, the plaintiffs failed to prove that that opinion was reasonable. Moreover, there is no evidence that the provision that was made was made in respect of stock that was bought as a consequence of Mr Abboud and Mr Potts's breaches of duty (as opposed to stock that was acquired before any breach). Nor have the plaintiffs proved that the write-down in stock caused the receivership. On the evidence, the receivership was brought about by what appears to have been an unintentional breach by DSH of the agreement extending the terms of the overdraft facility and the Banks' decision not to waive that breach.

434 The defendants, particularly Mr Cave, raise a number of other issues concerning the way in which the plaintiffs calculate their loss. They point to the fact that the plaintiffs define Bad Stock as including all stock bought from a supplier which at any time provided O&A rebates where DSH already had more than 16 weeks cover. They then point to a number of examples where it appears that the purchase of particular SKUs identified by Ms Etlin as loss making were in fact not made in order to obtain O&A rebates. That submission itself raised factual issues in relation to the acquisition of particular SKUs which were the subject of substantial submissions from the plaintiffs and the defendants.

435 The defendants also point out that, according to the approach taken by Ms Etlin, the recent purchase of substantial quantities of new products are often classified as the purchase of Bad Stock because there has been no or few past sales, with the result that a backwards looking calculation of weeks cover makes the number of weeks covered appear artificially high. As I have pointed out, Ms Etlin attempts to take account of the problem by calculating weeks covered over different periods of time and by an adjustment she makes in her Scenario 2. The defendants seek to demonstrate by reference to particular examples that those adjustments are not enough.

436 The defendants also point to the fact that the approach taken by Ms Etlin in identifying Bad Stock makes insufficient allowance for the fact that the data relied on by Ms Oliver contained anomalies. In particular, in the case of some

SKUs the sales data available from DSH's AS400 system is higher than the aggregated stock balances over the same period. Ms Oliver has still relied on that data. Mr Samuel, on the other hand, expresses the view that the relevant SKUs should be excluded from the loss calculation, which would have the effect of reducing the loss under Scenario 2 by $1.2 million. Ms Oliver disagrees with Mr Samuel's approach on the basis that the effect of excluding those SKUs involves an implicit assumption that it is the sales data that is wrong whereas the anomaly may be explained either because the sales data or stock balance data is incorrect. However, the implicit assumption in Ms Oliver's approach is that it is the sales data which is correct.

437 Similarly, according to submissions made on behalf of Mr Cave, Ms Oliver's analysis does not take account of adjustments to stock numbers to take account of errors. An example is SKU XG3553 (a Nikon 3200 TLK DSLR camera), which accounts for a loss of $655,384.54 on Scenario 2. According to the figures used by Ms Etlin, 310 units of that SKU remained unsold at the end of the receivership. However, Mr Cave points out that 216 units were written-off as a stock adjustment apparently resulting from an incorrect delivery by Nikon in October 2014 and a further 79 units were written off as an "error in store receipting". Both errors appear to have arisen because SKU XG3553 was a Nikon camera with lens, whereas what was received was the camera body, which ought to have been receipted under a different SKU reference. It is unclear whether what loss, if any, was suffered in respect of that SKU.

438 Lastly, the defendants point out that included in the list of loss-making SKUs were items acquired as demonstration or in-store display units. They point out that it is unlikely that the items were acquired in order to obtain O&A rebates. According to Mr Cave, $161,485.99 of the plaintiffs' claim on Scenario 2 fall into this category.

439 None of these points is of itself fatal to the plaintiffs' damages claim. And the fact that they may involve adjustments that are not capable of precise calculation either because of the inadequacy of the data or the nature of the issue is not itself a reason for refusing to award damages. However, it is not possible to express a view on what adjustment ought to be made without

knowing the figure to be adjusted and how it was calculated. For the reasons I have explained, the plaintiffs' approach to calculating damages suffers from more fundamental flaws which make it impossible to determine what further adjustments might be appropriate to take account of other issues raised by the defendants.

The dividend cases

The plaintiffs' case

440 The plaintiffs' case in relation to the dividends was somewhat amorphous. As pleaded, the case in relation to the interim dividend is summarised in para 53 of the C3ACLS, which provides:

> In the light of the Rebate Maximisation Policy, the Rebate Accounting Approach, and the matters set out in paragraphs 30, 34, 35(a) to (c), 38, 40, 41 to 47 … above, there was no proper or adequate basis for the DSH Directors to approve the payment of the 2015 Interim Dividend pursuant to the resolution set out in paragraph 50(b) above or otherwise because:
>
> (a) there was no proper or adequate basis to approve the 2015 Half Year Financial Report for the reasons set out in paragraph 52;
>
> (b) there was no proper or adequate basis for the DSH Directors to form the view that the payment of the 2015 Interim Dividend would not contravene section 254T of the Corporations Act.

441 Relevantly, s 254T provides that "A company must not pay a dividend unless … (c) the payment of the dividend does not materially prejudice the company's ability to pay its creditors". The resolution set out in paragraph 50(b) was the resolution passed at the board meeting on 16 February 2015 "that DSH pay an interim dividend of 7 cents with a record date to 12 March 2015 and a payment date of 30 April 2015".

442 Various matters are referred to in paragraphs 30, 34, 35(a) to (c), 38, 40, 41 to 47. The same matters are picked up by paragraph 52 of the C3ACLS. Those matters include the following:

> (a) DSH should have made, but failed to make, provisions and write-offs with respect to Bad Stock held or likely to be held as at 28 December 2014;
>
> (b) DSH had from time to time exceeded the limit of its facility with Westpac and required extensions in that facility to meet its financial obligations;
>
> (c) DSH had deferred payment for stock and delivery of goods;

(d) As at 12 February 2015, DSH had acquired excessive inventory;

(e) As at 12 February 2015, DSH's cash flow projections were unreliable.

The reference to the "Rebate Accounting Approach" is a reference to the way in which DSH accounted for rebates "payable" on private label stock.

443 A similar case is pleaded in relation to the resolution passed at the board meeting held on 17 August 2015 that DSH pay a final dividend of 5 cents with a record date of 30 September 2015 and a payment date of 30 September 2015 (C3ACLS para 64), although, of course, the precise facts relied on are different.

444 In their final written submissions, the plaintiffs sought to put their case in relation to the dividends in four ways. First, it was alleged that the directors, acting with reasonable care and diligence, could not or should not have declared either dividend because DSH had other needs for the money. In making that submission, the plaintiffs point to the deteriorating financial position of DSH compared to the FY15 Budget. Second, it was alleged that DSH had insufficient cash flow to pay a dividend consistently with s 254T(1) of the Corporations Act. It was alleged that the directors breached their duties under s 180 by causing DSH to pay the dividends in breach of that provision. Third, it was alleged that it was a breach by the directors of their duties to cause DSH to pay a dividend having regard to the policies DSH had adopted, particularly in relation to O&A rebates, and the absence of controls to mitigate the consequences of those policies. Fourth, it was submitted that the directors could not properly declare a dividend because they failed to exercise reasonable care in approving DSH's accounts. DSH claims as damages the amount of the dividends.

445 As finally put in oral submissions, the case rested principally on s 254T. An alternative case was put only if s 254T was construed narrowly so that it did not apply to future creditors. In that event, the plaintiffs submitted that the directors could still breach their duties under s 180 by paying a dividend if they knew or ought reasonably to have known that DSH would continue to incur debts and its ability to pay the creditors to whom those debts were owed would be materially prejudiced if the dividend was paid. In putting the case in that way,

however, the plaintiffs sought to retain many of the allegations that were included in the pleading and in the written submissions concerning the way in which DSH was managed.

DSH's constitution

446 Any dividend had to be paid in accordance with the company's constitution: *Industrial Equity Limited v Blackburn* (1977) 137 CLR 567; [1977] HCA 59 at 375-6 per Mason J (Stephen Murphy and Aickin JJ agreeing). In the case of DSH, the declaration and payment of dividends was governed by cls 85 and 86 of its Constitution, which provided:

> **85. Dividends**
>
> If, in their judgement, and subject to the requirements of the Corporations Act and common law relating to the declaration of dividends, the financial position of the Company justifies it, the Directors may by resolution either:
>
> (a) declare a dividend and may fix the amount, the time for and method of payment; or
>
> (b) determine a dividend is payable and fix the amount and the time for and method of payment.
>
> **86. Amend resolution to pay dividend**
>
> If the Directors determine that a dividend is payable under **clause 85(b)**, and if, in their judgement, and subject to the requirements of the Corporations Act and common law relating to the declaration of dividends, the financial position of the Company, either in the case of amendment, justifies it, or in the case of revocation, no longer justifies it, and if permitted by the ASX Listing Rules, the Directors may amend or revoke the resolution to pay the dividend before the record date notified to ASX for determining entitlements to that dividend.

Issues with the plaintiffs' case

447 Section 254T of the Corporations Act does not itself impose obligations on directors of a corporation in relation to the payment of a dividend. And the fact that a corporation breaches s 254T does not itself mean that the directors are in breach of their obligations under s 180: *Cassimatis v Australian Securities and Investments Commission* (2020) 275 FCR 533; [2020] FCAFC 52 at [463]; *Australian Securities and Investments Commission v Warrenmang Ltd* (2007) 63 ACSR 623; [2007] FCA 973 at [23]-[24] per Gordon J. Although directors do not owe a general duty to prevent a corporation from breaching the law, they owe a duty to exercise reasonable care and diligence to prevent the harm that a breach of the law may involve. Precisely what that involves will depend on a variety of factors including the nature of the law, the risk of harm to which a

breach will expose the corporation and what steps might reasonably have been taken to avoid the breach.

448 Section 254T sets out fundamental principles relating to the payment of dividends and it is to be expected that a director acting with reasonable care and diligence would, before participating in a decision to pay or to declare a dividend, be familiar with those principles and take reasonable steps to satisfy himself or herself that the company, in paying a dividend, would comply with them.

449 In their written submissions, Mr Abboud and Mr Potts advance an argument that the plaintiffs' case fails to identify why the payment of the interim and final dividends posed any risk of harm to DSH, as opposed to its creditors. They put the argument in these terms:

> It is not self-evident that the payment of a dividend poses any harm to the Company. On the contrary, prima facie, payment of a dividend is in the interests of the shareholders, who are the corporators and whose interests are usually considered to be aligned with the interests of the corporation.

They also rely on cases which establish the proposition that only where a corporation is insolvent or nearing insolvency do the directors owe a duty to consider the interests of creditors: see *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Australian Securities and Investments Commission v Maxwell* [2006] NSWSC 1052; (2006) 59 ACSR 373. Since there is no allegation that DSH was insolvent or nearing insolvency at the time the dividends were paid, it cannot be said that the directors' duties extended in this case to the consideration of the effect of the payment of the dividends on creditors.

450 In my opinion, this submission is not an answer to the case based on s 254T. The duty owed by the directors is a duty owed to the corporation. Discharge of that duty is not to be measured solely by reference to the interests of the shareholders. It is to be measured by reference to the interests of the corporation itself. Section 254T imposes a specific duty on the corporation not to pay a dividend in the circumstances set out in the section. It cannot be the case that a director when considering whether to pay a dividend is entitled to ignore the requirements of the section. However, the economic consequences

to the corporation are important to the relief available against the directors, assuming there has been a breach of the section. That issue is addressed below.

451 One notable feature about the pleaded claim is that it is not alleged that the HY15 or FY15 accounts contained material errors (a claim to that effect was struck out). Nor is it alleged that by paying the dividends DSH breached s 254T. Rather, what is alleged is that the directors breached their duties by paying the dividends because they did not have a proper basis to approve the accounts and did not have a proper basis to form the view that the payment of the 2015 interim dividend would not contravene s 254T of the Corporations Act. But there are difficulties with the plaintiffs' case framed in that way. The accounts were the subject of a review (in the case of the HY15 accounts) and an audit (in the case of the FY15 accounts) by Deloitte and Deloitte provided unqualified opinions in relation to them. Absent some challenge to the accounts, it is difficult to see why the directors were not entitled to proceed on the basis that the accounts gave a true and fair view of the financial position of DSH. And absent some allegation that DSH breached s 254T by paying the dividends, it is difficult to see what consequences could flow from the alleged breach by the directors of their duties under s 180. How could it be said that DSH suffered a loss because the directors did not consider adequately the question whether the payment of the dividends breached s 254T if, in fact, the payments did not breach that section? As Greenwood J explained in *Cassimatis v Australian Securities and Investments Commission* (2020) 275 FCR 533; [2020] FCAFC 52 at [79]:

> The contraventions of the particular sections of the Act by Storm were, of course, material to the foreseeable risk of serious harm to Storm which the appellants, as a matter of primary obligation on their part, were required to guard against, in the exercise of their powers of management and the discharge of their duties of management, by exercising the required statutory degree of objective care and diligence that a reasonable person would exercise in their position, in the corporation's circumstances and having the same responsibilities within the corporation as the appellants, particularly having regard to the degree of control the appellants exercised over Storm ... Had ASIC not been able to establish conduct that engaged contraventions of the sections of the Act by Storm as found, it would have been difficult, if not impossible, to sustain the contention that the appellants engaged in a contravention of s 180(1) by failing to guard against a foreseeable risk of serious harm to Storm which was said to have arisen out of such

> contraventions. …The contraventions of the Act by Storm were a necessary element of the harm, but not sufficient by themselves to result in a contravention of s 180 by the appellants as directors.

Similarly, in this case, without an allegation that s 254T was breached, what harm did DSH suffer as a consequence of the directors' conduct? I return to this question below when discussing damages. However, it appears to be a fundamental difficulty with this aspect of the plaintiffs' pleaded case.

452 As I have said, the plaintiffs also seek to advance an argument that the directors could breach their obligations under s 180 in relation to the payment of a dividend even if the payment is not prohibited by s 254T, at least if s 254T does not cover future creditors. How that could be so is unclear. The duties imposed on directors by s 180 are duties to the corporation, not to creditors. As explained earlier, the duties owed to the corporation may require the directors to consider the interests of creditors where the corporation is insolvent or nearing insolvency. However, it is not alleged that DSH was insolvent or nearing insolvency at the time the dividends were paid. The breach of s 180 arises, if at all, because the directors' conduct in paying the dividends exposed DSH to a contravention of s 254T.

453 Section 245T in its present form was introduced by the *Corporations Amendment (Corporate Reporting Reform) Act 2010* (Cth). Prior to the amendment, s 254T provided that "A dividend may only be paid out of profits of the company". Paragraph 3.2 of the explanatory memorandum which accompanied the relevant Bill gave the following reasons for the amendment:

> Industry has raised the following concerns with the profits test:
>
> ▪ the Corporations Act does not provide guidance about, or a definition of, the term 'profits'. In addition, the legal precedents on this issue are outdated and complex and not in line with current accounting principles. This makes it difficult for directors to understand the legal requirements when paying dividends;
>
> ▪ the nature of accounting principles for the calculation of profits has changed over time. Australian accounting standards, particularly following the adoption of International Financial Reporting Standards (IFRS), are increasingly linked to the fair value (whether realised or unrealised) impacting on the profitability of the company. This makes the profitability of Australian companies increasingly volatile with a large number of non-cash expenses being included in the net result. In these circumstances a company may have sufficient cash to pay a dividend to shareholders but is unable to do so because the

accounting profits of the company have been eliminated by non-cash expenses; and

- the requirement for companies to pay dividends only out of profits is inconsistent with the trend to lessen the capital maintenance doctrine in Australia.

One of the purposes, therefore, of the amendment was to simplify the law relating to the payment of dividends to make it easier for directors to understand their duties in that regard. It would be contrary to that purpose to interpret s 180 as imposing some broader and undefined duty on directors arising from the payment of a dividend and the alleged effect of that payment on creditors.

454 The claim in relation to the payment of the dividends raises three other legal issues. The first is whether the reference to "creditors" in s 254T includes a reference to future creditors. The second is what is meant by the expression "materially prejudice". The third is whether the business judgment rule contained in s 180(2) applies to the payment of a dividend.

455 As to the first of these issues, the prohibition is on the *payment* of the dividend. Consequently, at the time a dividend is declared or the date for its payment is fixed, the directors must, consistently with their duties under s 180, consider what creditors the company is likely to have at the time of payment and whether the interests of those creditors will be materially prejudiced. In that sense, the directors may be required to consider future creditors at the time they consider the issue. However, there is nothing in s 254T to suggest that it operates as a prohibition on the payment of a dividend because of the effect of the payment on persons who do not exist at the time that it is made. The ordinary meaning of the word "creditors" does not extend to future creditors in that sense; and it is difficult to see how the section could be applied if it was intended to cover future debts. How far into the future, for example, would it be necessary to look to consider whether the payment of a dividend would materially prejudice a future creditor?

456 Moreover, s 254T must be understood as one of a number of provisions in the Corporations Act which are designed to protect the interests of creditors. It should be read in conjunction with the insolvent trading provisions contained in s 588G, which have the effect of making a director liable for a debt incurred by

the company if the company was insolvent at the time the debt was incurred (or becomes insolvent as a result of incurring the debt) and the director suspected, or a reasonable person in the position of the director would suspect, that the company was insolvent (or would become insolvent). Although the legislature has chosen different means of achieving its objectives, it is apparent that s 254T is concerned to protect existing creditors by prohibiting a company from paying a dividend if the payment would materially prejudice the interests of those creditors. Section 588G is concerned to protect "future" creditors by making a director personally liable (in certain circumstances) for debts owed to them if the debts were incurred at a time when the company was insolvent.

457 As to the second issue, there appears to be no case directly on point. However, the concept of material prejudice appears in other contexts and has been considered in those. For example, s 256B(1) of the Corporations Act relevantly provides that a company may not reduce its share capital if, among other things, the reduction "materially prejudices" the company's ability to pay its creditors. In *Re CSR Ltd* (2010) 183 FCR 358; [2010] FCAFC 34, Keane CJ and Jacobson J, after referring to the explanatory memorandum which accompanied the Bill which introduced s 256B in the Act (and which not particularly helpfully stated that "Whether prejudice is 'material' will be a question of judgment to be determined in light of all relevant circumstances") said this (at [45]):

> One is, we think, on safe ground, however, in treating "material prejudice" to a company's ability to pay its creditors as relating to the creation of a material as opposed to theoretical increase, in the likelihood that the reduction in capital will result in a reduced ability to pay creditors.

Presumably, the "reduced ability" includes a material increase in risk that the creditors will not be paid at all and a material delay in paying them when their debts are due.

458 Similarly, s 260A of the Corporations Act relevantly provides that a company may not financially assist a person to acquire shares in the company if it would, among other things, "materially prejudice" the company's ability to pay its creditors. Commenting on the expression in that context, the High Court in *Connective Services Pty Ltd v Slea Pty Ltd* (2019) 767 CLR 461, [2019] HCA 33 at [26] said:

> The issue of material prejudice to the interests of the company or its shareholders or creditors requires an assessment of and comparison between the position before the giving of the financial assistance and the position after it to see whether the company or its shareholders or its ability to pay its creditors is in a worse position. It does not assist to gloss the concept of material prejudice by the introduction of further concepts, which themselves require further explanation …

459 As to the third issue, each of the directors other than Mr Abboud relies on s 180(2). It appears that Mr Abboud does not do so because he does not satisfy the requirement that he did not have a material personal interest in the decision, since a company he controlled held 15,345,639 shares in DSH at the time the board passed resolutions in relation to both dividends. For the same reason, the plaintiffs submit, and I accept, that Mr Wavish, who held 6,424,148 shares, cannot rely on s 180(2).

460 Section 180(2) applies to business judgments. "Business judgment" is defined in s 180(3) to mean "any decision to take or not take action in respect of a matter relevant to the business operations of the corporation". The question is whether the payment of a dividend is a matter relevant to the business operations of the corporation. In my opinion, it is. The payment of a dividend reduces the funds otherwise available to the corporation for use in its business. The decision to pay a dividend is, therefore, plainly relevant to the business operations of the corporation because it affects the funds available to conduct those operations.

461 The plaintiffs suggest that the decision to pay a dividend is not itself a decision concerning the business operations of the corporation and consequently is not one falling within the scope of s 180(2). But even accepting the premise, the conclusion does not follow. As I have explained, the payment of a dividend is *relevant* to the business operations of the corporation because it affects the funds available for use in the corporation's business. That is sufficient for the decision to pay the dividend to fall within s 180(2).

462 It follows that under s 180(2), the directors (other than Mr Abboud and Mr Wavish) are taken to have discharged their obligations in relation to the declaration of the dividends if they:

(a) made the judgment to declare the dividend in good faith for a proper purpose; and

(b) informed themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(c) rationally believed that the judgment was in the best interests of the corporation.

A pleading point

463 In final submissions, the plaintiffs also sought to advance a case in relation to the interim dividend (but not the final dividend) that the directors breached their duties by failing before 12 March 2015 to exercise their powers under cl 86 of DSH's Constitution to revoke the decision to pay a dividend in the light of events occurring between the date the dividend was declared and the record date. The plaintiffs explained that they did not raise the same point in relation to the final dividend for two reasons. First, the actual resolution passed by the directors was not recorded in the minutes. Consequently, it is not possible to know whether the directors resolved to pay the dividend (in which case cl 86 applied) or resolved to declare a dividend (in which case it didn't). Second, in the case of the final dividend, the record date was only two weeks after the date the resolution was passed. The plaintiffs do not suggest that DSH's financial position changed in those two weeks.

464 The question remains whether the plaintiffs are now entitled to advance an alternative case in relation to the interim dividend. They submit that that case is consistent with the pleading because the pleaded case that each of the relevant directors breached their duties to DSH by participating in the resolution on 16 February 2015 "is sufficient to encompass the directors not undoing the effect of the resolution before 12 March 2015 given they had the power to do so, because it is both the exercise of the power under cl 85(b) and the failure to exercise the power under cl 86 which "caused [the Company] to pay the 2015 Interim Dividend"".

465 I do not accept that submission. A decision to pay a dividend and a decision to revoke that decision involve the exercise of separate powers. The plaintiffs only plead an exercise by the directors of the power to decide to pay a dividend, not a failure to exercise a power to revoke that decision. Moreover, the pleading alleges what are said to be certain facts relevant to the financial position of DSH as at 16 February 2015. There is no allegation that the financial position

of DSH was different as at 12 March 2015 or how it was different, but allegations of that type are critical to a claim based on the later date. If those allegations had been made, the defendants may have conducted the case differently. In particular, they may have sought to lead evidence relevant to DSH's financial position at the later date and their knowledge of it. They would be prejudiced if the plaintiffs were now permitted to advance a case based on the position at the later date. For those reasons, the plaintiffs' case based on the later date must be rejected.

The interim dividend

466 As I have said, the plaintiffs' case as finally put is that the directors could not resolve to pay the interim dividend consistently with their duties under s 180 of the Corporations Act because they could not be satisfied based on what they knew or ought to have known that the interests of creditors would not be materially prejudiced by the payment of the dividend. Because the focus of the case was on an absence of satisfaction that the interests of creditors would not be materially prejudiced, the plaintiffs do not directly address the prejudice they say creditors suffered as a consequence of the payment of the dividend. Rather, the focus of the submissions is on what is said to be the poor and deteriorating financial position of DSH.

467 In making that submission, the plaintiffs continue to rely on the matters referred to in the pleading. Broadly speaking, those matters fall into four categories. First, there are matters relevant to the reliability or accuracy of the HY15 accounts, which relate principally to the way in which rebates resulting from the Rebate Uplift Practice were accounted for and the provision that was made in the accounts for Bad Stock. Second, there are the matters relating to stock – the fact that DSH had too much stock and the fact that that had arisen from the Rebate Maximisation Policy. Third, there are the matters relating to DSH's banking facility and the fact that on occasions DSH exceeded the limits of its facility. Fourth, there are the matters relating to DSH's cash flow including the deferral of creditors and what is said to be the unreliable nature of DSH's projections.

468 The plaintiffs never satisfactorily explained how they could assert that the directors (particularly Mr Abboud and Mr Potts) appreciated or ought to have appreciated that they could not rely on the HY15 accounts because of the way DSH accounted the Rebate Uplift Practice and because Bad Stock was inadequately provided for when at the same time they could not maintain a case that those accounts materially misstated DSH's financial position. It seems plain that the directors were entitled to rely on the HY15 accounts for the purpose of approving the dividend unless there was something wrong with those accounts; and the plaintiffs accept that it is not open to them to assert that there was anything wrong with them. Consequently, the starting point for a consideration of whether DSH's financial position was such as to permit the payment of a dividend was the HY15 accounts. Those accounts disclosed net profit for the half year ended 28 December 2014 of $25,204,000. They also disclosed total current assets of $444,670,000 (which included $17,930,000 in cash, inventory of $335,843,000 and trade and other receivables of $79,590,000), current liabilities of $358,266,000 (including trade and other payables of $337,916,000 and provisions of $12,625,000), and net assets of $179,055,000.

469 The trading update for January 2015 which was included in the board papers for the meeting on 16 February 2015 (when the dividend was approved) is summarised earlier in this judgment (see para [166_Ref69122630]). It showed that for FY15 sales (of $794,177,000) were slightly ahead of budget, that NPAT (of $26,803,000) was approximately ten percent behind budget, that working capital was $139,410,000 and that net inventory was $356,700,000, well in excess of the November forecast of $213,769,000. It also showed that net cash at the end of the month was negative $52,827,000.

470 These figures suggest two things. The first is that DSH continued to make significant profits, although somewhat lower than forecast. The second is that DSH was overstocked, with a corresponding deterioration in its cash position. They certainly do not suggest that creditors would be materially prejudiced if DSH paid an interim dividend totalling $16.56 million.

471 As already mentioned, there is no question that DSH was substantially overstocked at the time the interim dividend was approved and that that fact was apparent to all directors. I have also concluded that it was apparent by that stage to Mr Abboud and Mr Potts (but not the NEDs) that one of the contributing factors to that position was the drive by DSH to obtain O&A rebates. But again, it is difficult to see why those facts suggested that creditors would be materially prejudiced if the interim dividend was paid. It was not apparent in February 2015 that that stock could not be sold for the value recorded in the accounts for HY15. Nor was it suggested that the position had changed to such an extent between 28 December 2014 and 16 February 2015 that the value attributed to DSH's stock could no longer be relied on. Nor was it suggested that that stock was incapable of being sold. The plaintiffs' case appears to be that until the excess stock was addressed it was imprudent to pay the dividend. They say this in their written submissions:

> What was required from the directors was a clear recognition that the Company was overstocked, an investigation into why it had happened (although Mr Abboud and Mr Potts well knew why, of course), a clear and documented plan to address the inventory problems (including by amending the FY15 budget), immediately paying outstanding debts to creditors and repairing relations with them, ending the Company's practice of not paying its debts on time, investing in systems and processes to ensure that the risks around buying were appropriately controlled and ending the accounting approach that encouraged the pursuit of O&A rebates and the recognition of profit through buying rather than selling. By paying the Interim Dividend, the Company's operations, in contrast, were jeopardised with no immediate or concrete benefit.

472 There are, however, a number of difficulties with this submission. First, that is not how the case is pleaded. Second, the directors did do a number of things it is said they should have done. They clearly recognised that DSH was overstocked, the NEDs were told that management had a plan to address the position and the evidence is that a plan to that effect was implemented which met with some success. Third, it is unclear why some of the steps it is said the directors should have taken were necessary. It is not entirely clear why it was necessary to document the plan or to amend the FY15 budget. As I have explained, it is not clear what additional systems DSH should have invested in. It already had systems in place to monitor the ordering of stock. Fourth, it is unclear why many of the steps it is said the directors should have taken

provided a reason for not paying an interim dividend. If they were necessary, they could have been taken in conjunction with the payment of the dividend. The plaintiffs do not explain why the creditors would not be paid in the ordinary course of events through the sale of stock (and, if necessary, drawing on DSH's available facility) irrespective of whether the dividend was paid, or why the directors were not entitled to form the view that they would be. Fifth, it is not correct to say that the payment of the dividend had no immediate or concrete benefits. It was of considerable benefit to the shareholders and was consistent with a policy that had been adopted by the board.

473 It is convenient to take the last two issues together. The gravamen of the plaintiffs' case is that DSH could not afford to pay the interim dividend without exceeding the Westpac facility or delaying the payment of creditors, or at least the directors could not be satisfied that it would be able to do so.

474 The cash flow forecasts included in the February 2015 board papers show that DSH's cash position would remain within its facility limit up until the end of the financial year and that DSH's net debt position would peak at $76,002,000 in April 2015, the month in which the dividend was to be paid.

475 The plaintiffs submit that the directors were not entitled to rely on that forecast for three reasons. First, they plead that DSH's cash flow forecasts were unreliable. Second, they submit that the monthly cash flow forecasts included in the board papers did not show peak debt. Third, they submit that the forecasts do not take account of the fact that DSH had a practice of pushing out the payment of creditors.

476 The plaintiffs do not explain in their submissions why the cash flow forecasts included in the board papers were so unreliable that the directors were not entitled to rely on them in approving the payment of the dividend and it is unclear whether that aspect of the pleaded case has been abandoned. The evidence does not support the contention that DSH's cash flow forecasts were generally unreliable. For example, it is apparent from Annexure 2, that there were no serious discrepancies between the forecasts included in the August 2014 board papers and the actual results until November and December 2014; and many of the later forecasts proved to be reasonably accurate. It is true that

there were large discrepancies between some of the forecasts and relevantly the actual results for December 2014 and January 2015. But those discrepancies arose from the fact that DSH bought too much stock starting in about October 2014. The directors were aware of that fact and substantial adjustments were made to the forecast included in the board papers for the February 2015 meeting to allow for it. As things turned out, those adjustments were not sufficient and more accurate forecasts were not made until the ones included in the board papers for the March 2015 meeting. But there is no reason to think that any of the directors should have appreciated that the February 2015 forecasts did not provide a reasonable basis for making a decision in relation to the payment of the interim dividend.

477 The evidence given by Mr Wavish, Mr Murray and Mr Tomlinson is that it would not be usual for a board of a public company to be provided with daily or weekly cash flow forecasts. Each of them has had considerable experience on the boards of public companies. The evidence they give is plausible and I accept it. What is important to a board is the financial performance of the company over time, not the daily or weekly management of the company's creditors. Even if the monthly forecasts do not disclose peak debt in any given month, that information itself is immaterial. What is important is whether there are changes in the level of debt over time and whether the company remains within its facility limits. The first matter is disclosed by the monthly cash flows. The second matter was the subject of a specific comment in Mr Potts's monthly report to the board.

478 As I have explained, the daily cash flow forecast that was current at the time the FAC and the board considered the payment of the interim dividend indicated that DSH would exceed its facility limit on several occasions before the dividend was to be paid. However, it suggested that DSH would be within its facility limit at the time the dividend was paid and would remain so for the rest of the financial year. The daily cash flows did not include cash in transit. The weekly forecast suggested that DSH was expected to exceed its facility limit only once by approximately $10 million. That was well before the dividend was due for payment.

479 There is no evidence that Mr Abboud was aware of the then current daily or weekly cash flow forecasts. He gives evidence that he cannot recall whether he was or not. The plaintiffs submit that it does not matter whether he was aware of them or not. According to them, he ought to have been aware of them so that the same consequences follow. I do not accept that submission. As the CEO, it is to be expected that Mr Abboud would monitor the actual financial performance of the company closely, including sales and profit. The evidence suggests that he did. It would also be important for Mr Abboud to know if there was any issue with the payment of creditors and whether DSH was likely to exceed the limits of its facilities. However, in my opinion, it would have been reasonable for Mr Abboud to rely on others to tell him if that was the case. I do not think that it was necessary for him to review the daily and weekly cash flow forecasts himself.

480 Mr Potts was in a different position. As CFO, it is to be expected that he would review the daily and weekly cash flow forecasts regularly. He was the executive with primary responsibility for overseeing the financial performance of the company, including monitoring its cash needs and the payment of creditors. In order to discharge those duties, it is to be expected that he would review the daily and weekly cash flow forecasts. Mr Potts prepared the dividend discussion paper. That paper specifically says that the payment of the dividend had been factored into the weekly cash flow forecasts. That statement must be interpreted as meaning not only that the payment had been included in the forecasts but that the dividend could be paid consistently with DSH's cash needs and the cash available to it. In order to make that statement, Mr Potts would have to have reviewed the then current forecast. He, of course, does not deny that he did. However, for the reasons I have given, I do not think that the daily or weekly forecasts indicated that the dividend could not be paid. On the contrary, they suggested that at the time of payment DSH had the necessary cash available to it (through borrowings) and that the payment would not deprive it of cash that it needed going forward.

481 The plaintiffs point to the fact that DSH had a history of exceeding its facility limit with Westpac on occasions. However, the relevance of that is unclear. The question is whether, as a result of the payment of the dividend, DSH would

exceed its facility limit. None of the cash flows prepared at the time suggested that it would. Moreover, it is somewhat misleading to characterise what happened as DSH exceeding its facility limit. The facility limit could not be exceeded without the agreement of Westpac. Sometimes that agreement was a formal extension for an agreed period. On other occasions, Westpac permitted DSH to exceed the facility limit in the expectation (which was correct) that the facility would only be exceeded for a short period of time. None of that points to a material prejudice to creditors if the dividend was paid.

482 The third point raised by the plaintiffs appears to have more force. It is apparent that Mr Abboud and Mr Potts, but not the NEDs, were aware that DSH was pushing out the payment of creditors. If creditors were being paid late and if the payment of the dividend made the position materially worse, then it might be said that the payment of the dividend materially prejudiced the interests of creditors. However, in order to reach that conclusion, it would be necessary to know the length of the delays, whether the delays occurred with the agreement or acquiescence of the creditors and the extent to which the payment of the dividend made the position worse. None of those things are known in this case, but the evidence suggests that the delay in the payment of creditors was not a serious issue at the time the interim dividend was paid.

483 The evidence in relation to this aspect of the case is dealt with in some detail earlier: see para [132_Ref69200335]ff. That evidence establishes that at least from about October 2014 DSH started delaying the payment of some creditors as a cash management tool. The evidence is that that was common in the retail industry. Mr Tomlinson gave unchallenged evidence to that effect. His evidence was supported by a Discussion Paper "Australian Prompt Payment Protocol" published by the Australian Government, Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, which was tendered by the defendants. According to that discussion paper "over 32 per cent of all business payments were made beyond the standard 30 day term" and the average for retail trade was 53.5 days.

484 In some cases, the delays were with the agreement or acquiescence of the creditors concerned. In others, they were not. Neither Ms Howard's nor Mr

Dougall's analysis takes account of cases where a creditor agreed or acquiesced in an extension or where there was a valid reason for a delay (because, for example, there was a dispute concerning supply). A further difficulty with Mr Dougall's analysis is that he classified an invoice as having been paid late if it was paid in the calendar month after it was issued. However, DSH operated on the basis of financial months. In their written submissions, Mr Abboud and Mr Potts point to examples of invoices which would not have been paid late according to Mr Dougall's approach if he had adopted financial months rather than calendar months because the invoices were issued and paid in the same financial month. How significant this point is is unclear, but it makes it difficult to rely on Mr Dougall's conclusions. Moreover, it is not possible to determine accurately the length of the delays. Even on Ms Howard's evidence in most months it was no more than about 14 days. There is no evidence of what the effect on creditors would have been if the interim dividend had not been paid. One possibility is that it would simply have reduced the extent to which DSH drew on the Westpac facility. That would have had no material effect on creditors at all.

485 Mr Dougall undertakes an analysis which is said to demonstrate that once unpaid creditors are taken into account, DSH could not pay its creditors without exceeding the limit on the Westpac facility. However, the value of this analysis is seriously undermined by the way in which Mr Dougall seeks to identify overdue creditors.

486 Taking these matters into account, it could not be said that DSH's practice of delaying paying some creditors meant that the payment of the interim dividend materially prejudiced the interests of creditors or that Mr Abboud and Mr Potts ought to have appreciated that that would be or was likely to be the case.

The final dividend

487 With one exception, the final dividend raises similar issues to the interim dividend. The exception is that it is also alleged against Mr Abboud and Mr Potts that they had no proper basis for giving the declaration required by s 295A of the Corporations Act. That section required Mr Abboud and Mr Potts as CEO and CFO respectively relevantly to give a declaration to the effect that

the FY15 financial statements complied with the accounting standards and gave a true and fair view of DSH's financial position. It is difficult to see how that allegation adds anything to the allegation that the directors had no proper basis for approving the FY15 accounts. It must be rejected for the same reason.

488 It is unnecessary to repeat much of what was said in this context about the way in which the plaintiffs put their case. The points already made apply equally to the payment of the final dividend. Instead, it is necessary to focus on what the directors' knew about the financial position of DSH and whether (to put the issue in terms of the pleaded case) there was no proper or adequate basis for directors in the position of the DSH Directors to form the view that the payment of the 2015 final dividend would not contravene s 254T of the Corporations Act.

489 At the time that the board resolved to pay or to declare the final dividend (at the board meeting on 17 August 2015) it had before it the audited FY15 accounts. As I have explained, it is no longer open to the plaintiffs to contend that those accounts were materially misstated. Those accounts disclosed NPAT for FY15 of $37,403,000 compared to $19,442,000 for the previous year, which was at the lower end of forecast. They also disclosed total current assets of $389,979,000 (which included cash of $29,511,000, inventory of $293,044,000 and trade and other receivables of $53,323,000), current liabilities of $316,527,000 (including trade and other payables of $228,442,000, borrowings of $70.500,000 and provisions of $13,294,000) and net assts of $169,147,000.

490 The trading update for August 2015 which was included in the board papers for the meeting on 17 August 2015 is summarised earlier in this judgment (see para [275_Ref69210139]). It showed that sales for July ($97,188,000) were approximately $2,521,000 behind budget, that NPAT (of negative $1.3 million) was $100,000 better than budget, that working capital was $163,460,000 and that net inventory was $315,586,000. It also showed that net debt was $100,800,000. At that time, DSH was forecasting a full year NPAT of $47.1 million, a $100,000 increase on the budget.

491 There is nothing in these figures themselves which would suggest that creditors would be materially prejudiced if DSH paid the proposed dividend of

5.0 cents a share (which totalled $11.83 million). It is plain from the figures that DSH remained substantially overstocked, and that the stock position had deteriorated further between June and July 2015. It is also apparent from Annexure 2 that from at least March 2015 management's forecasts of the stock position were consistently overly optimistic. On the findings I have made, it was evident to Mr Abboud and Mr Potts that a substantial contributing factor to that position was the emphasis that was placed on the collection of O&A rebates. On the other hand, the FY15 accounts recorded a provision of $13,294,000 against inventory of $293,044,000. The update included in the board papers for the August 2015 meeting showed that net inventory was $315,586,000 against provisions and accruals of $13,189,000. It also showed that working capital was $163,460,000. These figures suggest that, if necessary, DSH could raise additional cash through the sale of stock.

492 The cash flow included with the August board papers indicated the following cash position (in thousands of dollars) for the first half of FY16:

Jul-15 (actual)	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15
(100,802)	(98,544)	(70,983)	(82,554)	(72,944)	8,926

493 As is apparent from Annexure 2, management's cash flow forecasts included in the board papers for March 2015 to July 2015 had proved to be reasonably accurate. In my opinion, the NEDs were entitled to rely on the cash flow forecasts included in the board papers for the meeting in August 2015 in deciding whether to pay a dividend. The forecast showed a gradual improvement in DSH's cash position up until the end of the year and showed that DSH remained well within its new facility limit of $135 million.

494 The plaintiffs submitted that Mr Tomlinson, at least, could not have relied on the financial information in the board papers because by that stage he had formed the view that Mr Potts was out of his depth and should leave the business. I do not accept that submission. It was not put to Mr Tomlinson that the views that he had formed in relation to Mr Potts meant that he could not

rely on the financial results or projections included in the August 2015 board papers. The results for July 2015 were consistent with audited results for FY15 and, as I have explained, it is not open to the plaintiffs to challenge those results. In addition, as I have said, the cash flow forecasts included in the board papers for earlier months had proved to be reasonably accurate.

495 In my opinion, this material provided a sufficient basis for the NEDs to conclude that payment of the final dividend would not cause DSH to breach s 254T of the Corporations Act.

496 The position is no different for Mr Abboud. There is no evidence that he was aware of the information contained in the daily cash flows; and I am not satisfied that he ought to have been aware of it. He was entitled to expect Mr Potts to raise with him any issue with the cash flows which cast doubt on the ability of DSH to pay the dividend. There is no evidence that Mr Potts did so. Mr Abboud was aware that DSH was continuing to delay the payment of some creditors. Ms Howard's analysis suggests that by July or August the delay had increased to three to four weeks and her analysis and Mr Dougall's suggest that the percentage of suppliers whose payments were delayed increased from about September 2014. As I have said, however, there are problems with both these analyses and I do not think that they form an adequate basis for concluding that Mr Abboud ought to have appreciated that there was a risk that the interests of creditors would be materially prejudiced if the dividend was paid. DSH continued to have ample working capital. Mr Abboud obviously thought that trade creditors would continue to be paid, albeit in some cases late, through cash realised from sales. Given the financial information before the board that was not an unreasonable conclusion to reach.

497 The position is different for Mr Potts. As CFO, he must have had access to the daily and weekly cash flow forecasts. In the dividend discussion paper which he prepared and which was considered by the board, he stated that the payment of the dividend had been factored into the weekly cash flows. In order to make that statement, he must have looked at the weekly cash flows. And in making the statement he must be understood as saying that DSH could pay the dividend and meet its other financial commitments.

498 An analysis of the daily and weekly cash flow forecasts is complicated by the fact that the parties rely on at least two forecasts. One was produced at the end of FY15 and was relied on by the plaintiffs in their opening submissions and was addressed orally by Mr Nixon SC in closing submissions on behalf of Mr Abboud and Mr Potts. The other one appears to have been produced shortly before the week commencing 17 August 2015 and is referred to in the plaintiffs' closing submissions. That forecast provides daily figures until 16 October 2015 and weekly figures from then on for the rest of the financial year. It is not entirely clear on what basis the weekly figures were prepared (whether they include cash in transit). The forecast did indicate that DSH would exceed its facility limit on multiple occasions and that it would exceed the facility limit by approximately $33 million on 30 September 2015 – the date that the dividend was due to be paid.

499 In their final written submissions, Mr Abboud and Mr Potts make three points in relation to the second cash flow. First, they point out that it does not include all sources of cash available to the company. Second, they say that the forecasts should be understood as a management tool to identify "pinch points" well in advance so that they could be addressed. Third, they point to the fact that DSH did not in fact exceed its facility limit with NAB and HSBC on a single occasion from the time of entry into them through to the end of December 2015.

500 As to the first of these points, it is not entirely clear what sources of cash Mr Abboud and Mr Potts say were excluded from the cash flow. The likelihood is that it excludes cash in transit. However, that would not have been sufficient to make up the projected shortfall of $33 million. The cash flow obviously includes cash from the sale of merchandise. However, I accept evidence given by Mr Wavish that DSH also had the ability to raise additional cash by, for example, conducting a sale either generally or in one or more specific markets.

501 The second point also appears to be correct, but, of course, one of the purposes of the management tool was to determine whether it was appropriate to pay a dividend and, if so, when.

502 The third point is very relevant to the question of damages. However, it is not relevant to the way in which the plaintiffs put their case on liability. The

question that arises is how Mr Potts could have said in his dividend discussion paper that the payment of the dividend had been factored into the weekly cash flow forecast and how he could have concluded that the interests of creditors would not be materially prejudiced by the payment of the dividend when the relevant weekly cash flow forecast plainly shows that DSH could not meet all its projected liabilities whether or not it paid the dividend.

503 It was not apparent from the cash flow statement available to Mr Potts how DSH would pay all its creditors at the time the dividend was due to be paid. Accepting that, the payment of the dividend was likely to make the position materially worse because it reduced the amount available to pay creditors. It was open to Mr Potts to explain how he concluded that DSH could afford to pay the final dividend at the end of September 2015 in the light of the weekly cash flow forecasts. However, he chose not to do so. It may be that Mr Potts believed that the problem could be solved by delaying paying some creditors, who would be paid eventually. The difficulty with that response is that there is no evidence of how Mr Potts informed himself about the matter and reached a conclusion rationally in relation to it. Accordingly, in my opinion, Mr Potts did breach his duties under s 180 of the Corporations Act by voting in favour of the resolution to pay or to declare the final dividend.

Damages

504 Assuming that the directors contravened their duties under s 180 of the Corporations Act by authorising the payment of the dividends, the question raised by s 1317H is whether damage resulted from the contravention and, if it did, whether the Court should order the directors who contravened the section to pay DSH compensation for that damage.

505 The plaintiffs contend that the damage in this case is that DSH paid the dividends when it would not have had the directors complied with their duties. It is appropriate to focus on the payment of the final dividend and the position of Mr Potts, since, on the findings I have made, it is only Mr Potts's conduct in relation to the payment of that dividend that gives rise to a breach of s 180. Although the plaintiffs do not deal specifically with the position if only one director is found to be in breach of s 180, their case must be that, if Mr Potts

had complied with his duties, he would have told the other directors that the daily or weekly cash flow forecasts showed that DSH would exceed its facility limits for most of the period between September and December 2015 and that far from paying a dividend the company would need to take steps to raise additional cash to pay creditors. The result, the plaintiffs appear to submit, is that the dividend would not have been paid.

506 There are, however, three interrelated difficulties with that submission.

507 First, as I have already explained, the plaintiffs' case appears to be that the directors, and Mr Potts in particular, breached their duties because they could not be satisfied that the payment of the dividend would not result in a breach of s 254T. In other words, the directors breached their duties because, as a result of their lack of diligence and care, they exposed DSH to the risk that by paying the dividends it would breach s 254T. However, unless that risk came to fruition, DSH suffered no loss as a result of the breach.

508 Second, it is not at all clear that the dividend would not have been paid or could not have been paid even if the directors had been aware of the projections contained in the daily/weekly cash flow. The forecast did indicate that DSH would have sufficient cash in December 2015 to pay the dividend and would not exceed its facility limit (even if the dividend was paid) for the rest of the financial year. One option available to the board was to delay payment of the dividend. Another option would have been to require management to formulate a plan to raise additional cash through the sale of stock to enable the dividend to be paid.

509 Third, the task required by s 1317H is an enquiry into the harm that resulted from the payment of the dividend. That harm is not to be measured by the amount of the dividend, but rather the consequences for the company of its payment. In a sense, a company always suffers a detriment when it pays a dividend because it has paid away a sum of money and has received nothing in return. The relevant harm in the case of a breach of s 254T is the inability to pay creditors or to pay them on time. However, the evidence in this case is that, notwithstanding what the cash projections indicated, trade creditors were paid, albeit in some cases late. The payment of the dividend did not prevent

that from happening. Ultimately, NAB and HSBC were not paid in full. However, it cannot be said that they were not paid because DSH paid the final dividend. The fact that DSH ultimately went into receivership and could not repay the Banks in full arose from a complicated series of events that occurred after the dividend was paid, and not because of the payment of the dividend. The fact that DSH may have had more money to repay the Banks if it had not paid the dividends does not mean that it was the payment of the dividends that brought about the circumstances in which DSH could not repay the Banks in full.

510 The likelihood is that the payment of the final dividend caused DSH to delay paying some trade creditors whose debts were due at the time of the payment. However, there is no evidence that those delays caused DSH damage. The creditors were paid, and there is no suggestion that the delay caused DSH some other form of harm. There is some evidence that on occasions some suppliers put DSH's account on hold due to non-payment. However, there is no suggestion that that happened for any significant periods of time at the time the dividends were paid and there is no evidence of what stock could have been bought and was not if the dividends had not been paid that would have resulted in an improvement in DSH's financial position.

511 For these reasons, I have concluded that the plaintiffs are unable to establish that DSH suffered any damage as a consequence of the payment of the dividends, even if their payment involved a breach of s 180 of the Corporations Act.

Other defences

512 The directors rely on defences under ss 1317S and 1318 of the Corporations Act. Section 1317S gives the Court power to relieve a person from the consequences of breach of a civil penalty provision (including the consequences under s 1317H arising from a breach of s 180) where the person has acted honestly and "having regard to all the circumstances of the case … the person ought fairly be excused". Section 1318 gives the Court a similar power in relation to any negligence, default, breach of trust or breach of duty relevantly by an officer of a corporation committed in a capacity as such a

person. Having regard to the conclusions I have reached, it is unnecessary to consider the application of these sections.

The Bank Proceedings

Introduction

513 The case that Mr Abboud and Mr Potts engaged in misleading and deceptive conduct in connection with the HSBC and NAB facilities has three limbs. First, HSBC alleges that it was induced to enter into the Syndicated Facility on 22 June 2015 by the misleading and deceptive conduct of Mr Abboud and Mr Potts. Second, NAB advances a similar claim in relation to the same agreement. Although the two claims arise out of the same agreement or suite of agreements, the Banks concede that the two claims are separate. Each depends on different conduct both on the part of Mr Abboud and Mr Potts and on the part of the Banks and each gives rise to a separate claim for damages.

514 Each bank claims as damages the difference between the amount it advanced and the amount that it has recovered, on the basis that neither would have advanced the funds they did if the misleading and deceptive conduct had not occurred. The calculation of those amounts raises two questions. One arises from the fact that the legal costs of the case have been paid for by the receivers and those legal costs have been deducted from the distributions made to the Banks. The question is whether the Banks must give credit for those legal costs. The other is whether the Banks must give credit for amounts that are currently held by the receivers and not distributed to them. There is also a question whether the Banks have adequately proved the amounts they are entitled to recover and consequently whether they have adequately proved that they suffered any damage at all.

515 Mr Abboud and Mr Potts pleaded a number of positive defences. As finally put, they only rely on one – namely, a proportionate liability defence that DSH and each other were concurrent wrongdoers. A case that Deloitte was also a concurrent wrongdoer was abandoned following the striking-out of the claims based on errors in the audited accounts and the subsequent discontinuance of all claims against Deloitte. A case that Mr Abboud and Mr Potts should be excused under s 1318 of the Corporations Act and a defence of contributory

negligence were not advanced in final submissions and should be taken to have been abandoned.

516 The third limb of the claim is advanced only if the primary claim brought by HSBC fails. In that event, HSBC alleges that it was induced to enter into the Extension Agreement on 16 November 2015 by the misleading and deceptive conduct of Mr Potts. It claims as damages the amount advanced under that agreement.

517 It is convenient first to set out some relevant legal principles and then to deal with each of the three claims, leaving the question of damages and the proportionate liability defence to the end.

Relevant legal principles

518 The Banks rely on s 18 of the *Australian Consumer Law* (***ACL***), s 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (***ASIC Act***), and s 1041H of the Corporations Act. Each of them prohibits a person, in trade or commerce, from engaging in conduct that is misleading or deceptive. Section 12DA applies to conduct in relation to financial services. Section 1041H applies to conduct in relation to a financial product or a financial service. Section 18 applies in other cases. It is unnecessary in this case to deal with the issue whether the conduct in question occurred in relation to a financial service or a financial product or otherwise. Plainly, if the relevant conduct was in trade or commerce and was misleading or deceptive one section or the other applies.

519 The expression "engaging in conduct" is defined in s 2(2) of the ACL (as well as in ss (2) and 12BA(2) of the ASIC Act and s 9 of the Corporations Act). It is of wide import and it is not confined to making a representation: *Miller & Associates Insurance Broking Pty Ltd v BMW Australia Finance Limited* (2010) 241 CLR 357, [2010] HCA 31 at [14]-[15] per French CJ and Kiefel J. It may cover partial disclosure of information (*Australian Competition and Consumer Commission v LG Electronics Australia Pty Ltd* [2017] FCA 1047 at [53]) and silence. Normally, however, for silence to amount to misleading or deceptive conduct the circumstances must be such that they give rise to a reasonable expectation of disclosure: *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31

at 41 (Gummow J, with whom Black CJ and Cooper J agreed). As Gleeson CJ (with whom Samuels AJA and Meagher JA agreed) explained in *Lam v Ausintel Investments Australia Pty Ltd* (1989) 97 FLR 458 at 475:

> Where parties are dealing at arms' length in a commercial situation in which they have conflicting interests it will often be the case that one party will be aware of information which, if known to the other, would or might cause that other party to take a different negotiating stance. This does not in itself impose any obligation on the first party to bring the information to the attention of the other party, and failure to do so would not, without more, ordinarily be regarded as dishonesty or even sharp practice. It would normally only be if there were an obligation of full disclosure that a different result would follow. That could occur, for example, by reason of some feature of the relationship between the parties, or because previous communications between them gave rise to a duty to add to or correct earlier information.

520 In ordinary commercial negotiations between sophisticated parties, as in this case, the court will not readily infer that one party or the other had a reasonable expectation of disclosure by the other. Rather, it is to be expected that both parties will make their own enquiries and, if necessary, ask questions about matters that are material to their decision to enter into the transaction: see *DCT Projects Pty Limited v Champion Homes Sales Pty Limited* [2016] NSWCA 117 at [136] per Gleeson JA (with whom Macfarlan JA and Sackville AJA agreed).

521 Conduct is misleading or deceptive (or is likely to mislead or deceive) if it has a tendency to lead a person into error. As French CJ, Crennan, Bell and Keane JJ explained in *Australian Competition and Consumer Commission* v *TPG Internet Pty Ltd* (2013) 250 CLR 640, [2013] HCA 54 at [39]:

> Conduct is misleading or deceptive, or likely to mislead or deceive, if it has a tendency to lead into error. That is to say there must be a sufficient causal link between the conduct and error on the part of the persons exposed to it. [Footnote omitted]

The possibility of that effect must be real and not remote: *Global Sportsman Pty Ltd* v *Mirror Newspapers Ltd* (1984) 2 FCR 82, [1984] FCA 180 at [14]. The assessment of whether conduct is misleading or deceptive is an objective one, and must take into account the character of the particular conduct in all the circumstances: *Campbell v Backoffice Investments* (2009) 238 CLR 304, [2009] HCA 25 at [25] per French CJ.

522 Section 236 of the ACL, s 12GF of the ASIC Act and s 1041I of the Corporations Act each permits a person who has suffered loss or damage "because of" or "by" the conduct of another in contravention of the relevant statutory prohibition to recover the amount of that loss or damage. The relevant casual connection is described by the expression "because of" in s 236 of the ACL, and by the expression "by" in s 12GF of the ASIC Act and s 1041I of the Corporations Act. There does not appear to be any meaningful difference between the two expressions. The conduct in question needs not be the only cause of the loss or injury suffered. It is sufficient if it contributed materially to it: *Henville v Walker* (2001) 206 CLR 459, [2001] HCA 52 at [14], [61], [109], [153], [163]-[164].

523 If an individual engages in conduct that is misleading and deceptive as a principal or agent of a company, liability may attach to both. As the High Court explained in *Houghton v Arms* (2006) 225 CLR 553, [2006] HCA 59 at [40]:

> …As a general proposition, and as Lord Rodger of Earlsferry stressed in *Standard Chartered Bank v Pakistan Shipping Corpn (Nos 2 and 4),* in the world of tort the status of an individual as an employee does not divest that person of personal liability for wrongful acts committed while an employee. There is no good reason for treating the text of [s 18 of the ACL] any differently and, in particular, for construing the section as if it read '[a] person, as principal, must not …' [Footnote omitted]

524 Similarly, in *Williams v Pisano* (2015) 90 NSWLR 342, [2015] NSWCA 177 at [42] the NSW Court of Appeal (per Emmett JA, Bathurst CJ and McColl JA agreeing) said:

> An employee, who engages in misleading and deceptive conduct in the course of his employment by his employer, engages in that conduct in trade or commerce if the activity of the employer in the pursuit of which the conduct is engaged in is itself in trade or commerce. That is to say, it is not the trade or commerce of the employee but the trade or commerce of the employer in which the conduct takes place. It is not to the point that the employee is not a proprietor of the business or that the employee's activities were an aspect or element not of his own trade or commerce but of the trade or commerce of his employer. The employee nevertheless engages in conduct in the course of trade or commerce and their conduct constitutes a contravention of s 18 by the employee personally. [Footnote omitted]

525 The question in each case is whether "all of the elements of the contravention are made out against the individual or whether he or she merely acted as a corporate organ, binding the company but not the person individually": *Australian Securities and Investments Commission v Narain* (2008) 169 FCR

211, [2008] FCAFC 120 per Jacobson and Gordon JJ at [96], citing *Cleary v Australian Co-Operative Foods Ltd (Nos 2 & 3)* (1999) 32 ACSR 701, [1999] NSWSC 991 at [54], [56] and [57]; *Pico Holdings Inc v Voss* [2004] VSC 263 at [157]; *Genocanna Nominees Pty Ltd v Thirsty Point Pty Ltd* [2006] FCA 1268 at [297]-[305]. That is a question of fact in each case: *Narain* at [97] citing *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets (No 6)* (2007) 63 ACSR 1, [2007] NSWSC 124 at [1056]-[1057].

526 *Narain* provides an example of the application of these principles. Mr Narain was the director of a company called Citrofresh International Ltd (CTF). He (with the assistance of others) prepared an Australian Stock Exchange (***ASX***) release in which it was claimed that CTF's products were effective against HIV/AIDS and other major diseases. He then instructed the company secretary to send the statement to the ASX for publication. The Full Court of the Federal Court, overturning the primary judge's decision, found that Mr Narain (as a person with the authority to order the statement's release and knowledge of the representations contained in it) had personally engaged in misleading and deceptive conduct (at [19] and [98]). On the other hand, the company secretary had no personal liability. He was merely the person who forwarded the statement to ASIC at Mr Narain's direction. His actions were ministerial in nature and undertaken solely as an organ of the company (again at [19] and [98]).

527 Personal liability may be more difficult to establish where the relevant conduct consists of silence. As Hammerschlag J explained in *Swiss Re International SE v Simpson* (2018) 354 ALR 607; [2018] NSWSC 233 at [529]:

> It is one thing to attribute to [Bell] personally the consequences of what he said, because those flow from action which he took. It is another to take a non-disclosure by Forge as Bell's own because he was one, amongst many other potential human embodiments of Forge, who did not disclose it. The non-disclosure was always Forge's. It does not become Bell's non-disclosure because he was not the one on Forge's behalf to disclose it.

HSBC's primary claim

The pleaded case

528 The Banks plead a large number of express and implied representations. Some appear to be pleaded by way of background only and some others are no longer pressed. In substance, HSBC's pleaded case is that:

(1) At the meeting with representatives of HSBC on 3 February 2015 Mr Abboud made the following representations (which were adopted by Mr Potts by his silence):

(a) The net profit after tax of DSH had increased from $6.7 million in the 2013 financial year to $42.2 million in the 2014 financial year;

(b) The keys to the turnaround strategy were (1) centralising buying power (2) cost control and commission based sales and (3) supply chain savings by using each store as a warehouse;

(2) Before 5 March 2015, Mr Abboud or Mr Potts or both stated to HSBC that:

(a) DSH expected that stock would remain at around 100 days going forward;

(b) Build up of inventory from June 2014 was common given seasonal needs and an increase in inventory per store of 25 percent;

(3) During a telephone conversation on 23 March 2015, Mr Potts told Mr Kowik that:

(a) DSH anticipated EBITDA of $90 million for the 2015 financial year, giving a leverage ratio of 1:5;

(b) The revolving credit facility of $70 million was needed to fund expansion by 15 to 20 stores per annum at a cost of around $1.25 million to $1.3 million per store and to fund other capital expenditure including current store refurbishment and information technology;

(4) Neither Mr Abboud nor Mr Potts disclosed to HSBC many of the matters that are the subject of complaint in the Bad Stock case and the Dividend case, including implementation of the Rebate Maximisation Policy, implementation of the Rebate Uplift Practice, the absence of adequate controls, the fact that DSH exceeded the Westpac facility limit on occasions and the fact that DSH delayed paying some creditors;

(5) By reason of the representations and non-disclosures, each of Mr Abboud and Mr Potts impliedly represented that:

(a) DSH had appropriate and effective inventory and cash flow management practices;

(b) The excess inventory position following December 2014 and January 2015 was the consequence of events beyond DSH's control, could be explained and was unlikely to be repeated;

(c) DSH had met its obligations to lenders and trade creditors over the previous six to twelve months;

(d) There was a proper or adequate basis to pay the interim dividend.

Consideration

529 It is common ground that Mr Abboud said at the meeting on 3 February 2015 words to the effect that net profit after tax of DSH had increased from $6.7 million in the 2013 financial year to $42.2 million in the 2014 financial year. However, that statement must be understood as a statement about what the audited financial statements disclosed. It could not be understood as some expression of opinion by Mr Abboud divorced from those statements. Nor could it be understood as an expression of opinion by Mr Abboud on the accuracy of the financial statements. The statements themselves had been audited and signed. HSBC could not have thought that Mr Abboud had engaged in some separate evaluative process of the statements and was expressing an opinion on the statements formed as a consequence of that process. Understood as a statement of what the audited accounts disclosed, the statement was unquestionably true.

530 There is a dispute about whether Mr Abboud used the term "centralised buying power". As I have said, nothing turns on whether he did or not. The statement attributed to Mr Abboud is not alleged to be misleading. Rather, what is said is that by referring to the matters that he did, Mr Abboud engaged in misleading conduct because he did not refer to other matters that were key to the profit result, including the Rebate Maximisation Policy and Mr Abboud and Mr Potts's encouragement of that policy, the Rebate Uplift Practice, the fact that the Rebate Maximisation Policy had caused DSH to buy too much stock and the fact that DSH had no basis for paying the interim dividend. That contention is dealt with below.

531 There is no evidence that Mr Abboud or Mr Potts made the statements attributed to them after the meeting and before 5 March 2015. HSBC relies on the information contained in the CARM circulated by Mr Kowik on 5 March

2015. However, Mr Kowik was not called to give evidence. As I have explained, much of the information contained in the CARM was obtained from other sources, including a previous CARM prepared by Mr Kowik and broker reports. It cannot be inferred that any of the information contained in 5 March 2015 CARM came from Mr Abboud or Mr Potts.

532 It is apparent from Mr Kowik's call report that he spoke to Mr Potts on 23 March 2015. The pleaded representations are consistent with what is recorded in the call report and the likelihood is that they were made. However, there is no evidence that any of them were false. At the DSH board meeting on 20 April 2015, the board approved the FY16 budget which forecast EBITDA of $88.9 million. There is no reason to think that the company was forecasting a different EBITDA at the time Mr Potts spoke to Mr Kowik; and $90 million was plainly a rounded number. Similarly, there is no suggestion that the figures Mr Potts gave for new stores was incorrect. HSBC submitted that it was misleading to suggest that the facility was required for capital expenditure when on the figures given by Mr Potts at most $26 million was required for that purpose. That submission must be rejected. The note goes on to record that DSH spent approximately $25 million per annum on capital expenditure other than new stores. It was obvious from the information that Mr Kowik was given that DSH did not intend to use the whole facility for capital expenditure. Anything Mr Potts said must have been understood as stating that the principal purpose of the facility was to fund capital expenditure. Again, there is no suggestion that a statement to that effect was misleading.

533 HSBC's case on non-disclosure appears to depend on two contentions. One is that by stating that DSH had significantly increased NPAT based on a turnaround strategy that involved centralising buying power, controlling cost and making supply chain savings, Mr Abboud gave the misleading impression that nothing else contributed to the increase in NPAT, whereas the fact was that the increase resulted largely from the Rebate Maximisation Policy and the Rebate Uplift Practice which had resulted in DSH acquiring too much stock and in delaying the payment of creditors. The other is that by Mr Potts describing DSH's banking requirements he somehow or another gave a misleading picture of DSH's past banking relationship and in particular what were said to

be recent breaches of the Westpac facility and of DSH's history of paying some creditors late.

534 In my opinion, these submissions cannot be accepted. A person in the position of the HSBC representatives who attended the meeting could not possibly have thought that Mr Abboud was giving or intending to give a complete account of all the steps that DSH had taken to bring about the improvement in reported NPAT. The meeting was an informal and introductory one. The slides presented by Mr Abboud and Mr Abboud's comments on them were pitched at a general level. Even someone with the most rudimentary understanding of a retail business would have appreciated that the profits that were achieved would have been the result of a large range of decisions concerning matters such as stock acquisition, pricing, and staffing. HSBC was a sophisticated financial institution which, no doubt, had considerable experience itself of the way in which a retail business operated. It is to be expected that it would ask questions about matters that were relevant to its assessment of whether to advance funds to DSH. It could not reasonably have been left with the impression that the only things that led to the increase in NPAT were the things referred to by Mr Abboud. At most, someone at the meeting would have understood that Mr Abboud was referring to some of the steps that DSH had taken to increase its profitability.

535 A number of the things said not to be disclosed are described by reference to practices that did not exist or misdescribe the correct position. According to the findings I have made, there was, for example, no Rebate Maximisation Policy of the type pleaded. Nor was there an error in the FY14 or HY15 accounts. There was nothing wrong with the Rebate Accounting Approach. There was a proper basis to pay the 2015 interim dividend. It could hardly be misleading to fail to disclose matters that were not correct.

536 Moreover, HSBC had conducted a detailed analysis of DSH's financial position and results in the November 2014 CARM. That CARM observed that "Inventory increased by A$85m to A$254m in FY14" and gave explanations for the increase. It also stated that "Trade and vendor receivables increased by A$36m to A$47m largely due to increased vendor rebates receivable' and that

"Other receivables (vendor receivables) of A$37.7m relate primarily to marketing rebates due from vendors (or vendor funded promotional activity)".

Later on, the CARM states:

> Creditor turn was 86 days in FY14, up from 37 in FY13. The increased [sic] in suppliers term is mainly due to supplier renegotiation program FY13-FY14 implemented by the new management. This renegotiation program includes (1) increase in rebate and/or (2) extend payment terms. DSE management has confirmed that creditor turn of 80-90 days is considered sustainable;

And one of the points at the beginning of the CARM states:

> 10. Working capital is considered stable with stock turn targeted at 100 days. Credit days need to remain under review given the business strategy of extending creditor days to provide cash flow.

Against that background, it is to be expected that if HSBC wanted additional information in relation to those matters or an update on those figures, it would have asked. Given what it knew, it could not have thought that Mr Abboud had said all there was to say on the reasons for DSH's improvement in profitability.

537 The position is even clearer in the case of the statements made by Mr Potts. One of the purposes of the meeting was for DSH to tell HSBC about the facilities it was seeking. The fact that Mr Potts did that conveyed nothing about DSH's previous banking relationship or the payment of creditors. No one could have been led into error about those matters by a description of the facilities that DSH wanted. As I have said, HSBC was already aware that DSH had a "strategy of extending creditor days to provide cash flow", which was something that needed "to remain under review". Knowing that, it is to be expected that if HSBC required further information in relation to creditors and DSH's relationship with Westpac, it would have asked.

538 It is unclear whether HSBC still presses a case based on the implied representations. It did not advance any submissions in support of that case. In any event, the implied representations pleaded by HSBC depend on the non-disclosure case. The case is that HSBC was entitled to infer that the pleaded representations were true because Mr Abboud and Mr Potts did not disclose matters that made them false. It must be rejected for the same reasons.

539 It follows that HSBC has failed to prove that Mr Abboud or Mr Potts engaged in any misleading or deceptive conduct in connection with the facility.

540 Mr Abboud and Mr Potts submit that, even if, contrary to the conclusions of the previous paragraph, the Court finds that one or other of them did engage in misleading or deceptive conduct, HSBC has failed to prove that it relied on that conduct in entering the facility agreement and consequently has failed to prove reliance.

541 It is not possible to express a definitive view on this issue without knowing the respects in which their conduct is found to be misleading. However, some general points can be made.

542 In support of its case on reliance, HSBC relies on evidence given by Mr Rogers, who states that had he been told about the matters said not to have been disclosed it is unlikely that he would have approved the facility, at least without a satisfactory explanation of the undisclosed conduct. As the Court of Appeal has pointed out, evidence of this type, given as it is with the benefit of hindsight, has "always been considered to be of little probative value unless the reliability of the statement is confirmed by reference to objective factors": *Attard v James Legal Pty Ltd* (2010) 80 ACSR 585; [2010] NSWCA 311 at [120] per Tobias JA (with whom Beazley and Giles JJA agreed). See also *Fabcot Pty Ltd v Port Macquarie-Hastings Council* [2011] NSWCA 167 at [184]ff per Sackville JA (with whom Beazley and Campbell JJA agreed).

543 In the present case, it is apparent that HSBC had detailed policies and procedures for assessing credit applications and that, in accordance with those policies and procedures, Mr Rogers was provided with detailed information and analysis in relation to DSH's business and its financial position. With some minor and irrelevant exceptions, there is no evidence that any of that information came from Mr Abboud or Mr Potts. As Mr Rogers said in cross-examination, he placed considerable reliance on DSH's audited financial statements and he expected that any issues relevant to his assessment of the credit application would be revealed by those. Where Mr Rogers required additional information or clarification, he asked Mr Kowik to obtain it. Mr Kowik obtained some of that information from Mr Potts. None of the information he obtained was misleading. It is not plausible that Mr Rogers relied on DSH to disclose information he had not asked for. It is even less plausible that he

relied on Mr Abboud or Mr Potts to do so. Against that background, it is difficult to see how Mr Rogers relied on any conduct by Mr Abboud or Mr Potts in deciding to approve the loan to DSH.

NAB's claim

The pleaded case

544 In substance, NAB's pleaded case is that:

(1) At the meeting with representatives of NAB on 28 April 2015 (wrongly described in the Third Further Amended Commercial List Statement (***B3FACLS***) as a telephone call) one or both of Mr Abboud and Mr Potts made the following statements:

(a) DSH's inventory was now focused on week's cover in store;

(b) DSH's inventory was monitored through a real time inventory management system;

(c) The margin on each SKU was monitored and a report was reviewed weekly for underperforming or slow moving stock;

(d) Discounts could be used to push sales through;

(e) Usually discounts were negotiated with suppliers who provided rebates so that DSH could maintain the same gross profit margin;

(f) Private label stock was being used to help restore margin for DSH with 1,400 SKUs currently increasing to 1,600 SKUs by Christmas 2015;

(g) DSH's competitive advantage was in lower cost, improved inventory management and efficient stores/

(2) On 5 May 2015, Mr Potts provided NAB with the management accounts for FY2015 and by doing so represented that:

(a) To the extent that the accounts contained historical information, they were prepared on a proper and adequate basis and were true and fair;

(b) To the extent that the management accounts contained projections for April, May and June 2015, they were prepared on a proper or adequate basis.

(3) During the meeting on 6 May 2015 or in subsequent telephone calls, Mr Potts represented that:

(a) DSH's high level of inventory at the start of 2015 was the result of delayed shipment of private label stock and a moderate level of opportunistic purchases to obtain rebates from suppliers;

(b) The shelf life of inventory was good and DSH did not expect to have to sell it at a discount;

(c) Inventory levels for private label goods were forecast to return to normal during 2015;

(d) DSH had improved inventory management and internal controls including by instituting weekly meetings between Mr Potts and the buying team and had a system in which Mr Potts reviewed the buying practices of each buyer and reduced the OTB of buyers who were not buying appropriate stock at the appropriate level;

(e) DSH had information technology systems that provided real time information down to the SKU level which was used to help monitor inventory levels, make buying decisions and monitor SKU performance in real time;

(f) Large orders outside of standard business were discussed with the board;

(g) DSH's approach to rebates was to get support from suppliers to clear any excess inventory.

(4) On 7 May 2015, Mr Potts directed an employee of DSH to provide NAB with the management accounts for FY2016 and by doing so represented that:

(a) To the extent that the accounts contained historical information, they were prepared on a proper and adequate basis and were true and fair;

(b) To the extent that the management accounts contained projections for April, May and June 2015, they were prepared on a proper or adequate basis.

(5) Neither Mr Abboud nor Mr Potts disclosed to NAB many of the matters that are the subject of complaint in the Bad Stock case and the Dividend case, including implementation of the Rebate Maximisation Policy, implementation of the Rebate Uplift Practice, the absence of adequate controls, the fact that DSH exceeded the Westpac facility limit on occasions and the fact that DSH delayed paying some creditors;

(6) By reason of the representations and non-disclosures, each of Mr Abboud and Mr Potts represented that:

(a) DSH had appropriate and effective inventory and cash flow management practices;

(b) The excess inventory position following December 2014 and January 2015 was the consequence of events beyond DSH's control, could be explained and was unlikely to be repeated;

(c) DSH had met its obligations to lenders and trade creditors over the previous six to twelve months;

(d) There was a proper or adequate basis to pay the interim dividend.

Consideration

545 I have already found that Mr Abboud did not make a statement at the meeting on 28 April 2015 to the effect that DSH was focused on having one week's cover of stock in store (if that is what the pleaded representation is meant to convey). Mr Abboud accepts that he did say something to the effect that DSH's focus was on weeks covered as a management tool. DSH certainly used weeks covered as a management tool and any statement to that effect was obviously true.

546 There is no evidence that Mr Abboud or Mr Potts made a statement at the meeting on 28 April 2015 to the effect that DSH's inventory was monitored through a real time inventory management system. The final version of the credit application does state that "Inventory is monitored via a real time inventory management system, to the SKU level" and it seems plain that NAB obtained that information from DSH. However, it is doubtful that it obtained it from Mr Abboud or Mr Potts at the meeting on 28 April 2015. The likelihood is that it obtained the information from Mr Potts during the conversation Mr Alan Menzies had with him on 11 or 12 May 2015. In any event, there is no suggestion that any such statement was misleading.

547 I have already found that the statement that was made by Mr Abboud about the monitoring of stock was true. There is no allegation that the statement that discounts could be used to push sales through was misleading. It was obviously true. Again, I have already found that Mr Abboud did say something about the use of scan rebates to protect gross profit margins, although not precisely what is pleaded, and that what he said was true. In any event, there is no allegation that the pleaded representation was misleading.

548 The representation concerning private label stock comes from the slide pack. There is a question whether it was a representation made by Mr Abboud or Mr Potts or whether it was a representation made by DSH alone. However, it is unnecessary to resolve that question. There is no evidence that the representation was passed on to a decision-maker. It was not included in the credit memorandum. Nor is there any evidence that the representation was misleading. The representation concerning DSH's competitive advantage falls

into the same category. Moreover, it is expressed in such vague and general terms that it is implausible that anyone from NAB relied on it.

549 In my opinion, Mr Potts made no representations by supplying a copy of the most recent management accounts, other than a representation that the accounts he supplied were a true copy of those accounts. The accounts were requested by NAB. What NAB requested was a copy of DSH's accounts, not accounts that had been prepared or approved by Mr Potts. By supplying those accounts, Mr Potts was simply responding to NAB's request and in doing so carrying out a purely ministerial act.

550 Much of the pleaded case in relation to the meeting on 6 May 2015 and subsequent telephone calls with Mr Potts is consistent with the evidence given by Mr Taylor and Mr Menzies, which itself is supported by Mr Menzies' file note. Mr Potts did not give evidence and it is reasonable to infer from that fact that he was not in a position to deny any of the representations attributed to him. Even so, Mr Potts made extensive submissions concerning each of the representations said to have been made at the meeting on 6 May 2015 and takes issue at least with the precise form in which the representations are pleaded.

551 In relation to the first representation, Mr Potts's principal point appears to be that the Court should not accept that he said that the high level of inventory was due, at least in part, to a "moderate" level of opportunistic purchasing. The word "moderate" certainly appears in Mr Menzies' file note, although what it is intended to qualify is not entirely clear. Nothing, however, turns on the question whether Mr Potts used the word "moderate" or not to describe the level of opportunistic purchasing. The real question is whether the reasons Mr Potts gave for the high level of inventory gave a misleading picture of the true position. I return to that question below.

552 It appears to be accepted that Mr Potts said that the stock had a good shelf life. It is not accepted that he said that it would not be discounted. Rather, Mr Potts contends that the Court should find that he said that it would not be discounted below cost. That contention is consistent with evidence given by Mr Taylor and Mr Menzies in cross-examination and I accept it.

553 In relation to the representation concerning inventory levels for private label goods, Mr Potts accepts that he made a statement concerning inventory levels returning to normal during 2015 but says that the Court should conclude that the statement related to all inventory, not just private label inventory. That seems likely. It was apparent that NAB was concerned with the fact that, contrary to expectations, DSH was overstocked in January 2015 and it wanted an explanation of how that had come about, whether the stock could be sold and at a profit and what steps DSH had put in place to prevent a recurrence of the problem. In that context, it seems likely that Mr Potts would have talked about inventory generally returning to a normal level.

554 In relation to the representation concerning improved inventory management and internal controls, the pleaded representation is consistent with the evidence given by Mr Taylor. Mr Taylor was cross-examined on that evidence. He gave this evidence in cross-examination:

> Q. The weekly meeting that Mr Potts spoke of was, do you agree, attending weekly stock meetings at which he monitored funds, that is to say OTB, available to be spent by buyers to achieve the closing stock position or targeted for June 2015?
>
> A. The weekly meetings, as I recall them, were absolutely to discuss the open to buy positions of all the buyers, increasing ones that were making the right decisions and buying stock that can be sold for a margin, and significantly reducing those buyers who were buying the incorrect stock.
>
> Q. But this is a meeting independent, I suggest, of meeting with buyers at which he's monitoring, as he said, expenditure available to buyers during the balance of the period up to June 2015 to achieve a targeted stock on hand position?
>
> A. My understanding was this meeting included the buyers directly.
>
> Q. May you be mistaken about that, because he may well have referred, do you agree, to a meeting called a weekly stock meeting at which OTB available to buyers was monitored?
>
> A. Perhaps. My recollection was that it was a meeting with the buyers specifically on open to buy positions of each of them.
>
> Q. Do you accept that you may have misunderstood what he said about the weekly meetings in relation to the availability of OTB to buyers?
>
> A. It's possible.

555 Mr Menzies' file note of the conversation is unclear. It simply records "Weekly meeting OTB – discuss purchasing". One of the later versions of the credit memorandum prepared by Mr Menzies on 11 May 2015 and the final version of

the credit memorandum records the following on this topic: "The CFO has implemented a weekly meeting with the buying team to review purchasing". In broad terms, that is consistent with Mr Taylor's evidence. He and Mr Menzies were concerned to find out what steps DSH had taken to prevent a repetition of what happened in December 2014 and January 2015. Mr Taylor's evidence and the final credit memorandum support the contention that one thing that they were told was that Mr Potts had implemented weekly meetings with buyers to review their buying decisions. It may be that the reference to the "buying team" was not intended to be a reference to all buyers but only to those that supervised the buyers. On the other hand, the credit memorandum does suggest that Mr Potts attended the meetings; and it is likely that Mr Potts said something to that effect. It was important for Mr Potts to give NAB some assurance that DSH had taken steps to ensure that the problem that had occurred in December 2014 and January 2015 would not be repeated. In that context to say that he had implemented weekly meetings suggests that they were meetings he attended. NAB was unlikely to obtain much comfort if all Mr Potts said was that he had set up a process for reviewing stock in which he himself was not involved.

556 In relation to the representation concerning DSH's information technology systems, it appears to be accepted that the representation was made. The representation is referred to in the final version of the credit memorandum. Mr Potts was the likely source of the information.

557 As to the representation concerning large orders outside of standard business being discussed with the board, Mr Potts contends that what he said in effect was that large orders outside standard business were discussed with a member of the board, namely Mr Abboud. That contention seems implausible. If Mr Potts had meant to refer to Mr Abboud he would have done so specifically. Although Mr Menzies' file note does not record the representation, it is recorded in the final version of the credit memorandum and it seems apparent that the source of the information was Mr Potts. On the other hand, both Mr Johnson and Ms Peter accept that it would not have made a material difference to their approval if they had been told that the discussion was with Mr Abboud rather than the board.

558 Finally, Mr Potts appears to accept that he made a representation to the effect that DSH sought rebates from suppliers as support to clear any excess inventory.

559 The representation concerning DSH's high level of inventory at the start of 2015 goes to the heart of NAB's case. The representation is alleged to be misleading not just because of what was said but because of what was not said – and, in particular, the fact that Mr Potts did not explain that a substantial cause of the high level of inventory was the emphasis DSH, and Mr Abboud in particular, placed on the collection of O&A rebates. I return to that issue below.

560 I am not satisfied that the representation that the overstocked inventory had a good shelf life was misleading. As I have said in the context of the discussion of the Bad Stock case, the plaintiffs did not attempt to lead any expert evidence concerning the stock that DSH had acquired and its shelf life. The HY15 and FY15 accounts contain small provisions in respect of stock. The HY15 accounts were reviewed and the FY15 accounts were audited by Deloitte and there is no longer a case that either set of accounts contained a material error. The small provision made in respect of stock in those accounts indicate that most of the stock could be sold at least for its carrying value in the accounts, which is consistent with it not having to be sold at a discount.

561 I have concluded that what Mr Potts said was that inventory levels would return to normal during 2015. It is not entirely clear whether the reference to "2015" was intended to be a reference of to the financial or calendar year. It could not have been a reference to the end of the calendar year, since the expectation must have been that there would be another build up for Christmas 2015. It is also not entirely clear what Mr Potts should be taken to have meant when he said that inventory levels would return to "normal". As I have explained, DSH's targeted stock levels were generally in the order of $250 million and that was the level of stock that it held in July and August 2014. In my opinion, Mr Potts must be understood as saying that he expected stock to return to that level by the end of FY15. The statement Mr Potts accepts that he made is a statement of opinion or a statement concerning the future. It would only be misleading if Mr Potts did not have a reasonable basis for making it at the time it was made.

The likelihood is that the statement was made during the telephone call on 11 or 12 May 2015, since it was included in the final version of the credit memorandum but not in Mr Menzies' handwritten note. It is likely that at that time Mr Potts had the forecast which was included in the board papers for the meeting on 19 May 2015. That forecast showed that stock had decreased from $360,146,000 in January to $331,747,000 by the end of April 2015 and was forecast to be $270,162,000 by the end of the financial year. There is no evidence to suggest that as at 11 May 2015 Mr Potts was aware of the forecasts for the following financial year. There appears to be a tension between what Mr Potts was saying to NAB and what, according to Mr Tomlinson, he said to the board on 19 May 2015 – namely, that inventory had not decreased as projected because management was making deliberate decisions in building up inventory. There is also a tension between the forecast provided to the board and weekly forecasts that DSH was at that time providing to Westpac. According to the forecast provided to Westpac for the week ending 3 May 2015, stock was forecast to be $280 million by the end of FY15. However, on 13 May 2015 Mr Potts sent an email to Mr Dean O'Neill at Westpac which attached "our revised stock flight path which is now expected to close at $290m at the year end". It is unclear whether that forecast was available at the time that Mr Potts spoke to Mr Menzies.

562 To the extent that Mr Potts's statement was based on the forecast given to the board, there appears to be a reasonable basis for making it. It is true that the forecast predicted that the level of stock would be approximately $270 million, whereas the evidence indicates that a "normal" level of stock was about $250 million. However, a difference of $20 million is not material in the context of DSH's business. The position is not as clear if the relevant forecast is the one provided to Westpac. More significantly, the question remains whether Mr Potts had a reasonable basis for relying on the forecasts. The answer to that question is tied up with what Mr Potts knew about the practice of "maximising" O&A rebates and the effect that that practice was having on stock levels. It is convenient to deal with that issue when dealing with the reasons for the high level of inventory.

563 As to the statement concerning improved inventory management and internal controls, whether this representation was misleading or not is again tied to the question of what was and was not said about O&A rebates and is best dealt with in that context.

564 The representation concerning DSH's information technology systems was unquestionably true. The representation concerning large orders outside normal business was misleading insofar as it suggested that those orders were discussed with the board. However, as I have explained, the decision-makers at NAB did not rely on it. The final representation said to have been made by Mr Potts (concerning support from suppliers) was unquestionably true.

565 Mr Potts did not make a representation to NAB by directing an employee of DSH to provide NAB with the 2016 forecasts. The position is even clearer than the position in relation to the management accounts provided by Mr Potts. The forecasts were prepared by DSH. Mr Potts was simply engaged in a ministerial act by arranging for an employee to provide them in response to a request from NAB.

566 The case based on non-disclosure arising from the meeting between Mr Abboud and Mr Potts with representatives of NAB on 28 April 2015 and the presentation given during that meeting must fail for the same reasons as the case based on a similar meeting between Mr Abboud and Mr Potts with representatives of HSBC. The pleaded representations were either not made or were true or were not relied on. The fact that Mr Abboud or Mr Potts made some general comments about DSH's profits and business did not mean that Mr Abboud or Mr Potts engaged in misleading conduct because they failed to disclose other matters about the business which may have been of interest to NAB. NAB understood that perfectly well; and it was for that reason that it requested additional information, including the management accounts and projections for FY16 and asked further question of Mr Potts. For similar reasons, any case based on implied representations said to have arisen from the meeting, to the extent that they are still pressed, must also fail.

567 The real question, which is relevant to the case against Mr Potts but not the case against Mr Abboud, is whether Mr Potts engaged in misleading or

deceptive conduct in answering the questions NAB had about the stock position in January 2015, the reasons for it and how DSH intended to address it.

568 In answering NAB's questions, Mr Potts was not acting in a purely ministerial capacity. He was answering questions that fell within his area of responsibility and about which he could be expected to have, and did have, personal knowledge. It was obviously important to NAB to understand why, contrary to its expectations, the level of stock had increased rather than decreased in January 2015. The answers to those questions were unlikely to be found, or could not easily be found, in the records of the company, but rather depended on an intimate knowledge of the company which someone in the position of Mr Potts could be expected to have. That is, no doubt, why NAB requested a meeting with Mr Potts and why Mr Menzies spoke directly to Mr Potts. Mr Potts must have understood that that was the position and that is why he agreed to the meeting and spoke to Mr Menzies himself, rather than delegating those tasks to someone else at DSH or suggesting to NAB that it would be more appropriate for its representatives to deal with someone else at DSH. Accordingly, to the extent that Mr Potts gave misleading answers to the questions he was asked or did not disclose information that left NAB with a misleading impression, he was personally liable for that conduct.

569 As I have explained, NAB wanted to know why DSH was carrying so much stock in January 2015 and it wanted to know what steps DSH had taken to ensure that there would not be a repetition of the events that brought about those circumstances. As to the first of these, it seems to me that in order for NAB not to be misled it was essential that it be told all of the principal reasons for the increase in stock. Unless it was given that information, it was not in a position to judge the effectiveness of any steps taken by DSH to make sure that the problem did not recur.

570 I have concluded that by January 2015 Mr Potts was aware that the emphasis that DSH was placing on the collection of O&A rebates was causing it to buy too much stock: see para [412_Ref70948021]. That was a substantial cause of the fact that DSH was overstocked in January 2015. It must have been evident

to Mr Potts that it was a continuing problem. The emphasis on O&A rebates had not changed. DSH continued to be overstocked. In late May 2015, Mr Abboud approved an increase in OTB in order to obtain additional O&A rebates. Of course, that occurred after Mr Potts met with representatives of NAB and after his conversation with Mr Menzies. However, it is unlikely that the relevant events happened out of the blue. By May 2015, it was apparent that DSH had a significant problem with being over-stocked. Mr Potts had been told by Mr Borg in December 2014 that the emphasis on O&A rebates was causing DSH to be overstocked. If Mr Potts disagreed with that view or thought that circumstances had changed by the time that he spoke to Mr Menzies, it was open to him to explain why that was the case. He chose not to do so.

571 Mr Potts submits that NAB was not misled because it knew at least from the broker reports that there were a number of other reasons DSH was overstocked in December 2014 in addition to a seasonal increase in stock and that it knew that on occasions DSH had engaged in "opportunistic purchasing" including to obtain rebates and that that had occurred "during January/February 15". If it wanted to know more than that, it could have asked further questions. I do not accept that submission. I accept that Mr Potts was not obliged to disclose what he might have expected NAB already to know and he might reasonably have expected NAB to know what had been disclosed publicly, including in broker reports. However, the information that was disclosed did not suggest that DSH was overstocked in December 2014. Rather, it suggested that it had made a deliberate decision to increase the level of stock it held, in part to engage in opportunistic purchasing. But no such decision was made by the board; and it is only in the most literal sense that it could be said that DSH had decided to buy additional stock to take advantage of rebates offered by suppliers. As I have sought to explain, the true position was that DSH acquired stock that it did not need in order to obtain O&A rebates; and it did that in order to increase its reported profits. In doing so, it ran that risk that some of its stock would become obsolete. Mr Potts knew that DSH was acquiring stock to obtain O&A rebates. He knew that it was becoming overstocked as a result, and that that was a contributing factor to the fact that DSH was overstocked in January 2015. In order not to give a misleading

picture to NAB, it was necessary for him to explain the position. Without such an explanation, NAB was not able to make a proper assessment of the risks associated with the fact that DSH was overstocked.

572 The evidence is that Mr Potts told Mr Menzies that he had implemented a weekly meeting with the buying team to review purchasing in order to prevent a recurrence of the problem. The only evidence a weekly meeting was introduced is the minutes of the meeting on 20 April 2015 between Mr Abboud, Mr Potts and others to review the position of stock. That meeting was to be between Mr Abboud, Mr Potts, Mr Orrock and Mr Skellern. It is apparent from the minutes that the purpose of the meeting was to ensure that the new OTB target of $104 million for May and June was met. It appears that that goal was short-lived since in late May Mr Abboud approved an increase in OTB of $12 million which it appears was increased to $20 million in June 2015. The impression that NAB would have obtained from Mr Potts's statement was that DSH had identified the reasons for the build-up in stock and taken appropriate steps to prevent it from recurring. However, the true position was that there was no real recognition of the fact that an important contributing factor to the problem was the fact that DSH, with the encouragement of Mr Abboud, was seeking to use O&A rebates to increase its reported profits and no real steps had been taken to prevent a recurrence of that problem. It is true, as I have said, that some of the events that support that conclusion occurred after the conversations between Mr Potts and Mr Menzies. But those events cannot be viewed in isolation. The problem had existed for a number of months. Both Mr Abboud and Mr Potts had been told about it by Mr Borg at least in late 2014. They had not taken any real steps to address the underlying problem of an over-emphasis on O&A rebates. The meeting on 20 April 2015 was not a turning point. If Mr Potts believed that it was, it is to be expected that he would give evidence to that effect.

573 It follows that, in my opinion, Mr Potts's conduct at the meeting on 6 May 2015 or in his subsequent conversation with Mr Menzies was misleading and deceptive because it gave a misleading impression concerning the reasons for the build-up in stock in January 2015 and the appropriateness of the steps that DSH had taken to address the problem.

574 In my opinion, NAB relied on Mr Potts's conduct. Ms Peter and Mr Taylor give evidence of reliance which is couched in terms of NAB's pleaded case concerning the Rebate Maximisation Policy and its alleged consequences. That evidence is of no assistance. However, as I have explained, NAB was concerned to understand what had caused the build-up in stock and wanted to be satisfied that DSH had taken appropriate steps to prevent it from happening again. Careful stock management was obviously important to the profitability and success of a business such as DSH's. NAB understood that and that explains why it paid considerable attention to the stock position in January 2015. It would not have given the issue the attention that it did if the way in which DSH managed its stock was not important to its decision. In my opinion, the likelihood is that if it had been told that one of the reasons for the build-up in stock was the emphasis on O&A rebates and that DSH had not taken steps to change its policies and procedures to deal with that problem, it would not have agreed to participate in the syndicate with HSBC.

The Extension Agreement

The pleaded case

575 The claim in respect of the Extension Agreement is only made against Mr Potts. The pleaded representations are to the following effect:

(1) On 2 September 2015 Mr Potts stated that DSH may need a $20 million temporary increase in its finance facility with HSBC for the first two weeks of each of November and December 2015 and January and February 2016;

(2) On 13 October 2015, Mr Potts requested that HSBC increase by $20 million its finance facility with DSH for the period 15 November to 31 December 2015;

(3) On or before 14 October 2015, Mr Potts represented to HSBC that the purpose of the increase was to fund increased inventory required for anticipated Boxing Day sales;

(4) On or before 19 October 2015, Mr Potts represented to HSBC that the increase in funding was a normal seasonal requirement and the requirement was in line with the previous year when similar financing of $20 million was provided by Westpac;

(5) By engaging in that conduct, Mr Potts represented that the financing facility was a seasonal requirement and that Westpac had provided a similar extension for the same reason in the previous year.

576 In addition, HSBC alleges that Mr Potts engaged in misleading and deceptive conduct by failing to disclose essentially the same matters that are the subject of the non-disclosure case in relation to the Syndicated Facility, including the Rebate Maximisation Policy and its alleged consequences, the Rebate Accounting Approach, the absence of internal controls, the absence of a proper basis for concluding that the HY15 and FY15 accounts provided a true and fair view of DSH's financial position and prepared on a proper and adequate basis, the absence of a proper basis to pay the interim dividend and the final dividend and the fact that DSH had delayed paying certain invoices.

Consideration

577 The first two paragraphs of the claim do not set out representations or other conduct that itself is said to be misleading. It is difficult to see what the last paragraph adds to the fourth. Moreover, the broad-ranging non-disclosure case of the type pleaded must fail for the same reasons as it must fail in relation to the Syndicated Facility. It cannot possibly be the case that by asking for a temporary increase in the facility limit for specific reasons Mr Potts effectively became obliged to disclose a range of matters relevant to DSH's financial position that were not the subject of any enquiry by HSBC.

578 In substance, HSBC's case is that Mr Potts engaged in misleading conduct by stating that the temporary increase in the facility was (1) needed to fund an increase in inventory for the Boxing Day sales; and (2) a normal seasonal requirement which had been provided by Westpac in previous years, whereas the true position was that DSH was facing serious liquidity problems resulting from the fact that it was overstocked, substantially as a consequence of its strategy to obtain O&A rebates.

579 I have already found that the likelihood is that Mr Potts was the source of the information that the increase in the facility was required to fund an increase in inventory for the Boxing Day sales. It is less clear whether he was the source of the information concerning Westpac and whether the extension was a normal seasonal requirement. That information was given by Mr Kowik in response to questions contained in emails from Mr Byrne. But there is no evidence that Mr Kowik spoke to Mr Potts before responding to Mr Byrne's

emails. He kept call reports of the earlier conversations he had had with Mr Potts concerning the Extension Agreement and it is to be expected that he would have done so if he had spoken to Mr Potts again. It is plausible that Mr Kowik already thought that he knew enough about DSH's business to respond to Mr Byrne's questions without seeking further information from Mr Potts. In the absence of evidence from Mr Kowik, I am not satisfied that he spoke to Mr Potts again about the extension.

580 In my opinion, Mr Potts did engage in misleading conduct when he said that the increase in the overdraft was to fund the acquisition of additional stock for the Boxing Day sales. Even if that was literally true, that state of affairs had come about because DSH was facing serious problems with its liquidity, which are described earlier in this judgment: see para [292_Ref71036828]ff. DSH was overstocked and sales had declined substantially. If it required additional stock that was because it was overstocked with product that was selling poorly. To say that DSH needed a temporary increase in its facility to buy additional stock for the Boxing Day sales suggested that the business was otherwise performing satisfactorily and DSH wanted additional funds to capitalise on an opportunity. The true position was that it needed additional funds because it was in financial difficulties.

581 The real question is whether Mr Byrne relied on Mr Potts's conduct. Mr Potts submits that he did not. He submits that no weight can be placed on Mr Byrne's evidence of reliance. Evidence of that type carries little weight and, in any event, it is directed at quite a different case than the one that is made out. Before the Extension Agreement was signed, DSH announced its profit downgrade. Despite that, HSBC signed the Extension Agreement. There is no other objective evidence of reliance.

582 I accept that no weight can be placed on Mr Byrne's evidence of reliance. Little can be inferred from the fact that HSBC entered into the agreement following the profit downgrade. Mr Byrne says that he was concerned about the profit downgrade but thought that HSBC was committed to entering into the Extension Agreement. It is unlikely that Mr Byrne would have thought that HSBC was committed to entering into the agreement if he had thought that he

had been misled. It is more likely that the profit downgrade itself was not something that was sufficiently important to HSBC to cause it to act differently.

583 The profit downgrade was not the only issue confronting DSH. As I have explained, at the time it requested an increase in the facility limit it was facing serious liquidity problems. In my opinion, if Mr Potts had disclosed that the reason DSH wanted an increase in its facility was because it was facing serious liquidity problems, HSBC would not have entered into the Extension Agreement on the terms that it did. But it may well still have granted an extension on some terms. Support for that conclusion can be found in the reaction of the Banks when DSH announced that it was taking a provision of $60 million and Mr Potts asked for an extension of the temporary increase in the facility limit. The Banks did not refuse that extension. Instead, they placed tight restrictions on DSH and monitored DSH's financial position closely. It is true that by that stage the money had been advanced. It is one thing for a lender to agree to an extension of a loan already made. It is quite another for it to agree to lend additional money. Moreover, it is apparent from what happened when the Banks discovered that the Macquarie facility had been repaid on 31 December 2015 that they were willing to take a hard line. But by that stage, HSBC may well have thought that it had been seriously misled in relation to DSH's financial position, which helps to explain why it acted in the way that it did. And the fact that it was prepared to act somewhat precipitously at the end of December 2015 does not establish that it would have done so if DSH had disclosed the true reason it required the increase in the facility limit at the time the increase was requested. It is hard to believe that if HSBC was satisfied that DSH needed an additional $20 million to trade out of its difficulties it would not have advanced that sum on any terms when the Banks agreed to an extension of the facility once they knew the true position. Certainly, there is no evidence from HSBC which would explain why it would not have agreed to advance the money on some terms if it had known the true position. Indeed, an unsatisfactory aspect of Mr Byrne's evidence is that he says in a somewhat formulaic way that he would not have approved the increase if he had known certain things without saying what steps he would have taken and how those steps were consistent with HSBC's policies and procedures. Given the existing

relationship between DSH and the Banks it is not plausible that Mr Byrne would simply have refused the increase and that that would have been the end of the matter.

584 HSBC's case on reliance is that it would not have entered into the Extension Agreement at all. It does not advance an alternative case that it would have been prepared to enter into some other agreement that would have been more beneficial to it. It bears the onus of proof on reliance. I am not satisfied that it has discharged that onus.

Damages and the apportionment defence

585 I have concluded that NAB's case in respect of misleading and deceptive conduct succeeds but HSBC's case fails. The question therefore arises what damages NAB is entitled to recover. It is unnecessary to say anything about the damages to which HSBC might have been entitled if it had succeeded in its claim in respect of the Syndicated Facility, since the issues are the same as those that arise in relation to NAB's claim. It will, however, be necessary to say something about HSBC's claim for damages in respect of the Extension Agreement.

586 I have also concluded that NAB's claim only succeeds against Mr Potts. Consequently, the question of apportionment does not arise. Nor is it possible to say something useful about the position if, contrary to my findings, NAB was entitled to succeed against Mr Abboud. That would depend on precisely how the claim succeeded, which raises a hypothetical question with more variables than it is practical to consider.

NAB's claim for damages

587 It is common ground that NAB's loss should be assessed by comparing the position it is in now with the position that it would have been in if it had not advanced the funds and that NAB bears the onus of proof in relation to that matter. It is also common ground that in determining the amount to which NAB is entitled it must give credit for any benefit it received from the transaction. Applying those principles, NAB seeks to calculate its loss by proving the amount that it lent and deducting from that the amount that it has recovered in respect of its loan. According to uncontested evidence given by Mr Taylor, the

amount the Bank lent was $74,500,000. Mr Taylor also gives evidence that NAB has received $18,321,488.18 from the receivership. NAB is also prepared to accept that it should give credit for the interest and fees it received under the Syndicated Facility on the basis that it would not have received those amounts if it had not entered into the Syndicated Facility. It is agreed that the total of those amounts is $973,192.15. Accordingly, NAB submits that it is entitled to recover $55,205,319.67 plus interest.

588 Mr Potts submits that that analysis is not adequate to prove that NAB has suffered a loss. The Banks obtained security at the time they entered into the Syndicated Facility. NAB must give credit for the value of its security and it bears the onus of proof on that issue, since it bears the onus of establishing that it has suffered a loss. NAB has failed to discharge that onus, since it has failed to lead any evidence on the value of the security that it obtained – and, in particular, that the value is less than the amount it is owed. In making that submission, Mr Potts relies on a number of cases including *Moloney v Bells Securities Pty Ltd* [2005] QSC 13. In that case, Chesterman J stated the relevant principles in these terms:

> [105] … In 'no transaction' cases, of which this is one, the assessment depends upon the extent to which the plaintiff is worse off as a result of entering the contract which, on the relevant hypothesis, he did because of the negligence or statutory contravention.
>
> [106] The plaintiffs are therefore entitled to recover the difference between the amount of $1,040,000 advanced by the contributors and the amount recovered from the sale of the mortgaged property. This amount will reflect appropriate expenses incurred in the realisation. As well the plaintiffs are entitled to interest from the date of the advance to judgment. The capital amount on which interest accrues will be the amount of the initial advance until the date of receipt of the proceeds of sale and thereafter on the amount reduced by those proceeds.

589 Mr Potts also relies on the principle that, in proving its loss, NAB must do so with a degree of precision which reflects the proof that is reasonably available to it. The Court will do the best it can to assess damages where evidence of the precise loss is unavailable. However, that principle will not be applied to relieve a party of proving damages precisely where it can: *Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd* (2003) 77 ALJR 768 at [38] per Hayne J (with whom Gleeson CJ, McHugh and Kirby JJ agreed); *Pages*

Property Investments Pty Ltd v Boros [2020] NSWSC 1270 at [196] per Black J (where the relevant authorities are collected).

590 Applying those principles, Mr Potts submits that NAB has not proved that it has suffered any loss, since it has not proved that it has realised all that it can from its security. According to Mr Potts, an obvious way NAB could have proved its loss was through evidence of one of the receivers setting out all the secured assets that had been identified during the course of the receivership, the amount realised from those assets, the costs of realisation and, if some assets had not yet been realised, proper evidence of the value of those assets. That evidence was available to be given by NAB. In failing to give that evidence, NAB has failed to prove that it has suffered any loss.

591 NAB, on the other hand, contends that Mr Potts bears the onus of proving "the benefit has been gained and the extent to which the *prima facie* loss or damage arising because of the misleading or deceptive conduct has been avoided by the benefit obtained from such expenditure". In support of that proposition, NAB refers to *EK Nominees Pty Ltd v Woolworths Ltd* [2006] NSWSC 1172; *Ikon Communications Pty Ltd v Advangen International Pty Ltd* [2018] NSWSC 1650 and *Bennett v Elysium Noosa Pty Ltd (in liq)* (2012) 202 FCR 72, among other cases. In *EK Nominees*, for example, the plaintiff was a developer who was misled into believing that the defendant would lease and build a supermarket on the plaintiff's land and who incurred expenditure as a consequence of the misleading conduct. The plaintiff claimed as damages the amount of the wasted expenditure. The defendant resisted that claim on the basis that the plaintiff had to prove that the expenditure had no value to it. In rejecting that argument White J, after referring to the decision of the High Court in *Ted Brown Quarries Pty Ltd v General Quarries (Gilston) Pty Ltd* (1977) 16 ALR 23, said this (at [195]):

> The present case is not of that kind. It is one thing to say that where the measure of damages is the difference between the purchase price and the value of the property purchased, the plaintiff bears the onus of showing both the purchase price and the value of the property purchased. However, that is not the relevant principle in this case. E K Nominees was induced to incur expenditure by reason of Woolworths' misleading and deceptive conduct. Prima facie, its damages are the money it spent which it would not otherwise have spent. To the extent to which that expenditure resulted in a benefit to E K Nominees, the benefit must be allowed for in the calculation of damages

> because it is a direct consequence of the breach of s 52 of the Trade Practices Act (*British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 at 690, 691). That is what is meant by E K Nominees being entitled to damages for wasted expenditure. However, the defendant bears the burden of proving the extent to which the loss arising from the expenditure of money has been avoided by the benefit obtained from such expenditure (*Monroe Schneider Associates (Inc) v No. 1 Raberem Pty Ltd* (1991) 33 FCR 1 at 17; *Tyco Australia Pty Ltd v Optus Networks Pty Ltd* [2004] NSWCA 333 at [255], [264]; *Ruthol Pty Ltd v Tricon (Australia) Pty Ltd* [2005] NSWCA 443 at [44], [53]). [Footnotes omitted]

592 I accept that this case is analogous to cases in which the misled party has acquired something of value as a result of misleading conduct – namely, security over DSH's assets – and that, as a consequence, it had to prove that the value of its security was less than the amount it advanced. However, the analogy is not perfect. In the cases to which Mr Potts refers, the claimant acquired an asset as a consequence of misleading and deceptive conduct and, in order to prove a loss, it had to prove that the value of the asset was less than the amount paid. In the present case, on the findings I have made, NAB advanced money as a result of misleading and deceptive conduct in exchange for a promise to repay that money and security. The security took the form of a charge over DSH's assets which was enforceable by the appointment of receivers. The receivers had broad powers to operate the business, pursue rights and sell assets of the company that were the subject of the security. The benefit NAB obtained was the right to be paid dividends out of the receivership.

593 It appears to be Mr Potts's contention that, before NAB can prove that it has suffered a loss, it must prove the total amount of the dividends to which it is entitled and that that amount is less than the amount advanced. Although it is not entirely clear, it also appears that, according to Mr Potts, NAB must prove that the receivers conducted the receivership in accordance with their obligations and, in particular, conducted the receivership with reasonable skill and care and complied with their obligations under s 420A of the Corporations Act, which requires the receivers in exercising a power of sale to exercise all reasonable care to sell the secured property for its market value, if it has one, or for the best price that is reasonably obtainable, if it does not.

594 I do not accept either of those propositions.

595 I accept that NAB must prove that it has suffered a loss and that in order to do so it must prove that the value of its security is less than the value of its loan. However, it can do that by proving that the dividends it has received and is likely to receive are less than the amount of its loan. In my opinion, it has done that. It has certainly proved the amount of the dividends it has received. But I am also satisfied that any future dividend will fall well short of the amount still owing to NAB. It will be necessary to address a number of specific issues raised by Mr Potts. But looking at the position generally, the evidence is that the receivers have sold DSH's principal assets, including its stock and that they expect there to be a substantial shortfall. It is true that in their report dated 1 November 2018, they say that their estimates do not take account of "any allowance for recoveries which may result from further investigations or litigation, including future preference recoveries made by the liquidators", although no such qualification was included in their most recent report dated 7 November 2018. It is understandable that the receivers included that qualification, since one of the potential recoveries was their claim in these proceedings, which I have concluded fails. There is no evidence to suggest that the receivers or liquidators are pursuing other substantial claims. In the absence of any evidence to the contrary, it is reasonable to infer that the receivers have complied with their duties and have acted reasonably promptly, and that any substantial claim of which they were aware would have been pursued by now. Although it may have been better for NAB to lead evidence from the receivers concerning the precise stage the receivership has reached, in my opinion, it is apparent from the reports of the receivers in evidence that the receivership is largely complete. It is also apparent from those reports that any future dividends will fall well short of the amount owing.

596 That leaves the question of quantification. NAB has not sought to prove the precise amount of its loss. Instead, it has given credit for the dividends it has received. It accepts that it must also give credit for any future dividends. It submits that it can do that by applying the principle that a claimant cannot recover twice. Accordingly, it submits that if it receives dividends in the future it must set off the amount it receives against the judgment it obtains or, if the judgment has already been satisfied, repay to Mr Potts that amount.

597 In my opinion, the approach adopted by NAB is appropriate and any other approach is likely to lead to unsatisfactory results. NAB's actual loss is only reduced by the amount of the dividends that it receives. The amount of any future dividend is uncertain. For example, the evidence is that the receivers currently have $21,728,725.62 cash on hand. On the other hand, it is plain that they may have future liabilities in the form of costs orders against them and DSH arising from these proceedings. Until those orders are made, any costs assessed, and the outcome of any possible appeal known, it is uncertain how much of the cash currently held by the receivers will be available for distribution to the Banks, or whether more might become available.

598 It cannot be the case that NAB was unable to bring the proceedings it has until the receivership was complete. Its cause of action arose when it became reasonably ascertainable that it was worse off as a consequence of entering into the Syndicated Facility: *Wardley Australia Limited v State of Western Australia* (1992) 175 CLR 514 at 527 (Mason CJ, Dawson, Gaudron and McHugh JJ), 536-7 (Brennan J). That became apparent no later than when it became apparent that it would not be possible to sell the business as a going concern and the receivers estimated that there would be a very substantial shortfall in recoveries. There is no principle of law which required NAB to wait to bring proceedings until its loss could be ascertained precisely.

599 Accepting that, there are two possibilities. One is to calculate damages by reference to the amount NAB has actually received, on the basis that if it recovers any more it must account to Mr Potts for the amount of the recovery. The other is to put a value on the prospect of receiving future dividends now. That could never be the subject of accurate proof. It would presumably require the Court to speculate on matters such as the prospect of an appeal being brought by the receivers in the claim that is the subject of this judgment and, if one is brought, its prospects of success and the amount of costs that might have to be paid by the receivers. Plainly, the first of these alternatives is preferable. As I have said, it recognises the fact that NAB's actual loss is only reduced by the amount of the dividends it receives. It avoids the necessity of the Court engaging in speculation which almost inevitably will result in NAB being over-compensated or under-compensated for its actual loss.

600 As I have said, it is not entirely clear whether Mr Potts also submits that NAB must prove that the receivership was conducted by the receivers in accordance with their legal obligations. I accept that it would be open to Mr Potts to prove, for example, that the receivers did not comply with their duty under s 420A of the Corporations Act and that he should be given credit for the difference between the amount actually realised and the amount that would have been realised if the receivers had complied with their duties. As between Mr Potts and NAB, NAB should bear the consequences of some breach of duty by the receivers. However, in my opinion, it is not for NAB to prove that the receivers did not breach their duties. Rather, it is for Mr Potts to allege and prove the breach he relies on and the financial consequences of that breach. Even if that is not correct, absent evidence to the contrary, it is reasonable to infer that the receivers complied with their duties. That at least casts an evidential onus on Mr Potts, which he has not discharged.

601 Mr Potts points to a number of matters which it is said demonstrate that the distributions to NAB (and HSBC) do not account for the total value of the secured assets. Those matters are:

(a) There is evidence that the receivers continue to hold substantial amounts of cash;

(b) There is evidence that the receivers paid for the costs of the Company Proceeding and the Bank Proceeding, which was a benefit to the Banks for which NAB has not given credit;

(c) There is no evidence concerning the stock held by the receivers or its value;

(d) NAB has not given credit for other potential recoveries.

602 I have already dealt with the first of these issues. In my opinion NAB does not have to give credit for amounts recovered by the receivers until those amounts are distributed to it, since it is only then that the amounts distributed reduce NAB's loss.

603 In relation to the second point, the evidence is that the receivers have paid their own and the Banks' costs of both proceedings. They have not sought to separate those costs between the two proceedings. The Banks have sought to prove those costs by tendering the relevant invoices, which total $20,426,731.22. They have apportioned those costs between themselves in

the ratio represented by the distribution of dividends to date, which itself reflects the proportion of the total debt owed to each of them at the date of the receivership. On that basis, $12,164,023.70 is attributed to NAB.

604 In my opinion, the payment of NAB's legal costs in a case brought by NAB for its own benefit is equivalent to a distribution of that amount by the receivers to NAB. Consequently, as the evidence stands, the receivers paid NAB's legal costs of bringing the current proceedings. That was a benefit received by NAB. NAB has sought to prove that benefit by tendering the relevant invoices. It led no evidence from which it would be possible to apportion those costs between the Bank Proceeding and the Company Proceeding. In my opinion, it bore the onus of proving that some of the costs did not relate to the Bank proceeding. It has not discharged that onus. On the other hand, I accept that it is reasonable to apportion the costs as between NAB and HSBC by reference to the dividends that have been paid, since if the costs had not been paid presumably the same amount would have been available for distribution as a dividend. It follows that NAB's claim must be reduced by $12,164,023.70.

605 The third point made by Mr Potts is not correct. The evidence from the report of the receivers is that all the stock has been disposed of.

606 As to Mr Potts's fourth point, the point is in the nature of a positive defence. In substance, it is Mr Potts's contention that there is some claim available to NAB or the receivers which would reduce the loss. In my opinion, Mr Potts bears the onus of proof on that issue: see *Boyd v Leftwich* (1982) 43 ALR 280 at 282 per Gibbs CJ (Murphy, Wilson and Brennan JJ agreeing). Mr Potts has not discharged that onus.

607 Accordingly, NAB is entitled to judgment against Mr Potts in the sum of $43,041,295.97.

HSBC's claim for damages in relation to the Extension Agreement

608 The Extension Agreement was executed on 12 November 2015. On that date, the balance of DSH's overdraft facility with HSBC was approximately $58,149,000. The overdraft then increased to a maximum of approximately $77,844,000 on 20 November 2015. From there, it decreased so that at the time the receivers were appointed on 4 January 2016, it was approximately

$50 million (following the late processing of a number of deposits with a "value date" of 4 January 2016).

609 Based on those facts, Mr Potts contends that HSBC suffered no loss as a consequence of executing the Extension Agreement because the amount the subject of the extension had been repaid at the time the receivers were appointed. HSBC, on the other hand, contends that it has still suffered a loss because the cash that DSH generated that was used to reduce the overdraft would have been used to reduce the overdraft as it existed before the extension was granted.

610 I do not accept HSBC's submission. It assumes that if the extension had not been granted DSH would have been able to continue to trade and would have earned the same income and have continued to pay the same creditors as it did in the actual world. None of those assumptions is made out, and one or more of them is unlikely, since the logical consequence of those assumptions is that DSH did not need the extension to the overdraft at all. As Mr Potts submits, it is also difficult to see how the loss HSBC claims could be said to have been caused by Mr Potts's misleading conduct. It is HSBC's case that it was misled into entering into the Extension Agreement and advancing additional money under that agreement. Its loss was the payment of the additional money. That loss was extinguished when the money was repaid. The fact that in the counterfactual world DSH may have had an additional $20 million and that amount may have been used, or may have been available, to repay the amount due to HSBC under the Syndicated Facility does not mean that HSBC suffered a loss that resulted from entry into the Extension Agreement.

611 It follows that even if HSBC had succeeded on the issue of reliance, its case in relation to the Extension Agreement must fail because it has not proved that it suffered any loss as a result of Mr Potts's misleading conduct.

Orders

612 It follows from what I have said that the Company case must be dismissed. NAB is entitled to judgment against Mr Potts in the sum of $43,041,295.97

together with interest. The Bank case must otherwise be dismissed. I will hear the parties in relation to costs if costs cannot be agreed.

613 The orders of the Court therefore are:

(1) Within 21 days of the date of this judgment the parties bring in short minutes of order which give effect to these reasons for judgment and, if costs can be agreed, deal with the question of costs;

(2) If the parties cannot agree on the form of orders or the question of costs, the matter be relisted by contacting my Associate to deal with any outstanding questions.

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Annexure 1 (202213, pdf)http://www.caselaw.nsw.gov.au/asset/179f9cb97a9944d745050d8d.pdf

Annexure 2 (100544, pdf)http://www.caselaw.nsw.gov.au/asset/179f9cbda59b592aba496f24.pdf | Annexure 2 - text version (417228, rtf)http://www.caselaw.nsw.gov.au/asset/179f9cd6105fd3e56e2e58bd.rtf

Annexure 3 (119900, pdf)http://www.caselaw.nsw.gov.au/asset/179f9cc089baf1acc8b5b95c.pdf | Annexure 3 - text version (122474, rtf)http://www.caselaw.nsw.gov.au/asset/179f9ce9e7f850022dba1c39.rtf