Excerpt from:

Shadow Ledgers and the Default Process in the Australian Banking Sector

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The Troiani case

Sante Troiani was Managing Director and with his wife, Rita, majority owner of their Bundaberg-based company, Wide Bay Brickworks Pty Ltd (WBB). Troiani had reconstructed a defunct brickworks from the mid 1970s, turning it into a successful and innovative enterprise by the early 1990s.[1] The business was foreclosed in 1999. We have inferred from the documentary evidence that the Troianis have been the victim of an engineered defalcation of their business from the outset of their banking relationship with the National Australia Bank in 1993.

Document discovery for this case was derisory. The NAB sought Summary Judgment against Sante & Rita Troiani as Third Party Guarantors in the Supreme Court of Queensland. The NAB was awarded a decision in its favour on 19 March 2001, formalised on 22 March, without the NAB being compelled to discover its WBB file documents. The WBB records were in the hands of the receivers, unavailable to the Troianis. Even the transcript of the hearings was subsequently destroyed. The NAB had the Troianis declared bankrupt in 2002.

This case is distinctive in that the NAB implemented a de facto default structure in February 1996, unbeknown to Troiani as managing director. Formal demand was not issued until August 1999, 42 months later. During that time the NAB ran parallel mainframe accounts and shadow ledger records for WBB's two main facilities, unprecedented in bank default cases.

Sante Troiani moved his business to the NAB in 1993 after much importuning by the NAB's Bundaberg manager (and an inducement in the form of a small business award from the NAB itself). In November, the NAB approved a welter of facilities for WBB, the two main ones being a 'multi option facility' at $7,450,000, and a 10-year leasing facility at $8,400,000 (grossed up to $13,500,000 with interest). The leasing facility was to finance a 'state of the art' kiln that Troiani was importing from Italy. The multi option

[1] At the time of the move to the NAB in 1993, WBB had a turnover of $12 million, employed 130 people and was recognised as a major industrial concern in Queensland.

facility was a minefield of complexity, and was the key means by which Troiani was defaulted and defrauded.

This complex facility began life as a bill facility, commencing immediately in November 1993 and becoming fully drawn by May 1995 at $7,450,000. The bank subsequently converted the bill into two 30 day bills, for $3,450,000 and $4,000,000. The bank declined to roll over the two bills in early 1996. Instead, the sums were debited in February and March 1996 to a new account labeled 'Wide Bay Brickworks Pty Ltd No 2 Account'. This change meant that previous contractual arrangements had been voided unilaterally by the bank.[2] One infers from this documentation that the bank had determined before February 1996 to foreclose on WBB, a little over two years into a long term lending commitment by the NAB. WBB's accounts subsequently become chaotic. The chaos appears to be due to the fact that the NAB had put WBB into default de facto while maintaining a façade of business as usual. The accounts are structured as if the customer has been defaulted, but the business remains in operation and is paying interest (for a time) and reducing debt.

Much of the character of No 2 account indicates that the customer has been determined as non-accrual. The space intended for direction of dispatch indicates 'DO NOT MAIL REFER MANAGER'. Statements also record a 'Z' indicator in the top right hand corner, which conventionally means that the account ceases to attract interest and fees.

However, contrary to the 'Z' indicator, interest was charged and drawn from the WBB operating account from March 1996 to June 1997.[3] As per non-accrual convention, the interest paid is not recorded on the No 2 account statements. The account's principal function was to log transfers from the company's Cash Management Account for the reduction of the No 2 account's principal (pending the formal issue of default). The bank had required the company to set up the Cash Management Account, with regular deposits from its operating account, as a pool from which bank officers could draw irregular transfer sums at their discretion.[4]

Simultaneously a parallel shadow ledger record was created for the No 2 account (confirming de facto default). Several overlapping statement pages bearing no formal identification, with entries from February 1996 to February 1999, were made available to

[2] The character of the account bears no relation to any standard bank facility. The ambiguous character of this account is reflected in its chameleonic titling – in correspondence, variously labeled 'Overdraft No 2 and/or Bills', 'Bank Bills', and, upon final demand, an 'Overdraft in Reduction Account'. The fundamental divergence between a bill facility and an overdraft in reduction account implies that, if the mislabeling is due to incompetence, it is incompetence on a substantial scale.

[3] There is a curious non-rational round robin process by which the Cash Management Account, itself funded by the operating account, then reimburses the operating account for the interest payments.

[4] C/f Barry T Byrne, Bundaberg manager, NAB, to Troiani and others, 16 October 1996.

Troiani's solicitor in early 2000. The earliest page is merely a blank sheet (Appendix 3). Because the pages were faxed (to a WBB staffer), the pages bear the fax imprint 'FROM NAB BUNDABERG BBC' or 'Bundaberg BBC 4-368'. The last two pages are of a standard NAB format, typically used for issue of emergency statements.

Formally, a shadow ledger record logs virtual interest (interest foregone) on a debt incurred by a business no longer generating revenue. But WBB in operation was paying real interest on the No 2 account debt; 'appropriately' the real interest payments for the first 13 months of interest payments are not recorded on the shadow ledger statement. Thus neither of the parallel records for the No 2 account records these interest payments on the debt. Three months of real interest payments are recorded on the shadow ledger statement for April to June 1997. This phase was possibly due to a mistake by a bank officer not apprised of the inconsistent status of the WBB account.

From July 1997 until foreclosure, 'interest' (amounts ranging over $38,000-42,000 per month) continue to be debited to the shadow ledger record, but no corresponding withdrawals from a mainframe account exist. Thus, interest payments are real for 16 months (with the last three recorded 'inappropriately' on the shadow ledger statement), but from July 1997 until foreclosure, interest is notional, as is appropriate for a business subject to non-accrual status. WBB, however, remained in operation.

On 9 April 1997 the shadow ledger statement is credited with a sum of almost $645,000 (coupled with a later $20,000 deposit) arising from the forced sale of a WBB property. However, the 1.4 hectare property (WBB's engineering shop on Enterprise Street across the road from the brickworks) sold for $760,000 on 4 March. The remaining $95,000 is formally unaccounted for. Moreover, the certified valuation of the property was $1,100,000.[5]

The same statement page shows a debit on 24 April 1997 of $28,704, described as a 'KPMG fee', yet KPMG delivered no services to the company.[6] The same entries are also made on the parallel No 2 statement itself, albeit merely as 'transfer' and 'miscellaneous debit' respectively. The shadow ledger is taken as the defining record for discretionary entries.

Again, contrary to convention, the No 2 account shadow ledger displays a series of credit entries, labelled 'Repayment'. The irregular transfers from the company's Cash

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[5] The property is one of 13 subject to certified valuations by either Maddern Valuation Services or Herron Todd White (Hancock Sawyer Corpe to Ernst & Young, acting for WBB, dated 22 April 1996), with a market valuation of $1,100,000 and 'forced sale valuation' of $1,000,000.

[6] A letter from the NAB, dated 16 October 1996, demanded that KPMG be hired to process the sale of non-core assets, and that WBB will 'continue to pay $10,000 per week to KPMG until such time as the debt owing to [the bank] is paid in full'. Troiani resisted this demand.

Management Account to the No 2 account, to reduce its principal (as noted above), have also been credited to the shadow ledger record.

The NAB issued its Formal Demand Notice dated 4th August 1999 for the sum claimed due on the No 2 account, $6,278,936.40, formally transposed from the shadow ledger record (the final shadow ledger statement was never discovered). However, the balance recorded on the final statement of the No 2 account as at 4 August 1999 is $3,160,673.76, some $3,118,000 less than that shown on the Formal Demand Notice. A discretionary partial bad debt write-off of $2 million was credited to the No 2 account on 29 March 1999, which leaves $1,118,000 unaccounted for.

The mainframe leasing statements were included in an affidavit filed on 2 March 2001 by the NAB Asset Structuring Manager for the Troiani Summary Judgment hearing. The most striking disclosure was that the NAB had credited the WBB leasing account on 22 May 1996 with $3,984,550.90, marked as a 'Rebate'. This credit reduced the balance from $11,759,320.04 to $7,774,769.14. The bank reversed the 'Rebate' three years later on 28 May 1999 ('RVSL Rebate'), with foreclosure imminent (Appendix 4). This reversal increased the balance outstanding from $4,060,425.79 to $8,044,976.69.

When Salmon brought the rebate to Troiani's notice in late 2004, he surmised that the sum possibly represented the proceeds from a federal government development grant associated with the ultra-modern kiln. Troiani had given the paperwork to his auditor for completion and submission and had heard nothing further. In June 2005, Troiani made a formal complaint to the Queensland Police alleging that the NAB had misappropriated the rebate sum (as above). The bank replied to the Police as follows:[7]

> By May 1996 the lease facility was classified as "non-performing". As a result the bank would normally apply an internal entry to the facility representing the future net income we expected to forgo if the realisation of the facility was to occur. … It is important to note that the customer has no entitlement to any such reduction in the facility balance and it represents a purely internal entry in the financial accounts of the bank. … By 28 May 1999, after extensive negotiations, the facility had been receiving regular payments. The entry on 28 May 1999 simply reversed the early entry …

The bank had also brought a parallel shadow ledger record into play for the leasing contract. On 1st April 1999, the NAB faxed (to a WBB staffer) a one page statement with respect to the leasing facility from commencement to 31 March 1999. There is no

[7] Arthur Stalley, Major Fraud Investigation Group, Queensland Police Service, to Troiani, n.d. (August 2005).

identification (save for the NAB fax imprint). This page constitutes the shadow ledger statement for the leasing facility (Appendix 5).

The leasing shadow ledger statement has no entries pertaining to the rebate and rebate reversal. The balances on the mainframe leasing statements and the shadow ledger statement thus diverge by almost $4 million over a three year period. The 'Current Arrears' column is instructive. It indicates that an expanding arrears was rectified by April 1996, and that regular repayments (with one exception) were made from that time. The bank's explanation of the rebate and rebate reversal is curious; moreover, the timing of these two entries is incompatible with the explanation.

The mainframe statement pages also highlight that the bank brought the account to a 'zero' balance by recording a write-off amounting to $4,775,540.30 on 15 August 2000.[8] [9] The write-off, as per banking convention, does not appear on the shadow ledger statement. Which is the 'true' record?

WBB's assets relevant to brick manufacturing comprised at least six properties in Bundaberg; moreover the Troianis were the registered proprietors of at least eighteen other properties (comprising 40 individual lots) throughout Queensland. Troiani was forced to sell these properties on an ongoing basis (albeit most property disposal was engineered by the receiver/manager). The parallel accounting system at its most flexible has facilitated the loss by the Troianis of their considerable assets, both business and personal.

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The NAB foreclosed on the Troiani brickworks at Bundaberg in 1999 (discussed below). The brickworks and related properties were sold in March 2000 for $3.132 million.10 11 It appears that the brickworks itself, on a 13.67 hectare site, comprised a mere $400,000 of that aggregated sale figure. Yet the 1996-97 financial accounts (the last audited accounts) have 'property, plant and equipment' of the brickworks valued at just under $27.5 million.

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[8] The effected write-off is some $60,000 in excess of the (contrived) final debit balance of $4,715,000.
[9] Two entries arising during the period of receiver/manager control after August 1999 conclude the statement – an unexplained credit of over $1,900,000 labeled 'termination' appears in April 2000, and a credit arising from asset sales of almost $1 million appears in July 2000. No detail of receiver/manager activity, in disposing of the Wide Bay Bricks business and assets and the bulk of the Troianis' other properties, was ever advised to the former Managing Director.
[10] Malleson Stephen Jaques, NAB solicitors, to Redchip Lawyers, 4 April 2000.
[11] The Troiani brickworks was purchased by a consortium of individuals intimately associated with the brickworks itself, the ownership devolving to the firm's solicitor and one of the brickwork's regional agents.