

FEDERAL COURT OF AUSTRALIA

Australian Securities and Investments Commission v Merlin Diamonds Limited

[2019] FCA 1546

File number: VID 505 of 2019

Judge: **O'BRYAN J**

Date of judgment: 20 September 2019

Catchwords: **CORPORATIONS** – application for appointment of provisional liquidators to the defendant pending hearing of winding up application made pursuant to ss 464 and 651(1)(e) and (k) of the *Corporations Act* 2001 (Cth) – whether there is reasonable prospect that winding up order will be made – whether sufficient reason shown for intervention pending hearing of winding up application – provisional liquidators appointed

Legislation: *Corporations Act* 2001 (Cth), ss 464, 472(2), 651(1)(e), 651(1)(k)

Cases cited: *Allstate Explorations NL v Batepro Australia Pty Ltd* [2004] NSWSC 261
Anfrank Nominees Pty Ltd v Connell (1989) 1 ACSR 365; 8 ACLC 319
ASIC v ActiveSuper Pty Ltd (No 2) (2013) 93 ACSR 189
ASIC v AGM Markets Pty Ltd (2018) 129 ACSR 335
ASIC v Finchley Central Funds Management Ltd [2009] FCA 1110
ASIC v Global SDR Technologies Pty Ltd (2004) 51 ACSR 42
ASIC v Tax Returns Australia Dot Com Pty Ltd [2010] FCA 715
Australian Broadcasting Corporation v O'Neill (2006) 227 CLR 57
Australian Securities Commission v AS Nominees Limited (1995) 62 FCR 504
Australian Securities Commission v Solomon (1996) 19 ACSR 73
Constantinidis v JGL Trading Pty Ltd (1995) 17 ACSR 625
Earth Loop Pty Ltd v AIAN Investments Pty Ltd [2008] NSWSC 1042
Emmacourt Pty Ltd v Jewels of Australia Pty Ltd [2007]

FCA 1483

Loch v John Blackwood Ltd [1924] AC 783

Lubavitch Mazal Pty Ltd v Yeshiva Properties No 1 Pty Ltd
(2003) 47 ACSR 197; 22 ACLC 735

Northern Territory v Sangare (2019) 93 ALJR 959; [2019]
HCA 25

Re Club Mediterranean Pty Ltd (1975) 11 SASR 481

Riviana (Aust) Pty Ltd v Laospac Trading Pty Ltd (1986)
10 ACLR 865

Zempilas v J N Taylor Holdings Limited (No 2) (1990) 55
SASR 103

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| Date of hearing: | 2, 3 September 2019 |
| Registry: | Victoria |
| Division: | General Division |
| National Practice Area: | Commercial and Corporations |
| Sub-area: | Corporations and Corporate Insolvency |
| Category: | Catchwords |
| Number of paragraphs: | 146 |
| Counsel for the Plaintiff: | Mr S Senathirajah with Ms C Klemis |
| Solicitor for the Plaintiff: | Australian Securities and Investments Commission |
| Counsel for the Defendant: | Mr P L Ehrlich QC |
| Solicitor for the Defendant: | Waterson Legal |
| Counsel for the Interested Persons: | Mr M S Osborne QC with Mr N Cozens |
| Solicitor for the Interested Persons: | O'Donnell Salzano |
| Counsel for Mr J Gutnik and Mr M Gutnik: | Mr A Silver |

ORDERS

VID 505 of 2019

BETWEEN: **AUSTRALIAN SECURITIES & INVESTMENTS
COMMISSION**
Plaintiff

AND: **MERLIN DIAMONDS LIMITED (ACN 009 153 119)**
Defendant

JUDGE: **O'BRYAN J**

DATE OF ORDER: **20 SEPTEMBER 2019**

THE COURT ORDERS THAT:

1. Pursuant to s 472(2) of the *Corporations Act* 2001 (Cth), Salvatore Algeri and Timothy Norman of Deloitte Financial Advisory Pty Ltd, 550 Bourke Street, Melbourne, Victoria 3000, be appointed as joint and several provisional liquidators to the defendant.
2. Within 14 days of their appointment, the provisional liquidators send a notice to each creditor and each member of the defendant at the last known address for each such person as shown in the books and records of the defendant giving notice of:
 - (a) the appointment of the provisional liquidators; and
 - (b) a contact address for the provisional liquidators.
3. The plaintiff provide to the provisional liquidators access to and (if requested) copies of the documents held by the plaintiff in relation to the following persons and entities:
 - (a) the defendant;
 - (b) Axis Consultants Pty Ltd (ACN 006 804 708);
 - (c) Brocho Investments Pty Ltd (ACN 115 028 521);
 - (d) Hoydu Nominees Proprietary Limited (ACN 609 971 011);
 - (e) The Hoydu Family Trust No.1;
 - (f) Chabad Properties Pty Ltd (ACN 107 936 229);
 - (g) Edensor Holdings Pty Ltd (ACN 094 414 954);
 - (h) Morzev Pty Ltd (ACN 604 624 535);
 - (i) Joseph Isaac Gutnick (date of birth: 8 June 1952); and

- (j) Stera Miriam Gutnick (date of birth: 27 October 1953),
produced to the plaintiff in answer to notices issued under sections 30 and 33 of the *Australian Securities and Investments Commission Act 2001* (Cth) in the course of the investigation referred to in paragraph 10 of the affidavit of Brendan Francis Caridi sworn 8 May 2019.
4. The provisional liquidators shall, within 42 days of their appointment, provide to the Court and to the plaintiff a report as to the provisional liquidation of the defendant, including:
- (a) the identification of the assets and liabilities of the defendant;
 - (b) an opinion as to the solvency of the defendant;
 - (c) an opinion as to the value of the assets of the defendant;
 - (d) the likely return to creditors of the defendant;
 - (e) an opinion as to whether the defendant has proper financial records;
 - (f) any other information necessary to enable the financial position of the defendant to be assessed;
 - (g) an opinion as to whether the defendant contravened any provisions of the Act;
and
 - (h) an opinion as to whether there are any suspected contraventions of the Act by the current and former directors and officers of the defendant.
5. In addition to the powers conferred by the *Corporations Act 2001* (Cth), the provisional liquidators shall also have the power to investigate and report on:
- (a) the matters set out in Order 4 above; and
 - (b) any other matter referred to in paragraphs 14 to 208 of the affidavit of Brendan Francis Caridi sworn 8 May 2019.
6. Liberty to apply.
7. Subject to further order, the costs of the application to appoint provisional liquidators be reserved.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

O'BRYAN J:

Introduction

- 1 By originating process filed on 14 May 2019, the plaintiff, Australian Securities and Investments Commission (**ASIC**), seeks an order that the defendant company, Merlin Diamonds Limited (**Merlin**), be wound up pursuant to ss 461(1)(e) and/or (k) or s 464 of the *Corporations Act 2001* (Cth) (**Act**). As an interim step, ASIC also seeks the appointment of a provisional liquidator under s 472(2) of the Act.
- 2 Merlin is a public company, the shares in which are listed on the Australian Securities Exchange (**ASX**) (although Merlin's shares have been suspended from official quotation since 1 October 2018). Merlin engages in the exploration and development of diamond mining projects. Its head office is in Melbourne.
- 3 The proceeding arises out of a formal investigation that was commenced by ASIC in May 2017 pursuant to Division 1 of Part 3 of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) in relation to suspected contraventions of ss 180, 181, 182, 184, 208 and 596(1)(b) of the Act in connection with the conduct of the affairs of Merlin. On 10 May 2018, the investigation in relation to the affairs of Merlin was expanded to include suspected contraventions of ss 344, 1308, 1309 of the Act and s 74 of the *Crimes Act 1958* (Vic). The investigation has revealed evidence of possible contraventions of the Act by Merlin and its directors. Those contraventions include the following:
 - (a) Merlin has advanced substantial funds (\$13,752,125 outstanding as at 30 June 2018) to Axis Consultants Pty Ltd (**Axis**) without shareholder approval and on uncommercial terms. At all relevant times, Axis has been controlled by one or more of the directors of Merlin and may be a related party of Merlin. The advances may involve contraventions of s 208 of the Act or breaches of directors' duties.
 - (b) Merlin has engaged in transactions involving the use of Merlin's own monies to fund the subscription by Chabad Properties Pty Ltd (**Chabad**), a related party of Merlin, of convertible notes issued by Merlin in the amount of \$900,000 in likely contravention of s 208 of the Act.
 - (c) Merlin has failed to lodge its half yearly report for the period ending 31 December 2018 with ASIC in contravention of s 320 of the Act.

(d) Merlin has had no company secretary since 8 January 2019 in contravention of s 204A(2) of the Act.

4 On 1 October 2018, the ASX suspended Merlin's shares from official quotation as a result of Merlin failing to file a quarterly report with the ASX on time. Subsequently, the ASX raised with Merlin a series of concerns about its operations and financial position and advised Merlin that its shares would not return to quotation until those matters were addressed to the ASX's satisfaction. That has not occurred.

5 ASIC has brought this proceeding to wind up Merlin because it considers that there is a justifiable lack of confidence in the directors' conduct and their ability to manage Merlin's affairs in the best interests of its shareholders and creditors. ASIC considers that the Merlin board is comprised of directors who have either been knowingly involved in uncommercial related party transactions or failed to exercise their duties to prevent those transactions from occurring.

6 ASIC seeks the appointment of a provisional liquidator to Merlin so as to identify, secure and preserve the assets of Merlin pending the final hearing and determination of ASIC's winding up application and to ensure, in the public interest, that an independent officer of the Court investigates Merlin's affairs and reports back to the Court.

7 The application to appoint a provisional liquidator is opposed by Merlin and a number of shareholders of Merlin who applied for leave to be heard on the application (which I granted) (**Opposing Shareholders**). There are 13 Opposing Shareholders and they hold, in aggregate, approximately 11% of the issued shares in Merlin. They include the third largest shareholder in Merlin holding approximately 3% of the issued shares, the sixth largest shareholder holding approximately 2.5% of the issued shares and the seventh largest shareholder holding approximately 2% of the issued shares. The aggregate number of shares held by the Opposing Shareholders is 376,485,089. At the last quoted price of Merlin shares (0.6 cents per share), the aggregate value of the shareholding is approximately \$2.26 million. Three of the Opposing Shareholders also hold secured notes in Merlin with an aggregate face value of \$160,000.

8 On the first return date of ASIC's application for the appointment of a provisional liquidator (4 June 2019), Merlin and each of its directors gave undertakings to the Court (**Undertakings**), in respect of the period either until the final hearing and determination of the proceeding or until excused by the Court:

- (a) to refrain from making any loan or advance of money by Merlin to Axis, other named entities discussed below and any related party of Merlin within the meaning of s 228 of the Act or doing any act in furtherance of or in connection with making such a loan; and
- (b) other than in the ordinary and proper course of business, to preserve the status quo of the affairs of Merlin.

9 The principal submission of Merlin and the Opposing Shareholders in opposition to the appointment of a provision liquidator is that, in light of the Undertakings, there is no need to appoint a provisional liquidator to maintain the status quo until the hearing of ASIC's winding up application. Neither Merlin nor the Opposing Shareholders contested the evidence relied on by ASIC on this application. Indeed, each of Merlin and the Opposing Shareholders acknowledged that the matters raised by ASIC, summarised above, give rise to concerns for the company and its shareholders. As a result, on this application there is no material contest on the facts. Rather, Merlin and the Opposing Shareholders contend that the appointment of a provisional liquidator, and the winding up of the company generally, would not be in the best interests of the company or its shareholders.

10 For the reasons that follow, I consider that there are proper grounds for the appointment of a provisional liquidator.

Relevant Facts

11 The evidence adduced by ASIC on this interlocutory application was largely documentary, comprising the business records of Merlin and certain associated companies. ASIC also relied on statements and admissions made by officers or employees of Merlin in the course of examinations conducted by ASIC under s 19 of the ASIC Act as part of its investigation of the conduct of the affairs of Merlin.

12 The evidence adduced by Merlin and the Opposing Shareholders was very limited and was also documentary. None of the directors of Merlin gave evidence.

13 The findings set out below reflect the evidence before the Court on this interlocutory application.

Company background

14 Merlin is a public company based in Melbourne. Its business activity is as an explorer and developer of diamond mining projects, its principal project being the Merlin diamond mine

located south of Borroloola in the Northern Territory. It is an ASX-listed company but, as discussed below, its shares are currently suspended from trading on the ASX.

15 Merlin has four directors: Mr Joseph Gutnick, Mr Mordechai Gutnick, Dr David Tyrwhitt and Mr Henry Herzog. Mr Joseph Gutnick was a director of Merlin from October 2008 until 7 July 2016 and re-joined the board on 8 June 2018 and is currently its executive chairman. Mr Gutnick's absence from the board of Merlin coincided with a period of voluntary bankruptcy, although Mr Gutnick remained employed as a consultant to Merlin during his bankruptcy. Mr Gutnick was re-appointed as executive chairman of Merlin on 8 June 2018 following the annulment of his bankruptcy. Mr Mordechai Gutnick is the son of Mr Joseph Gutnick and has been a director of Merlin since 7 July 2016. Dr Tyrwhitt has been a director of Merlin since December 2011. Mr Herzog has been a director of Merlin since December 2009.

16 Mr Peter Lee was appointed company secretary of Merlin on 25 August 2016 and resigned from that position on 8 January 2019. As noted above, since that date Merlin has not had a company secretary. However, during the course of the hearing of this application, Senior Counsel for Merlin informed the Court that Mr Joseph Gutnick has now been appointed as company secretary. No evidence was adduced about that appointment.

17 Grant Thornton Audit Pty Ltd (**Grant Thornton**) was appointed as Merlin's auditor on 30 November 2016.

Current financial position

18 In each of the financial years ended 30 June 2009 to 30 June 2018, Merlin has reported a net loss.

19 The most recent annual report for Merlin is for the year ended 30 June 2018. In that financial year, Merlin recorded a loss of \$15,238,431. Its balance sheet as at 30 June 2018 showed a deficiency in total equity of \$7,116,628, comprising issued capital of \$165,901,254, reserves of \$622,160 and accumulated losses of \$173,640,042. The balance sheet showed total assets of \$5,374,921 which included current assets of \$1,446,213 of which \$531,289 was cash. The balance sheet recorded total liabilities of \$12,491,549 of which current liabilities were \$6,275,441. Hence, the balance sheet showed a deficiency in working capital (current assets less current liabilities) of \$4,829,228.

20 The notes to the financial statements record the following:

Going Concern

The financial report has been prepared on the basis of going concern which contemplates continuity of normal business activities and the realisation of assets and settlement of liabilities in the ordinary course of business.

The Company has incurred a loss of \$15,238,432 in the year to 30 June 2018, had net cash operating outflows of \$2,876,298 for the year ending 30 June 2018 and has negative working capital of \$4,829,228 at 30 June 2018. In order to continue as a going concern, the Company will be required to raise further capital to meet its commitments, resume mining operations at commercial levels, and have the continued support of creditors. **These conditions indicate a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.** (emphasis added)

- 21 The notes to the financial statements also state that the directors believe the going concern basis to be appropriate. The reason for that view was the success of Merlin in raising capital since the balance date and further commitments of capital that had been made.
- 22 Grant Thornton issued a qualified opinion in respect of Merlin's financial report for the year ended 30 June 2018. In respect of the financial report being prepared on a going concern basis, Grant Thornton noted the disclosure of the material uncertainty about the raising of further capital and stated that that may cast significant doubt about Merlin's ability to continue as a going concern and therefore Merlin may be unable to realise its assets and discharge its liabilities in the normal course of business and at the amount stated in the financial report.
- 23 Under s 320 of the Act, Merlin was required to lodge audited accounts for the half year ending 31 December 2018 by 18 March 2019. To date, those accounts have not been lodged and Merlin is in breach of its obligations under s 320. On 25 March 2019, Grant Thornton reported Merlin's contravention of s 320 of the Act to ASIC. Grant Thornton advised ASIC that it had not been presented with any information from Merlin.
- 24 On 30 April 2019, Merlin lodged a report for the quarter ended 31 March 2019 with the ASX. The report stated that Merlin's diamond mine had been put on care and maintenance and that Merlin would report a full update on activities in June 2019.
- 25 On 31 July 2019, Merlin lodged a report with the ASX for the quarter ended 30 June 2019. The report did not provide any update on Merlin's activities, contrary to the statement that had been made in the report for the quarter ended 31 March 2019. In respect of the previous 12 months, the report disclosed that:
- (a) cash held at the beginning of the period was \$507,000;
 - (b) cash outflows totalled \$3,458,000;

- (c) cash inflows totalled \$2,956,000 which included borrowings of \$2,167,000 and proceeds from the issue of convertible notes of \$800,000; and
- (d) cash at the end of the period was \$5,000.

26 The report also stated that the estimated cash outflows for the following quarter would be \$580,000.

Loans to Axis

27 Merlin was a party to an agreement with Axis dated 31 August 2009 titled Service Deed. Under the agreement, Axis agreed to provide or procure the provision of a range of goods and services required by Merlin in the conduct of its business including:

- (a) managerial and administrative services including staff, payroll facilities, employee records, insurance, legal, financial and accounting advice and services;
- (b) either by purchase or lease, items of equipment (including vehicles) necessary for the conduct of the business; and
- (c) stationery, furniture, furnishings, library facilities, transport, secretarial services, telephone, photocopying and other services as may be required.

28 Axis also agreed to meet sundry office and running expenses incurred by Merlin and all outgoings in respect of services supplied.

29 In consideration of the services supplied by Axis, Merlin agreed to pay a service fee equal to the aggregate of the costs and expense to Axis of providing the services plus 15% of that cost. The service fee was required to be paid by Merlin within 21 days from the receipt of a monthly invoice from Axis.

30 Merlin's annual reports in each of the financial years from 2012 to 2018 disclose that Merlin has advanced loan monies to Axis, in addition to the service fee paid to Axis. Each of the annual reports state that the loans were made on normal commercial terms and at market rates, but also disclose that there were no fixed terms for the repayment of the loans and no security was given for the loans. The interest payable on the loans was the ANZ reference rate from time to time.

31 For each of the financial years from 2014 to 2018, Merlin's financial reports recorded an impairment provision for the entire amount of the loan and interest owing by Axis. In its auditor's report for the 2018 financial year, Grant Thornton stated that the loan receivable from

Axis had been fully provided for and that Grant Thornton had been unable to obtain “sufficient appropriate audit evidence in respect of the collectability or otherwise of this amount”.

32 The amounts paid and payable between Merlin and Axis, as shown in Merlin’s 2013 to 2018 annual reports (subject to the correction of certain discrepancies explained below), are shown in the following table:

| | FY12 | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Opening balance owing | (16,438) | 1,023,959 | 6,511,675 | 4,907,915 | 8,468,769 | 8,523,114 | 12,158,032 |
| Advance | 740,000 | 5,719,079 | 393,614 | 585,037 | 162,074 | 3,920,283 | 455,903 |
| Repayment of advance | - | - | (2,442,300) | (1,211,505) | (898,913) | (1,210,000) | - |
| Interest payable | 19,053 | 205,368 | 444,926 | 626,469 | 791,184 | 924,636 | 1,138,189 |
| Management services rendered | (2,592,801) | (4,485,968) | (6,024,582) | (3,871,528) | (1,508,324) | (2,173,985) | (1,974,497) |
| Management services paid | 2,874,145 | 4,049,237 | 6,024,582 | 3,871,528 | 1,508,324 | 2,173,985 | 1,974,497 |
| Impairment of receivable | - | - | (4,907,915) | (3,560,854) | (54,345) | (3,634,918) | (1,594,091) |
| Closing balance owing | 1,023,959 | 6,511,675 | 4,907,915 | 8,468,769 | 8,523,114 | 12,158,032 | 13,752,124 |

33 The figures in the above table have been extracted from the “related party transaction” section of the notes to Merlin’s financial statements in each of the annual reports for the financial years 2013 to 2018. There are a number of discrepancies in the figures from the annual reports which must be noted:

- (a) First, the figures recorded for FY12 in the 2012 annual report differ from the figures (for the same year) recorded in the 2013 annual report. As the figures from the 2013 annual report are then carried forward in subsequent years, I infer that they are the correct figures and the table above includes those figures.
- (b) The second discrepancy concerns the advance made in FY15. In the 2015 and 2016 annual reports, the advance is recorded as \$585,037, interest payable is recorded as \$626,469 and a repayment is recorded as \$1,211,506. If those figures were correct, the balance owing from Axis would not have increased in FY15 and there would have been no impairment recorded for the year. However, in both the 2015 and 2016 annual reports, an impairment of \$3,560,854 is recorded for FY15 and the balance owing is recorded as increasing to \$8,468,769. The latter figure is then carried forward into subsequent years. I infer that the figures recorded in FY15 for the advance, or the repayment of advance, or both, are incorrect and the balance owing is correct. However, the above table has not

corrected the figures in FY15 for the advance or the repayment of advance as it is not possible to allocate the error between them (it is only possible to conclude that the net figure must be an increase in advance of \$2,934,385).

- (c) The third discrepancy is the advance made in FY16. The figure shown in the 2016 annual report is \$107,729, whereas the figure shown in the 2017 annual report is \$162,074. I infer that the latter figure is correct because it reconciles with the recorded impairment in FY16 of \$54,345 and the table above includes the corrected figure.
- (d) The fourth discrepancy is the balance owing as at 30 June 2015. The 2015 annual report records two figures without explanation: \$8,468,769 and \$8,468,869. The latter is carried forward into the 2016 annual report, but the closing balance as at 30 June 2016 of \$8,523,114 indicates that the correct figure as at 30 June 2015 is \$8,468,769. The above table includes the corrected figure.

34 The above table includes a line for opening balance and closing balance outstanding. Those lines ignore the impairment of the receivable (which was taken up in each of the financial years from 2014 to 2018) in order to identify the total amount owing by Axis, including outstanding interest. It can be seen from the above table that the indebtedness of Axis to Merlin increased in every year from FY12 to FY18, notwithstanding that from FY14 the receivable was recorded in Merlin's financial report as fully impaired.

35 Axis is a private company. It was incorporated in 1987. Its registered office is the same address as that of Merlin. Mr Joseph Gutnick was a director of the company from 1987 until 7 July 2016. Dr Tyrwhitt was a director from 1997 until 13 October 2017. Mr Mordechai Gutnick was appointed a director on 7 July 2016 but resigned on 5 August 2016. He was then re-appointed a director on 18 October 2017. Mr Peter Lee was the company secretary until 8 January 2019.

36 Prior to entering into a loan agreement in or about June 2017 (discussed below), the loans that had been made by Merlin to Axis were not documented despite the auditors specifically calling for the loans to be documented in each of their annual audit completion reports since 2013. The loans had no fixed or certain date for repayment of principal or interest. The loans were unsecured despite the fact that from 2014 they were fully impaired in the same financial year in which they were advanced. Axis was not required to identify the purpose of the loans, nor were there any restrictions on Axis as to how it was to use the money loaned.

- 37 In my view, none of the provisions of the Service Deed contemplated the making of loans by Merlin to Axis. Clause 8 of the Service Deed required Merlin to pay Axis a service fee equal to the aggregate of the costs and expenses of Axis in providing the services, facilities and equipment under the agreement plus 15%. The clause contemplates that the service fee payable by Merlin will be in respect of actual costs and expenses incurred by Axis. Clause 9 provides that Axis may request Merlin to provide monies to Axis but only on receipt by Axis of an invoice, demand or account or notification of a claim or requirement to make a payment greater than \$1,000 in relation to or as a result of the provision or termination of any of the services, facilities or equipment provided by Axis to Merlin. Again, the clause contemplates that Axis will incur an obligation before Merlin is required to make a payment to it.
- 38 In or about June 2017, Merlin and Axis purported to enter into a loan agreement to record the terms of the loan that had been made many years prior. The agreement was purportedly executed by Mr Mordechai Gutnick on behalf of Merlin and by Mr Lee on behalf of Axis. In the agreement, the loan was defined to be the amount of \$11,997,353.98 (which was the balance outstanding as at 31 May 2007) and any further loan advanced pursuant to the agreement. The agreement contemplated that Axis could deliver to Merlin a drawdown notice requesting further funds, with the drawdown notice to specify the purpose for the use of the funds. Under the agreement, the decision whether to advance further funds to Axis was at the discretion of Merlin. Interest was payable at the ANZ Bank reference rate published from time to time. However, the loan contemplated that interest would accrue and be paid on the repayment date. The repayment date was specified as 36 months after the commencement date, being the date of the agreement. The agreement stipulated that the loan “may be repaid in cash or shares at the discretion of the Borrower”.
- 39 The evidence indicates that there are serious doubts as to whether the agreement was validly executed. At the time the agreement was executed, the sole director of Axis was Dr Tyrwhitt. When examined by ASIC, Dr Tyrwhitt said that he had no knowledge of the agreement. Mr Lee, who executed the agreement on behalf of Axis as company secretary, informed ASIC that he did so on the instructions of Mr Joseph Gutnick. However, at that time, Mr Joseph Gutnick was disqualified from managing corporations by reason of his bankruptcy and he was not a director of Axis. Mr Mordechai Gutnick told ASIC that he executed the agreement on behalf of Merlin after speaking with Mr Lee and Dr Tyrwhitt, neither of whom were independent from Axis (Dr Tyrwhitt was the sole director and Mr Lee was the secretary).

40 The loan agreement cannot be regarded as an arm's length commercial transaction. At the time it was entered into, Axis was indebted to Merlin in an amount in excess of \$11 million and the loan was fully impaired in Merlin's financial reports. Despite that, the agreement provided for further advances to be made by Merlin (at Merlin's discretion), interest payments were deferred until the loan repayment date in three years' time and no security was given for the loan. Further, and perhaps most significantly, Axis' obligation to repay the loan in three years was an obligation to pay cash or "shares" at the discretion of Axis. Although not entirely clear, the agreement appears to contemplate that Axis would repay the loan by the issue of shares in Axis to Merlin. However, the agreement does not specify any method for determining the value of Axis and the number of shares to be issued to satisfy that obligation. As a result, the repayment promise is wholly uncertain.

41 After the loan agreement was entered into in June 2017, Merlin lent further amounts to Axis, purportedly pursuant to the agreement, but Axis did not comply with the requirement to stipulate the use of the funds in the drawdown notice.

42 ASIC's investigations indicate that the monies loaned by Merlin to Axis may have been used to fund companies associated with Mr Joseph Gutnick. The accounting ledger of Axis for the nine month period to 31 March 2019 shows the following balances of advances made by Axis to the following companies:

| Borrowing Entity | Balance as at 31 March 2019 |
|---------------------------------|------------------------------------|
| Great Central Resources Corp | \$47,106.02 |
| Consolidated Gems, Inc | \$227,848.59 |
| Northern Capital Resources Corp | \$325,225.68 |
| Aurum Inc | \$381,468.27 |
| Brocho Investments Pty Ltd | \$8,275,284.01 |
| Brocho | \$266,613.64 |
| Brocho (M) | \$627,590.49 |

43 Great Central Resources Corp is a US company registered as a foreign company in Australia. Mr Joseph Gutnick was a director until 8 July 2016. Mr Mordechai Gutnick was appointed a director on 7 July 2016 (and became the sole director on 8 July 2016). Its local agent in Australia is Axis.

44 Consolidated Gems, Inc is a US company registered as a foreign company in Australia. Mr Joseph Gutnick was a director until 8 July 2016. Mr Mordechai Gutnick was appointed a director on 7 July 2016 (and became the sole director on 8 July 2016). Its local agent in Australia is Axis.

45 Northern Capital Resources Corp is a US company registered as a foreign company in Australia. Mr Joseph Gutnick was a director in Australia until 8 July 2016. Dr Tyrwhitt has been a local director since January 2008. Mr Mordechai Gutnick became a director on 7 July 2016. Its local agent in Australia is Axis.

46 Aurum Inc is a US company registered as a foreign company in Australia. Mr Joseph Gutnick was a director until 8 July 2016. Mr Mordechai Gutnick was appointed a director on 7 July 2016 (and became the sole director on 8 July 2016). Its local agent in Australia is Axis.

47 Brocho Investments Pty Ltd (**Brocho**) is a private company controlled by the Gutnick family. Mr Joseph Gutnick was a director from the date of incorporation of the company on 29 June 2005 until 7 July 2016. Mr Gutnick's wife, Stera Gutnick, and Mr Mordechai Gutnick, were each appointed as directors on 22 December 2015. Each of Mr Joseph Gutnick and Mrs Stera Gutnick own half the shares in Brocho.

48 As shown in the above table, Axis' draft balance sheet as at 31 March 2019 records loans made to "Brocho Investments", "Brocho" and "Brocho (M)". I infer that each of those entities is Brocho Investments Pty Ltd but that separate loans have been recorded in the balance sheet.

49 On 31 March 2013, Axis and Brocho entered into a loan agreement under which Axis agreed to loan the amount of \$1,354,266.19 (being the amount owing as at 31 March 2013) and any further amounts agreed to be loaned by Axis under the agreement up to a maximum of \$10 million. The repayment date stipulated in the agreement is 31 March 2020.

50 In response to a statutory notice to produce, Axis provided to ASIC a draft balance sheet of Axis as at 31 March 2019. The balance sheet records that, as at that date, Axis had negative equity of \$17,813,839.28 made up of total liabilities of \$28,372,360.61 and total assets of \$10,558,521.33. The assets include the loans referred to in the above table. The liabilities include the amount owing to Merlin, as well as substantial amounts owing to other entities.

51 In a s 19 examination conducted by ASIC, Mr Lee stated that the monies advanced by Merlin to Axis were on-lent to other parties, including to Brocho, Aurum and Consolidated Gems, for the purpose of building their businesses with a view that there would be a return to Axis and then a return to Merlin. Mr Lee said that the advances were made by him and other accounting staff at the direction of Mr Joseph Gutnick. He stated that there was no due diligence or financial assessment undertaken of whether Axis had the financial ability to meet its obligations to repay the loan.

52 In his s 19 examination conducted by ASIC, Dr Tyrwhitt said that while he was a non-executive director of Axis, he never had any involvement whatsoever with the day to day activities of Axis and that at no stage had he been asked to look at accounts or attend board meetings.

53 In his s 19 examination conducted by ASIC, Mr Mordechai Gutnick stated that he understood the loans made by Merlin to Axis were a way of compensating Axis for work done but that he did not know much about the loans.

54 In his s 19 examination conducted by ASIC, Mr Joseph Gutnick said that Merlin made loans to Axis instead of paying Axis commissions for raising capital on behalf of Merlin. He also stated that the monies lent to Axis were provided in order to help develop the activities of other companies within the “Axis Group” to try and make the “Axis Group” stronger. Mr Gutnick claimed that the loans benefited Merlin because Merlin would receive repayment of the loans rather than making a payment of commission to Axis for capital raising.

Issue of convertible notes to Chabad

55 On 27 November 2015, Merlin announced that it was proposing to raise up to \$10 million through the issue of unlisted debt notes to institutional and wholesale investors, with a minimum subscription of \$7 million. According to the announcement, the proceeds from the note issue were to be applied by Merlin for development activities aimed at recommencing diamond mining operations and for operational, exploration and working capital purposes. The notes would carry a 10% coupon rate and noteholders would have the right to convert the notes into ordinary shares at 5 cents per share within the first 12 months of issuance and, following the first anniversary, at the lesser of 5 cents per share or a 10% discount to the five day VWAP (value weighted average price) immediately prior to conversion. The convertible notes were to be issued pursuant to a Secured Note Deed and secured by a General Security Deed.

56 In late June 2016, Merlin issued 2 million convertible notes to Chabad in two tranches. On 28 June 2016, Merlin issued 1.1 million convertible notes to Chabad at a price of \$1 per note together with options over Merlin shares. An amount of \$1.1 million was transferred from Chabad’s bank account to Merlin’s bank account in payment of the subscription price. On 30 June 2016, Merlin issued a further 900,000 convertible notes, and accompanying options over Merlin shares, to Chabad. Payment for those notes was not made by Chabad until 20 October 2016 in the circumstances described below. At a general meeting of Merlin shareholders held on 6 September 2016, resolutions were passed approving the issue of convertible notes to several parties including the 2 million convertible notes issued to Chabad.

57 Chabad is the trustee of the Machon Chaim College Fund which is a registered charity. Each of Mr Joseph Gutnick and Mrs Stera Gutnick hold one third of its shares. Until 15 May 2017, the remaining one third of the shares was held by Mr Mordechai Gutnick. On 15 May 2017, those shares were transferred to Mr Zelman Gutnick. Mr Joseph Gutnick was a director until 7 July 2016. Mrs Stera Gutnick has been a director since 2004 and Mr Mordechai Gutnick has been a director since 22 December 2015.

58 During the audit of Merlin for the financial year ending 30 June 2016, the then auditors, BDO, considered Merlin's ability to continue as a going concern. In an audit working paper, BDO noted that, in order to continue as a going concern, Merlin had raised \$2.63 million through the issue of convertible notes and had received \$710,000 in cash since year end and a further \$900,000 pursuant to an outstanding cheque dated 29 September 2016. The audit working paper attached a partial image of that cheque which was drawn on a Westpac bank account in the name of Mrs Stera Gutnick. BDO's working paper indicated that BDO believed that the cheque was in payment of the 900,000 convertible notes which had been issued to Chabad on 30 June 2016. The evidence shows that that cheque was never presented and that the account on which it was written did not have sufficient funds to honour a cheque in that amount. Those circumstances raise a suspicion that the cheque was written and shown to BDO so as to mislead the auditors into believing that the subscription amount for the issue of convertible notes had been paid or would be paid shortly.

59 A transfer of \$900,000 was subsequently made by Chabad to Merlin on 20 October 2016 in the following circumstances. As at the close of business on 10 October 2016, Merlin's ANZ bank account was \$27,576.98 in credit. Between 11 October and 18 October 2016, amounts totalling \$951,000.76 were deposited into that account from investors other than Chabad who had subscribed for convertible notes with Merlin, plus an ATO deposit in the amount of \$110,746. On 19 and 20 October 2016, the following transactions involving the amount of \$900,000 occurred:

- (a) On 19 October 2016, Axis issued an invoice to Merlin in the amount of \$900,000 with the description "cash call for the month of October 2016 pursuant to Service Deed". On 19 October 2016 at 2.58pm, the amount of \$900,000 was electronically transferred from the Merlin ANZ account to an Axis ANZ account.

- (b) On 19 October 2016 at 3.25pm (27 minutes after the Merlin-Axis transfer), the amount of \$900,000 was electronically transferred from the Axis ANZ account to a Brocho Westpac account.
- (c) As at the close of business on 19 October 2016, the balance in Chabad's Westpac bank account was \$252.10 in credit. On 20 October 2016 at 9.05am, \$900,000 was electronically transferred from the Brocho Westpac account to the Chabad Westpac account.
- (d) On 20 October 2016 at 9.19am (14 minutes after the Brocho-Chabad transfer), the amount of \$900,000 was electronically transferred from the Chabad Westpac account to the Merlin ANZ account.

60 As ASIC submits, the foregoing transactions have the appearance of a "round-robin". Merlin's cash position at the end of the transactions was the same as it was immediately prior to the transactions. Accordingly, the issue of 900,000 convertible notes to Chabad did not result in Merlin increasing its capital. Although Chabad notionally satisfied its obligation to subscribe for those notes by the payment of \$900,000, that payment was funded by Merlin loaning \$900,000 to Axis. The effect of the transactions was that Chabad, a private company owned and controlled by the Gutnick family, received secured convertible notes and accompanying options in Merlin. However, instead of the transaction increasing Merlin's cash holdings by \$900,000, the transaction increased the amount owing from Axis to Merlin by \$900,000.

61 In his s 19 examination conducted by ASIC, Mr Lee stated that he was instructed by Mr Joseph Gutnick to make the \$900,000 payment from Merlin to Axis and then from Axis to Brocho. Mr Lee stated that he considered the transaction was inappropriate and raised his concerns with Mr Gutnick.

62 On 11 February 2019, the solicitors for Messrs Joseph and Mordechai Gutnick, Waterson Legal, wrote to ASIC stating that:

- (a) Messrs Joseph and Mordechai Gutnick had procured repayment to Merlin of the sum of \$900,000 which had been transferred to Axis;
- (b) the repayment was made by Edensor Holdings Pty Ltd by a total of 61 transactions between 1 October 2018 and 29 January 2019; and

- (c) payment of interest due by Axis to Merlin in respect of the \$900,000 would be effected by the immediate surrender or cancellation of equivalent convertible notes issued by Merlin to Edensor Holdings.

63 Edensor Holdings is a private company the shares in which are held by Mrs Stera Gutnick. Mr Joseph Gutnick was a director of the company from September 2000 until 7 July 2016 and then from 6 August 2018 onwards. Mr Mordechai Gutnick was a director from 22 December 2015 until 5 April 2017 and then from 6 August 2018 onwards. Mrs Stera Gutnick has been a director since 22 December 2015. ASIC is currently investigating the source of the funds used by Edensor Holdings to make the repayments to Merlin.

ASX suspension of Merlin shares

64 On 1 October 2018, Merlin's shares were suspended from quotation on the ASX as a result of Merlin's failure to lodge its 2018 annual financial report by the due date. Merlin subsequently lodged its annual report with the ASX on 8 October 2018.

65 On 9 October 2018, the ASX wrote to Merlin asking various questions arising out of the auditor's qualified opinion set out in the annual report. In relation to the \$900,000 loan made by Merlin to Axis, the ASX asked why the loan had been fully impaired, how Merlin had satisfied itself of the collectability of the loan, for what purpose the loan was advanced and whether Merlin expected the full amount of the loan to be repaid in June 2020. The ASX also asked whether Merlin's financial condition was sufficient to warrant continued listing on the ASX.

66 On 15 October 2018, Merlin responded to the ASX's letter. In relation to the Axis loan, the letter stated that Merlin had made available to the auditors all information it had in its possession. The letter then stated:

The Company does not have access to financial information of AXIS. From a search of AXIS, AXIS is not a reporting entity. Accordingly, on a conservative basis, the Company has provided for the loan as a doubtful debt.

67 The letter also stated that Merlin was not in a position to determine whether Axis will repay the loan in June 2020.

68 In relation to Merlin's financial condition, the letter stated (in part):

As also disclosed in the financial statements for the past few years, the company has a track record of raising capital to sustain its operations and there is no reason to believe that it will not be able to continue to raise capital in the future.

The Directors note that the financial position of the Company is not dis-similar to most companies in the exploration/development stage with the need to continue to raise capital to sustain operations until steady stage operations are reached.

69 The letter also stated that the responses included in the letter had been approved and authorised by the board of directors.

70 Unsurprisingly not satisfied with Merlin's response, on 17 October 2018 the ASX again wrote to Merlin. In relation to Merlin's statement that it did not have access to the financial information of Axis, the ASX noted that Mr Mordechai Gutnick signed the loan agreement on behalf of Merlin and Mr Lee signed the loan agreement on behalf of Axis; both Mr Mordechai Gutnick and Mr Lee were a director or employee of Merlin and Axis; Merlin and Axis are registered at the same address in Southbank and the ASX considered that Merlin and Axis were related parties. The ASX raised a number of questions including:

- (a) Why did Mr Mordechai Gutnick enter into the loan agreement on behalf of Merlin instead of someone independent of Axis?
- (b) Why were funds advanced to Axis in the form of a loan rather than paid as an expense for services provided?
- (c) Given Merlin does not have sufficient information about its related party, Axis, to be satisfied it has the capacity to repay loans on an unsecured basis, does Merlin intend to continue to lend to Axis and if so, why?

71 On 22 October 2018, Merlin responded to the ASX's further letter. Merlin's letter asserted that the Axis loan agreement was verbally approved by the independent directors. The letter also asserted that:

It is more beneficial for Merlin to treat the amount as a loan rather than payment for services. Merlin balances its cash requirements between the need for funds for mining, development, exploration and working capital needs which ensures that the services required from external sources are balanced.

72 In response to the question whether Merlin intended to continue to lend to Axis, Merlin responded "yes". The letter stated that Merlin's responses had been approved and authorised by the board of directors.

73 On 25 October 2018, the ASX issued a further market announcement stating that it had raised queries in relation to the auditor's report in Merlin's 2018 annual report. The ASX advised that Merlin's shares would remain suspended pending further inquiries to be made by the ASX.

74 Again, unsurprisingly not satisfied with Merlin's response of 22 October 2018, on 29 October 2018 the ASX sent a further letter to Merlin. The letter sought a copy of the Service Deed between Merlin and Axis, the board minute approving the entry into the Service Deed and a record of which directors voted in favour of it and which directors abstained from voting on the basis of their conflict of interest. The letter also questioned whether the Service Deed had been approved by shareholders under s 208 of the Act and, if no such approval had been sought, why that approval was not sought. Similar information was also sought in respect of the loan agreement between Merlin and Axis. The ASX also questioned whether Merlin had undertaken any due diligence in respect of Axis prior to entering into the loan agreement including by asking Axis to provide financial statements or other financial information to confirm its financial capacity to repay the loan.

75 On 1 November 2018, Merlin replied to the ASX letter. Merlin stated that it did not have any records concerning the decision to enter into the Service Deed. In relation to the loan agreement, Merlin re-asserted that it was verbally approved by the independent directors (and hence there was no written record). The letter asserted that the independent directors took the view that the terms and conditions of the loan agreement were at arm's length. The letter also asserted that given Merlin's long relationship with Axis, the independent directors did not believe that it was necessary to undertake due diligence. The letter stated that Merlin's responses had been approved and authorised by the board of directors.

76 On 7 November 2018, Merlin issued an ASX announcement in the following terms:

Merlin Diamonds (MED) and ASX met on Monday 5 November 2018. Following that meeting, MED has determined that two independent non-executive directors would be appointed to the Board of Directors of MED (to the satisfaction of ASX) and the Board will then review and revisit the queries and answers to the ASX from the 9, 17 and 29 October 2018 (Board Review). If ASX is satisfied with the outcome of the Board Review MED expects its securities to be reinstated to quotation on ASX soon thereafter.

77 Despite what was said in Merlin's announcement of 7 November 2018, Merlin has not appointed two independent non-executive directors. Further, there is no evidence to suggest that the board of Merlin has ever reviewed or revisited the responses given by Merlin to the ASX letters dated 9, 17 and 29 October 2018.

78 On 18 December 2018, Merlin wrote to the ASX. Amongst other things, the letter asserted that, in determining to enter into the Service Deed, the board of Merlin considered that shareholder approval was not required because the terms of the Deed were at arm's length. The

reason for that view was stated to include that: the services provided by Axis were billed on a cost plus 15% basis; Merlin only paid for services as and when requested; internal controls, including timesheets, were used to ensure that Merlin was only charged for services properly provided to it; and Merlin was entitled to terminate the Deed on 60 days' notice. In relation to the loan agreement, the letter asserted that the ASX queries had proceeded on the mistaken basis that the loan agreement provided new financial accommodation to Axis when the true position was that, when the agreement was entered into, the balance of prior year loans was \$11,997,353.98. The letter also asserted that, at the time the loan agreement was entered into, the board of Merlin did not undertake due diligence as to the ability of Axis to repay the loan, nor did it consider it necessary to seek shareholder approval, because the loan agreement documented existing loans.

- 79 On 4 January 2019, the ASX wrote to Merlin noting that it had failed to respond coherently to the ASX query about the purpose for which the loan was advanced to Axis. The ASX observed that Merlin's response in its letter of 22 October 2018 that "it is more beneficial for Merlin to treat the amount as a loan rather than payment for services" made no sense. That was because Merlin had separately paid for the services provided by Axis and the additional amounts paid to Axis were loans not justified by services provided. The ASX raised numerous other questions about the manner in which, and purpose for which, the loans were advanced to Axis.
- 80 On 11 February 2019, Merlin issued a further ASX announcement titled "Update on Suspension" in the following terms:

Merlin and ASX met recently and as a result:

- (1) Merlin (MED) is prepared to reconstitute the board so that it comprises a majority of independent directors.
- (2) Also to terminate the service deed dated the 31 August 2009 between MED and Axis Consultants Pty Ltd (AXIS) under which AXIS provides Merlin with company secretarial, finance, geology, exploration, IT and other services and its replacement with appropriate arrangements for MED to have access to these resources.
- (3) The independent directors to determine an appropriate arrangement to address the debt between MED and AXIS. MED agrees that if necessary a meeting of shareholders would be called to ratify such an arrangement.
- (4) Merlin hopes that when such action is taken that the ASX would consider reinstating MED's shares to trading.

- 81 There is no evidence that, since that announcement, Merlin has taken any steps to reconstitute its board. There is also no documentary evidence that Merlin and Axis have terminated the

Service Deed. However, Mr Ben Waterson, the solicitor for Merlin, has deposed in this proceeding that he is instructed that the Service Deed was terminated on 11 February 2019. There is no evidence that Merlin has taken any steps to put in place arrangements for services to be supplied in place of those previously supplied by Axis. There is also no evidence that any steps have been taken to address the debt owed by Axis to Merlin.

82 On 19 February 2019, the ASX issued a market announcement in the following terms:

To assist the market to understand why the shares in MED continue to be suspended from quotation ASX is today releasing a copy of a letter from MED to ASX dated 18 December 2018 and an ASX query letter to MED dated 4 January 2019.

Following the receipt by MED of ASX's letter and prior to the deadline for its response, MED sought a meeting with ASX to discuss the actions MED needed to take to allow MED's shares to be reinstated to trading on ASX. On that basis, ASX granted MED a two week extension to respond to ASX's query letter to put a proposal to ASX that, if acceptable to ASX, might see MED's shares reinstated to trading on ASX.

Although MED outlined such a proposal in its market release dated 11 February 2019 headed "Update on Suspension", ASX has not received any details of the proposal from MED for it to consider nor has it received a response to its query letter to MED dated 4 January 2019.

MED's securities will remain suspended in accordance with listing rule 17.3 until further notice.

83 As at the date of the hearing, Merlin's shares remained suspended by the ASX.

Affidavits of Ben Waterson

84 At the hearing, Merlin relied on three affidavits of Ben Waterson, the principal of Waterson Legal, being the solicitors representing Merlin in this proceeding. Mr Waterson's affidavits do not provide any information as to the source of his instructions when acting on behalf of Merlin in this proceeding. In the absence of direct evidence and having regard to the content of his affidavits, I infer that Mr Waterson is receiving instructions from the current directors of Merlin.

85 Mr Waterson deposed that he is informed by each of Mr Joseph Gutnick, Mr Mordechai Gutnick and Dr Tyrwhitt that each of them deny the allegations made against them by ASIC and that, under cover of that denial, each of them relies upon their privileges against self-incrimination and penalty privilege. Apart from that denial, Mr Waterson's affidavits do not contain any evidence that contradicts or undermines the evidence adduced by ASIC in this proceeding concerning the potential contraventions of the Act by Merlin and its directors.

86 Mr Waterson also deposed that he is informed by each of the directors of Merlin that they are prepared to stand down as directors of Merlin upon the shareholders identifying qualified persons to be appointed as directors in their place and to facilitate such persons being appointed in their place. There is no evidence that any shareholder has taken that step to date. Mr Waterson's affidavit is otherwise silent about any action that has, or has not, been taken by the directors in furtherance of their previous statements that they proposed to appoint additional independent directors to the board of Merlin. Given that silence, I infer that no action has been taken.

87 Mr Waterson also deposed that he is informed by each of the directors of Merlin that, since the Undertakings were given to the Court:

- (a) Merlin has not raised any capital, whether by equity or debt instrument, and would not do so without first making an application to the Court on the basis that the Undertakings operate to prevent such capital raisings;
- (b) Merlin has not advanced or paid any amounts to Axis or other companies connected with the Gutnicks; and
- (c) all of the Undertakings have been complied with.

88 Mr Waterson was not cross-examined and I accept that evidence as far as it goes. As discussed below, I consider that the evidence does not go very far.

89 Mr Waterson also deposed that he has been informed by each of the directors that Merlin remains in "care and maintenance" and wages and salaries are only being paid to four staff employees (none of whom are members of the Gutnick family). Mr Waterson further deposed that he had been informed by each of the directors that the operations of Merlin will remain in care and maintenance whilst this proceeding is ongoing. Again, I accept that evidence.

90 In relation to the failure of Merlin to appoint a company secretary, Mr Waterson deposed that it is unlikely that any person would accept employment with Merlin as its company secretary because of the application by ASIC to appoint a provisional liquidator to, and to wind up, the company. Nevertheless he was instructed that, in the interim, the members of the current board are fulfilling the secretarial function and that one of them would be formally appointed secretary prior to 4 September 2019 as an interim measure. No explanation was provided as to why one of the directors had not been appointed company secretary at an earlier point in time. As noted earlier, during the hearing, Senior Counsel for Merlin informed the Court that Mr

Joseph Gutnick had been appointed company secretary, although no record of that appointment was tendered in evidence.

91 Mr Waterson exhibited a copy of a Business Plan for Merlin for the financial years 2019 to 2021 ostensibly prepared by Empire Capital Partners and dated 1 April 2019. No information concerning Empire Capital Partners was included in the Business Plan. The Business Plan describes a proposed mining schedule for Merlin commencing on 1 July 2019. The Business Plan is based on numerous assumptions as to the availability of infrastructure, mining and processing rates, diamond grades and future diamond prices, amongst others. The Business Plan records that, as at April 2019, Merlin was negotiating a line of credit for the sum of \$39.7 million deliverable in multiple tranches to finance Merlin’s ongoing mining activities. The last page of the Business Plan was headed “Business Valuation” and recorded the following:

The following business net present valuation (NPV) has been performed as a discounted cash flow analysis based on the above proforma cash flows and the assumptions described in Figure 9.

| Discount Rate | |
|---------------|--------------|
| 10.0% - NPV | \$87,901,604 |

92 Mr Waterson deposed that he had been informed by Mr Peter Bird that:

- (a) Mr Bird is an associate director of Empire Capital Partners.
- (b) Mr Bird is the author of the Business Plan.
- (c) Mr Bird is of the opinion that the valuation of Merlin provided in the Business Plan of approximately \$87 million is appropriate and justified by the nature of the tenements and the existing infrastructure.
- (d) Mr Bird’s valuation is based upon discounted cashflow and net present valuation of projected earnings for the forthcoming years and cannot be relied upon in the event of liquidation of Merlin.
- (e) It is Mr Bird’s opinion that the proceeds available for creditors and shareholders, in the event of a receivership/liquidation of Merlin, would be no more than net tangible assets discounted by a “fire sale” discount of up to 40%.

93 The Business Plan is not a document on which I am prepared to place any reliance. The document contains numerous opinions, assumptions and forecasts. The author of the Business

Plan, Mr Peter Bird, did not give evidence. There is no evidence before the Court as to his qualifications for expressing the opinions contained in the Business Plan. Nor is there any evidence as to the basis of the opinions, including the sources of information relied upon in expressing those opinions and the reasonableness of the assumptions made. Nor does the Business Plan include any of the calculations that underpin the valuation that is expressed in the Business Plan. No reason was provided by Merlin as to why Mr Bird could not have given evidence at the hearing.

94 Mr Waterson further deposed that ASIC's application for the appointment of a provisional liquidator to Merlin constituted an ongoing and subsisting event of default under the Secured Note Deed pursuant to which Merlin has issued convertible notes. That is a matter of submission rather than evidence but it is a submission that I accept for the reasons discussed below. Mr Waterson also deposed that he was instructed by Mr Joseph Gutnick that Mr Gutnick had been told by a number of noteholders that if a provisional liquidator were to be appointed and their notes were not redeemed in full on demand, that they would exercise rights under the General Security Deed to appoint a receiver of the assets of Merlin. Mr Waterson deposed that he had contacted and spoken to representatives of three such noteholders, being the three Opposing Shareholders who hold convertible notes, who said that they intend to take that action. Those companies are Mosnow Pty Ltd, Mordel Investments Pty Ltd and Intanto Pty Ltd.

95 I accept that it is possible that if a provisional liquidator were to be appointed, convertible noteholders may demand repayment of their notes and, upon default of payment, appoint a receiver of the assets of Merlin. However, I do not accept that such action is a certainty. I also attach limited weight to the hearsay evidence of the intentions of Mosnow, Mordel Investments and Intanto. Each of Mosnow and Mordel Investments hold convertible notes to the value of \$50,000 and Intanto holds convertible notes to the value of \$60,000. In aggregate, they represent approximately 3% of all issued notes by value. Clause 12 of the General Security Deed stipulates that a noteholder cannot take enforcement action under the Deed (which includes the appointment of a receiver) unless the action is approved by a special resolution of noteholders (which, under the Secured Note Deed, requires approval by noteholders holding two thirds of all issued notes by value). Accordingly, Mosnow, Mordel Investments and Intanto have no power to appoint a receiver to Merlin and any such decision would require approval from noteholders holding two thirds of all issued notes by value.

Affidavit of Christopher Dale

96 At the hearing, the Opposing Shareholders relied on the affidavits of Mr Waterson and an affidavit of Mr Christopher Dale, a solicitor acting on behalf of the Opposing Shareholders. Mr Dale's affidavit exhibited a letter dated 14 June 2019 from ASIC to Waterson Legal and a copy of a reply from Waterson Legal dated 21 June 2019. ASIC's letter stated its belief that the Undertakings prevented Merlin from converting, repaying, terminating or redeeming any notes issued by Merlin other than upon maturity and only then if to do so was in the ordinary and proper course of its business. ASIC sought certain acknowledgements from Merlin in that respect. ASIC also requested information concerning conversions and repayments of the convertible notes as well as details of Merlin's liabilities. In my view, the response from Waterson Legal was obtuse and generally unhelpful, but nothing turns on this aspect of the evidence.

Relevant principles concerning the appointment of a provisional liquidator

97 In the principal proceeding, ASIC seeks an order of the Court for the winding up of Merlin pursuant to ss 461(1)(e) and/or (k), or s 464 of the Act. By way of interim relief, ASIC seeks the appointment of a provisional liquidator.

98 Pursuant to s 472(2) of the Act, the Court may appoint a registered liquidator provisionally at any time after the filing of a winding up application and before the making of a winding up order.

99 Section 472(3) provides that a liquidator appointed provisionally has or may exercise such functions and powers:

- (a) as are conferred on him or her by the Act or by rules of the court that appointed him or her; or
- (b) as the court specifies in the order appointing him or her.

100 Under s 472(4), a liquidator of a company appointed provisionally also has:

- (a) power to carry on the company's business; and
- (b) the powers that a liquidator of the company would have under paragraph 477(1)(d), s 477(2) (except paragraph 477(2)(m)) and s 477(3) if the company were being wound up in insolvency or by the Court.

101 The purpose of the appointment of a provisional liquidator was explained by Dodds-Streton J in *ASIC v Tax Returns Australia Dot Com Pty Ltd* [2010] FCA 715 at [86]:

The appointment of a provisional liquidator is ... uniquely apt and necessary to preserve effectively and expeditiously the status quo, prevent the dissipation of assets prior to the final hearing of the winding up application and to ensure, in the public interest, that an independent official liquidator investigates and identifies the companies' records, transactions, assets and liabilities.

102 The appointment of a provisional liquidator pending the determination of an application for winding up has been described as a “drastic intrusion into the affairs of the company and is not to be contemplated if other measures would be adequate to preserve the status quo”: *Zempilas v J N Taylor Holdings Limited (No 2)* (1990) 55 SASR 103 (*Zempilas*) at 106 per King CJ (with whom Cox and Olsson JJ agreed). That statement has been referred to with approval on many occasions: see for example *Constantinidis v JGL Trading Pty Ltd* (1995) 17 ACSR 625 (*Constantinidis*) at 635 per Kirby P and at 647 per Powell JA. The cautionary statement directs attention to the consequences of the appointment of a provisional liquidator. The appointment constitutes a significant intrusion into the affairs of the company because it has the effect of displacing the directors and the provisional liquidator assumes control of the company: *Anfrank Nominees Pty Ltd v Connell* (1989) 1 ACSR 365; 8 ACLC 319. The consequence of the appointment may be to paralyse the normal operations of the company.

103 Section 472(2) of the Act does not stipulate criteria governing the appointment of a provisional liquidator. As a discretionary power, it must be exercised judicially by reference to considerations relevant to its exercise. As the High Court recently observed in *Northern Territory v Sangare* (2019) 93 ALJR 959; [2019] HCA 25, in relation to the discretionary power to award costs in a proceeding (at [24]):

While the width of the discretion “cannot be narrowed by a legal rule devised by the Court to control its exercise”, the formulation of principles according to which the discretion should be exercised does not “constitute a fetter upon the discretion not intended by the legislature”. Rather, the formulation of principles to guide the exercise of the discretion avoids arbitrariness and serves the need for consistency that is an essential aspect of the exercise of judicial power.

104 A number of principles have been developed by the courts over the years to guide the exercise of the power to appoint a provisional liquidator. As observed by Austin J in *Lubavitch Mazal Pty Ltd v Yeshiva Properties No 1 Pty Ltd* (2003) 47 ACSR 197 at [106]; 22 ACLC 735, those principles are broadly analogous to the considerations relevant to the grant of other interlocutory relief to protect assets. In *Australian Broadcasting Corporation v O'Neill* (2006) 227 CLR 57, the High Court reiterated the organising principles for the grant of interlocutory

relief which take account of the strength of the applicant's case and the practical consequences likely to flow from the specific relief sought: see at [19] per Gleeson CJ and Crennan J and at [65]-[72] per Gummow and Hayne JJ.

105 Stated in broad terms, before appointing a provisional liquidator pursuant to s 472(2), the Court will need to be satisfied of two matters. The first is that a winding up application has been filed and there is a reasonable prospect, or it is reasonably likely, that a winding up order will be made on the application: *Constantinidis* at 635-636 per Kirby P (with whom Meagher JA agreed). In *Zempilas*, King CJ expressed the question as whether there is a sufficient prospect of a winding up order being made to justify consideration of the appointment of a provisional liquidator pending the determination of the petition for winding up (at 104).

106 The second factor is whether there is urgency and sufficient reason for intervention prior to the final hearing including whether the appointment is needed in the public interest, or to protect the company's assets or to preserve the status quo in relation to the affairs of the company: *Constantinidis* at 635-636 per Kirby P (with whom Meagher JA agreed); *Allstate Explorations NL v Batepro Australia Pty Ltd* [2004] NSWSC 261 at [30]. Circumstances that are relevant to the exercise of the discretion to appoint a provisional liquidator include:

- (a) the financial position of the company and the likelihood of insolvency: *Re Club Mediterranean Pty Ltd* (1975) 11 SASR 481 at 484;
- (b) where there is a need for an examination of the state of the accounts of a company in the public interest: *Australian Securities Commission v Solomon* (1996) 19 ACSR 73 (*Solomon*) at [7(e)]; and
- (c) whether the affairs of the company have been conducted casually without due regard to legal obligations such that the Court has no confidence that the affairs of the company are being carried on for the benefit of shareholders: *Solomon* at [7(f)].

107 In relation to the first factor, that there is a reasonable prospect of a winding up order being made, ASIC relies principally on the just and equitable ground in s 461(1)(k) of the Act. It has long been established that a company may be wound up on the just and equitable ground where there is "a justifiable lack of confidence in the conduct and management of the company's affairs" and thus a risk to the public interest that warrants protection: *Loch v John Blackwood Ltd* [1924] AC 783 at 788 per Lord Shaw. More broadly, the Court may wind up a company under the just and equitable ground if there is mismanagement, misconduct or a lack of confidence in the conduct and management of the affairs of the company; if there have been

breaches of the provisions of the Act including breaches of directors' duties, inadequacy of accounts and record keeping; if there is a need to ensure investor protection; and if the company has not carried on its business candidly and in a straightforward manner with the public: *Australian Securities Commission v AS Nominees Limited* (1995) 62 FCR 504 (*AS Nominees*) at 532-533 per Finn J. Public interest considerations may be prominent when ASIC applies for a winding up order. In *ASIC v Finchley Central Funds Management Ltd* [2009] FCA 1110, Gilmour J observed (at [3]):

The plaintiff stands in a somewhat different position to a private applicant for winding up on this ground because the public interest considerations attaching to ASIC as the corporate regulator are relevant to the application. Where companies are engaged in fund management and where there is evidence of serious mismanagement or repeated breaches of the Act so that there is a risk to the public, and in circumstances where ASIC has lost confidence in the company to comply with the relevant law, the court may act to wind up that company on the just and equitable ground.

108 Similarly, in *AS Nominees*, Finn J said (at 531) that where a statutory body is authorised to apply for the winding up of companies:

...there seems to be no reason at all why a court entertaining such an application should not have regard to such actual public interest considerations as have ... or may have induced the governmental body to seek a just and equitable winding up order.

109 In relation to the second factor, the sufficiency of the reason for intervention prior to the final hearing, there can be significant overlap between the matters relevant to the just and equitable ground for winding up a company and the matters which weigh in favour of the exercise of the court's discretion to appoint a provisional liquidator: *ASIC v ActiveSuper Pty Ltd (No 2)* (2013) 93 ACSR 189 (*ActiveSuper*) at [22] per Gordon J.

110 In *ASIC v AGM Markets Pty Ltd* (2018) 129 ACSR 335, Beach J observed (at [89]-[93]) that while a need for the examination of the books and accounts of the company by someone independent of the company is a factor weighing in favour of the appointment of a provisional liquidator, that factor has never been a sufficient condition alone to justify the appointment.

111 In assessing the evidence that has been adduced by ASIC on this application, I have taken into account the fact that Merlin has appeared on the application to resist the appointment of a provisional liquidator and has been given the opportunity to adduce evidence to rebut the case brought by ASIC. Indeed, on 15 May 2019, a few days after the commencement of this proceeding, Waterson Legal wrote to ASIC requesting that the application for the appointment of a provisional liquidator not be listed for a hearing for a period of at least 21 days "so that proper material may be prepared by our clients". On 30 May 2019, ASIC replied and proposed

consent orders timetabling the application to a hearing in a manner that would provide Merlin with sufficient time to file evidence. At a case management hearing on 4 June 2019, Merlin and each of the directors gave the Undertakings (referred to earlier) and timetabling orders were made by consent. Despite the time that was afforded to Merlin, it has chosen not to adduce evidence to rebut the case brought by ASIC, apart from the hearsay evidence of Mr Waterson that the directors deny the allegations made about their conduct. In *Riviana (Aust) Pty Ltd v Laospac Trading Pty Ltd* (1986) 10 ACLR 865 at 866, Young J observed:

... the court takes into account the fact that the company is present, so that the company has an opportunity of putting before the court any relevant factors as to why a provisional liquidator should not be appointed. If the plaintiff's affidavits raise matters to which a court would expect there to be some answer and there is no answer provided then that in itself raises a matter of suspicion that it may well be in the public interest to put in a provisional liquidator.

That passage was cited with approval in *Emmacourt Pty Ltd v Jewels of Australia Pty Ltd* [2007] FCA 1483 at [11], *Earth Loop Pty Ltd v AIAN Investments Pty Ltd* [2008] NSWSC 1042 at [19], *ASIC v Global SDR Technologies Pty Ltd* (2004) 51 ACSR 42 at [50] and *ActiveSuper* at [18].

Submissions of the parties

ASIC's submissions

- 112 ASIC submitted that there is a reasonable prospect that an order winding up Merlin will be made on the just and equitable ground because there is a justifiable lack of confidence in the conduct and management of Merlin's affairs, multiple contraventions of the Act and a risk to the public of further contraventions. ASIC said that Merlin's affairs have been carried on casually and without due regard to legal requirements so as to leave no confidence that its affairs will be properly conducted with due regard for the interests of shareholders.
- 113 ASIC submitted that the evidence shows that Merlin has committed, and is continuing to commit, contraventions of s 208 of the Act relating to the loans made to Axis and the convertible notes issued to Chabad, s 320 of the Act relating to Merlin's failure to lodge its financial report with ASIC for the half year ending 31 December 2018 and s 204A(2) of the Act relating to Merlin's failure to appoint a company secretary since 8 January 2019.
- 114 ASIC submitted that the involvement of the current directors in the above contraventions of the Act justify a lack of confidence in the management of the affairs of Merlin. The current directors have either been involved in the alleged related party transactions or failed to exercise

their duties to prevent those transactions. ASIC submitted that the entire board is in a position of conflict and is not in a position to address on behalf of the company the serious concerns raised by its auditors, the ASX and ASIC.

115 ASIC said that there are serious concerns about Merlin's solvency, noting that the 2018 annual report discloses that:

- (a) as at 30 June 2018, Merlin had a negative working capital position of \$4,829,228;
- (b) the 2018 financial report records significant doubt about Merlin's ability to continue as a going concern; and
- (c) the auditor expressed a qualified opinion, stating that the auditors were unable to obtain sufficient audit evidence in respect of the collectability or otherwise of the Axis loans and referring to the uncertainty about Merlin's ability to continue as a going concern.

116 ASIC submitted that the matters outlined above demonstrate a need for the affairs of Merlin to be independently examined. ASIC said that the appointment of a provisional liquidator to Merlin is necessary to identify, secure and preserve the assets of Merlin pending the final hearing and determination of ASIC's winding up application, and to ensure, in the public interest, that an independent expert and officer of the Court investigates Merlin's affairs, including its records, the Axis loans and other transactions, assets, liabilities and solvency and then reports back to the Court.

Submissions of the Opposing Shareholders

117 The principal opponents of ASIC's application to appoint a provisional liquidator are the Opposing Shareholders who, as noted above, in aggregate hold approximately 11% of the issued share capital in Merlin and a relatively modest investment in convertible notes (an aggregate face value of \$160,000).

118 The Opposing Shareholders did not contest ASIC's submission that there was prima facie evidence of wrongdoing in the conduct of the affairs of Merlin. Indeed, Senior Counsel for the Opposing Shareholders acknowledged that the matters raised by ASIC in this proceeding gave rise to serious concerns which were shared by the Opposing Shareholders. However, Senior Counsel for the Opposing Shareholders submitted that the apparent wrongdoing was by the directors and not by Merlin (which was said to be the victim of the apparent wrongdoing), and the Opposing Shareholders were critical of ASIC for bringing this proceeding to wind up Merlin rather than bringing proceedings against the directors of Merlin. Despite their

expressed concerns for the apparent wrongdoing of the directors and their criticism of ASIC for failing to have brought proceedings against the directors, the Opposing Shareholders offered no explanation as to why they had not themselves taken any steps to remove the directors from office.

119 The principal submission of the Opposing Shareholders was that the appointment of a provisional liquidator to Merlin would be contrary to the interests of shareholders as a whole and would destroy shareholder value and not preserve or enhance it. That submission was supported by two contentions.

120 First, the Opposing Shareholders contended that the Undertakings given by Merlin and the directors to the Court would preserve the status quo until the hearing and determination of ASIC's application to wind up Merlin. They submitted that there was no basis to conclude that the Undertakings would not be complied with and, assuming that to be so, no further harm would be occasioned to Merlin pending the hearing and determination of the winding up application. In those circumstances, the appointment of a provisional liquidator was not warranted to protect the assets and business of Merlin. The Opposing Shareholders also submitted that the delay in hearing this application demonstrated that there was no urgency for the appointment of a provisional liquidator and that the Undertakings were sufficient to preserve the status quo.

121 Second, the Opposing Shareholders contended that the appointment of a provisional liquidator would be a step towards winding up the company, indeed they contended that the appointment would inevitably lead to a winding up, and that the winding up of Merlin would destroy the value of the company. In that respect, the Opposing Shareholders relied on the valuation of Merlin contained in the April 2014 Business Plan. They submitted that full value for Merlin's assets and business would only be realised if it were able to continue as a going concern. The Opposing Shareholders submitted that the appointment of a provisional liquidator would inevitably lead to winding up because the evidence shows that such an appointment would cause at least three noteholders (being part of the Opposing Shareholders) to demand repayment of their notes and, upon the failure of repayment, to exercise their rights under the General Security Deed to cause the appointment of a receiver to the assets of Merlin. As Merlin does not have the cash resources to repay the notes, the demands for repayment would render Merlin insolvent, justifying a winding up.

122 The Opposing Shareholders informed the Court that they had been told by Merlin that each of Mr Joseph Gutnick, Mr Mordechai Gutnick and Dr Tyrwhitt were willing to offer a further undertaking to the Court. The further undertaking was that each of the directors would resign as a director of Merlin if, at the final determination of the proceeding, the Court was otherwise minded to make an order for the winding up of Merlin. The Opposing Shareholders submitted that, having regard to that further undertaking, there was no reasonable prospect that the Court would make a winding up order and therefore a provisional liquidator should not be appointed.

Submissions of Merlin

123 As noted earlier, Merlin is represented by Waterson Legal in this proceeding. In the course of ASIC's investigation of the affairs of Merlin, Waterson Legal represented Merlin, Mr Joseph Gutnick and Mr Mordechai Gutnick. The affidavits filed by Mr Waterson on this application indicate that, in representing Merlin, Mr Waterson is taking his instructions from the current directors of Merlin. Senior Counsel for Merlin, instructed by Waterson Legal, submitted that he was appearing on behalf of Merlin in order to represent the interests of the corporate entity and its shareholders and with "complete disregard to the interests of the directors". There is an obvious tension, if not conflict, in that submission given that the apparent source of Mr Waterson's instructions is the current directors of Merlin.

124 The principal submissions made by Senior Counsel for Merlin can be stated shortly: first, the directors did not want the company to be wound up; second, Merlin sought an expedited hearing of the winding up application; and third, in the period to the determination of the winding up application, the Undertakings given by Merlin and the directors are sufficient to maintain the status quo.

125 As foreshadowed by the submissions of the Opposing Shareholders, Senior Counsel for Merlin confirmed that each of Mr Joseph Gutnick, Mr Mordechai Gutnick and Dr Tyrwhitt offered a further undertaking to the Court that he would resign as a director of Merlin if, at the final determination of the proceeding, the Court was otherwise minded to make an order for the winding up of the company. At the hearing, Mr Silver of counsel appeared to give the further undertaking on behalf of Mr Joseph Gutnick and Mr Mordechai Gutnick. The Court subsequently received a written undertaking from Dr Tyrwhitt in those terms. Like the Opposing Shareholders, Merlin submitted that, having regard to those further undertakings

from the directors, there was no reasonable prospect that the Court would make a winding up order and therefore a provisional liquidator should not be appointed.

126 A number of other submissions advanced by Merlin on the application should be noted. First, Senior Counsel for Merlin supported the submissions made by Senior Counsel for the Opposing Shareholders, which I understood to mean that Merlin itself acknowledged the very serious matters raised by ASIC as to possible contraventions of the Act. However, Senior Counsel sought to differentiate the position of Merlin and its directors, submitting that the matters raised by ASIC concerned wrongdoing by the directors, not wrongdoing by Merlin. That submission cannot be accepted. While it can be accepted that the impugned acts or omissions are acts or omissions of the directors, for the reasons discussed below, all of the contraventions alleged by ASIC concern both Merlin and its directors. On the basis of the erroneous submission that the wrongdoing is not Merlin's, Senior Counsel for Merlin submitted that it was not for Merlin to answer the evidence adduced by ASIC. Again, that submission cannot be accepted because the contraventions do involve Merlin. Further, and more significantly, if Merlin were truly concerned about the potential contraventions identified by ASIC, it would be expected that Merlin would have undertaken its own investigation of those matters and relevant evidence would have been provided to the Court. Instead, Senior Counsel for Merlin acknowledged that, as a corporate entity, Merlin had not pursued any of those matters as against the directors.

127 The second submission of note made by Merlin is that a provisional liquidator is not required to be appointed for the purpose of pursuing recovery of amounts owing by Axis to Merlin because Axis has no assets. The submission constituted an admission that the monies that had been advanced to Axis were not recoverable. There was no elaboration of the submission, including no elaboration of any investigations that had been undertaken by Merlin to come to that conclusion and no elaboration of when Merlin had reached that conclusion. For the reasons discussed below, I do not accept that the evidence establishes that Axis has no assets or that investigations are not warranted to determine whether any monies are recoverable from Axis.

Consideration

128 As noted earlier, before appointing a provisional liquidator pursuant to s 472(2) of the Act, the Court will need to be satisfied of two matters: the first is that a winding up application has been filed and there is a reasonable prospect that a winding up order will be made on the application; the second is that there is sufficient reason for intervention prior to the final hearing. For the following reasons, I am satisfied of both matters.

Reasonable prospect that a winding up order will be made

129 The evidence adduced by ASIC on this application satisfies me that there is a reasonable prospect that a winding up order will be made on the hearing of ASIC's principal application. There are two reasons why such a prospect exists. First, ASIC has shown a strong prima facie case that Merlin is, or has until recently been, contravening various provisions of the Act. Second, the nature of those contraventions is such as to lead to a justifiable lack of confidence in the conduct and management of Merlin's affairs.

130 ASIC has established a strong prima facie case that Merlin is, or has until recently been, contravening various provisions of the Act.

131 First, Merlin had no company secretary from 8 January 2019 in contravention of s 204A(2) of the Act. At the hearing of this application, Senior Counsel for Merlin informed the Court that Mr Joseph Gutnick has now been appointed company secretary, although no evidence was adduced in relation to that appointment. The failure of Merlin to attend to that obligation of the law, despite being on notice of the contravention for a considerable period of time, indicates that Merlin does not appear to take its legal obligations seriously. To some extent, that concern is exacerbated by Merlin announcing to the Court during the hearing of this application that it has remedied the position without providing the Court with any evidence that that has in fact occurred.

132 Second, Merlin has failed to lodge its half yearly report for the period ending 31 December 2018 with ASIC in contravention of s 320 of the Act. At the hearing, Merlin made no submissions about that contravention. It expressed no contrition for the contravention. Nor did it adduce any evidence of steps being taken to remedy the contravention. As noted earlier, on 25 March 2019, the current auditors of Merlin, Grant Thornton, reported Merlin's contravention of s 320 to ASIC and advised ASIC that Grant Thornton had not been presented with any information from Merlin.

133 Third, the transactions associated with the issue of 900,000 convertible notes to Chabad on 30 June 2016 establishes a strong prima facie case that Merlin has contravened both s 208 and other provisions of the Act. It is highly likely that Chabad was a related party of Merlin within the meaning of s 228 of the Act at the relevant time because it was, at that time, an entity controlled by two of the directors of Merlin. As at 30 June 2016, both Mr Joseph Gutnick and Mr Mordechai Gutnick were directors of Chabad. Merlin gave a financial benefit to Chabad by issuing convertible notes to Chabad and, instead of requiring the face value of those notes

to be paid by Chabad, Merlin loaned monies to Chabad through a series of round-robin transactions to enable Chabad to subscribe for those notes. The provision of finance, including through interposed entities, constitutes a financial benefit within the meaning of s 229 of the Act. There is no evidence that the giving of the financial benefit to Chabad was approved by the members of Merlin. The transactions constituting the financial benefit cannot be characterised as having been conducted on reasonable arm's length terms within the meaning of s 210 of the Act. Further, the round-robin transactions associated with the issue of convertible notes to Chabad have the appearance of uncommercial and dishonest transactions which may give rise to other contraventions of both the Act and other laws.

134 Fourth, ASIC has shown a prima facie case that Merlin has contravened s 208 of the Act by advancing loans to Axis in each of the financial years from 2012 to 2018. It is likely that Axis was at all relevant times a related party of Merlin within the meaning of s 228 of the Act because it was (and is) controlled by directors of Merlin. In the period in question, the only directors of Axis have been Mr Joseph Gutnick, Mr Mordechai Gutnick and Dr Tyrwhitt. The making of a loan is a financial benefit within the meaning of s 229 of the Act. There is no evidence that the loans were approved by the members of Merlin. In my view, it is very unlikely that the loans could be characterised as reasonable arm's length transactions. Until the loan agreement was entered into with Axis, the loans were not supported by any documentation. The loans are unsecured. There is no evidence that, prior to entry into the loan agreement with Axis, the loans had a specified repayment date. There was no apparent benefit to Merlin from the making of the loans. Despite the loans being fully impaired in the accounts from the 2014 financial year onwards, Merlin continued to advance further monies to Axis.

135 The contraventions of the Act referred to above create a justifiable lack of confidence in the conduct and management of Merlin's affairs. The most serious contraventions, involving the loans to Axis and the round-robin transactions associated with the issue of convertible notes to Chabad, strongly suggest that the current directors of Merlin have applied company monies for the benefit of entities related to Mr Joseph Gutnick and Mr Mordechai Gutnick. In my view, the transactions are not only likely to be in contravention of s 208 of the Act, but also constitute breaches of directors' duties. Merlin's current directors have permitted Merlin to advance funds totalling in excess of \$13 million on uncommercial terms to a company related to the Gutnicks for no real benefit to Merlin in circumstances where the loans were being fully impaired in the same year in which they were advanced.

136 The contraventions referred to above also indicate the likelihood of harm to investors. Throughout the financial years from 2012 to 2018, Merlin generated losses and its operations were funded by raising debt and equity capital from the public. At least part of the capital raised has been diverted to Axis (more than \$13 million as at 30 June 2018). The evidence shows that Axis has advanced loans to other entities associated with Mr Joseph Gutnick. The most concerning aspect is that more than \$9 million has been loaned to Brocho, a private company controlled by the Gutnick family.

137 The foregoing constitutes evidence of serious mismanagement and repeated breaches of the Act. Unsurprisingly, ASIC has lost confidence in Merlin's compliance with the Act.

138 I do not accept the submission of Merlin and the Opposing Shareholders that the further undertaking offered to the Court by each of Mr Joseph Gutnick, Mr Mordechai Gutnick and Dr Tyrwhitt would prevent the Court from making an order for the winding up of Merlin at the final hearing of this matter. The mere fact that the board may resign does not preclude the Court from making a winding up order on the just and equitable ground. Even if the constitution of the board were altered, it may nevertheless be open to the Court to conclude that the affairs of Merlin have been brought to such a state that a winding up order is required. While that is ultimately a question for the final hearing in this matter, I am satisfied that there is presently a reasonable prospect of such an order being made.

Sufficient reason for intervention

139 The evidence on this application also satisfies me that there is a sufficient reason to appoint a provisional liquidator prior to the final hearing. Indeed, I consider that there are multiple reasons for intervention.

140 First, the nature and extent of the potential contraventions of the Act referred to above are such that I consider that the affairs of the company have been conducted without due regard to legal obligations. I have no confidence that the affairs of Merlin are being carried on for the benefit of its shareholders.

141 Second, I consider that there is a need for an examination of the books and accounts of Merlin by someone independent of the company. The necessity is not only to investigate those contraventions of the Act identified by ASIC. It is also to protect Merlin's assets. There is a need for someone independent of the company to investigate the loans that have been made to Axis and the recoverability of those loans. In my view, that need is urgent. There can be no

confidence that the current board will undertake the required actions given the directors' relationship to Axis.

142 Third, the financial position of Merlin and the likelihood of insolvency is a further reason for the appointment of a provisional liquidator. While the company is in "care and maintenance", it has ongoing costs and expenses. Merlin's quarterly report to the ASX for the quarter ended 30 June 2019 forecast cash outflows for the current quarter of \$580,000. However, Merlin's cash balance at 30 June 2019 was only \$5,000. Further, Merlin has negative working capital which means it has a deficiency of current assets from which to pay current liabilities. In those circumstances, I consider that the appointment of a provisional liquidator is required in the public interest.

143 I am not satisfied that the Undertakings given by Merlin and its directors avoids the need for the appointment of a provisional liquidator. The Undertakings are vague in their terms. The principal undertaking is "other than in the ordinary and proper course of business, to preserve the status quo of the affairs of Merlin". It is wholly unclear what business actions or decisions are permitted by that undertaking. Further, and more importantly, the evidence shows a need for intervention and action to protect the assets of Merlin prior to the final hearing. Preservation of the status quo in the affairs of Merlin, under the control of the current directors, is not appropriate in light of the serious concerns that exist as to their disregard of their legal obligations.

144 Finally, while I accept that the appointment of a provisional liquidator is an event of default under the Secured Note Deed entitling noteholders who hold two thirds of the notes by value to pass a resolution to exercise rights under the General Security Deed to appoint a receiver of the assets of Merlin, I do not consider that that is a reason not to appoint a provisional liquidator. As ASIC submitted, Merlin is already in default of its obligations under the Secured Note Deed. Under clause 9 of that Deed, events of default include insolvency events (which includes the appointment of a provisional liquidator or any step being taken to appoint a provisional liquidator) and the suspension of trading in Merlin shares on the ASX. Accordingly, events of default have already occurred in that steps have been taken to appoint a provisional liquidator and Merlin's shares have been suspended from trading. Noteholders are presently able to act on their security under the General Security Deed. Whether a two thirds majority of noteholders choose to appoint a receiver to the assets of Merlin will no doubt reflect their assessment of the prospects of recovery in that event, in comparison to awaiting the

determination of ASIC's application for a winding up of the company. That decision may also be affected by any shares held by the noteholders and the perceived value of the shares.

145 At this point in time, it is a matter of speculation as to what steps, if any, shareholders or noteholders may take following the appointment of a provisional liquidator. There is always the prospect of discussions and negotiations between the shareholders, noteholders and ASIC as to the future governance of Merlin. It seems reasonably likely that if the present board of Merlin had resigned, or if shareholders had acted to replace the board, at an earlier point in time, ASIC may not have felt compelled to bring this proceeding. In the circumstances, the possibility, and I consider it to be no more than a possibility, that noteholders may act to appoint a receiver to the assets of Merlin is not a reason not to appoint a provisional liquidator.

Conclusion

146 In conclusion, I am satisfied that it is appropriate to appoint a provisional liquidator to Merlin. I will hear the parties on the question of the costs of the application.

I certify that the preceding one hundred and forty-six (146) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice O'Bryan.

Associate:

Dated: 20 September 2019