

CAN WE CURB THE COMPANY CROOKS?

AUSTRALIA LAGS IN FIGHTING FRAUD



By JOHN SULAN

A decade ago, Hong Kong's Carrian went from success to scandal. For Australia, the lesson is that tougher supervision might be needed if we are to protect our commercial reputation

In recent years the issue of complex commercial crime has become a common topic among lawyers and in the community. There is no doubt that the community in general has become more conscious of the effects of large-scale commercial fraud. In the past when we talked of "white-collar" crime or commercial crime we understood it to mean, in most cases, crimes such as embezzlement. We now understand commercial crime in a much wider context.

The community is increasingly hearing of tax evasion, price fixing, the issuing of false statements by companies, the declaration of false profit, the failure to disclose relevant matters when announcing company performance and various other forms of corporate deception. Nowadays there is far more public discussion and concern about this sort of criminal conduct.

Although in Australia we have for some time been advanced in our thinking about commercial crime, in my view we have tended to rest on our laurels and have now slipped behind somewhat in our approach to the problem.

There is no doubt that the US has always been the most advanced in securities market regulation and the control of fraud and corporate misfeasance and misconduct. The UK for many years was far less advanced than Australia in this field; however, in recent years the UK has confronted the problem and is now

tackling it with vehemence.

The introduction of the Serious Fraud Office and the work of specialists in this area has ensured that the UK is now approaching crime with the necessary seriousness and commitment. In 1986, in a discussion of the Roskill report on fraud trials, the Lord Chancellor, Lord Hailsham, said in the House of Lords: "The more one believes in private enterprise, the more important it becomes to put down fraud. Private enterprise is based on confidence. If men do not trust one another they cannot trade; and as the Roskill report rightly points out in the passages I have quoted, confidence is destroyed if fraud is allowed to succeed unpunished. Indeed, as I have pointed out, the report went on to say that unpunished fraud is a threat to London and therefore to the country as a financial centre. Private enterprise remains about confidence and about credit, and that means mutual trust. If one undermines confidence, one undermines private enterprise; and we cannot have confidence where fraud goes undetected or unpunished.

"Nor must we forget, for those who are less enthusiastic than I about private enterprise, that the revenue, and therefore the taxpayer, is

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frequently made the victim of some of the most ingenious and profitable of fraud. So that in this enterprise of putting down fraud there should be no party politics at all and there is no conflict between the public and private sectors. It is the common interest of us all to pursue this matter to the end."

In a spirited debate in the House of Lords one view became clear: unless parliament and the legal profession and the government were prepared to approach the problem with a fundamental change in attitude and the commitment to solving it, commerce would become a jungle and private enterprise would destroy itself from within.

In my view there is no doubt that commercial crime has a significant effect on communities and on their economies. It involves, in many cases, large-scale corruption and the participation of highly placed citizens in criminal conduct. It has led to bankers becoming involved in the laundering of illegally obtained wealth and to professional people becoming involved in conduct which is criminal or, even if technically not criminal, unacceptable by normal community standards. We hear, as we have now heard in Australia, of politicians and even judges falling to the lure of large amounts of money.

My Hong Kong experience reinforced these views. When I first arrived in Hong Kong I found it difficult to believe the extent of private-sector fraud and corruption and the size of the deals. The office in which I worked looked at nothing under \$HK1 million.

The notorious Carrion case unfolded a story which people in the Australian securities industry may find has some things in common with other stories much closer to home.

The Carrion story evolved around a man of great charisma named George Tan. He came to Hong Kong from Singapore in the early to mid-1970s and became involved in property development. He began work in Hong Kong as a site supervisor for one C.M. Chung, then formed his own company and in the early days was assisted by Chung. By 1979 he seems to have become independent.

Then, as now, the Hong Kong stockmarket included a great number of property-based companies, many of them with extremely tightly held shareholdings, often family-controlled. The Hong Kong market

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is much more tightly held and controlled than many others throughout the world.

In May 1988, a committee headed by Ian Hay Davison reported to the Governor of Hong Kong about the practices and procedures of the market. The committee recommended regulation of the market by the creation of a single independent statutory body, outside the civil service, headed and staffed by full-time regulators and funded by the market. That body should be charged with ensuring the integrity of markets and the protection of investors. It should have extensive reserve powers to intervene if the exchanges fell down on the job of properly regulating their markets. Many of the matters on which that committee commented are relevant to markets in Australia today.

Back in the late-1970s, when the Carrion story began to be noticed, Hong Kong was expanding dramatically. Property was controlled tightly by a government which determined how much would be available for development. At the end of the 1970s property prices were spiralling. At that time a property developer could double his outlay on a building and finance his operation to completion by selling off the plans.

The first project George Tan's company entered into was said to have cost \$HK2.5 million and realised \$HK6.2 million. Carrion Holdings, formed in 1977, soon became known as a medium-sized property developer. In the late 1970s Tan became acquainted with Bumiputra Malaysia Finance Limited.

BMFL, a Hong Kong deposit-taking company, was a wholly-owned subsidiary of Bank Bumiputra Berhad, a Malaysian bank established for the benefit of the indigenous Malays. It did not have a full banking licence in Hong Kong so it set up

BMFL to tap into the financial markets and opportunities of the colony. BMFL was managed by Ibrahim Jaafar. The board consisted of a chairman, Lorrain Osman, a director, Hashim Shamsuddin, and an alternate director, Rais Saniman. The relationship between BMFL and Tan continued from 1979 until the collapse of the Tan empire (which also nearly caused the collapse of BMFL and its parent bank).

In 1979, Tan decided to go public. There was at that time a public property-development company called Mai Hon Enterprises Ltd with an issued capital of \$HK150 million. Of this, 37.5 per cent was publicly owned and the balance was controlled by a company called Stelux Manufacturing Company. Mai Hon's share price was steady at \$1.50. In December 1979 the price rose in eight days from \$1.50 to \$3.80. On December 29 it was announced that a George Tan company had acquired from Stelux 52.8 per cent of the issued capital at \$6 a share. An unconditional offer was made to all shareholders.

The structure was such that Carrion Holdings Limited, which was a wholly-owned subsidiary of Carrion Nominee Limited, a company controlled by George Tan, owned the company which held a controlling interest in the public company. The company made it clear it would retain its listing. In 1980 Mai Hon became Carrion Investments Limited.

The company plunged into the property market. There was the \$HK1 billion Gammon House project and a number of joint ventures with Chung.

Mystery surrounded the group's financial backing. It seemed to have unlimited access to funds. Money came from everywhere. The Hong Kong banks fell over themselves to lend money to George Tan—a great deal of it on the security of CIL shares. It was essential for Tan to keep the share price up.

The years 1980 and 1981 were big years as Carrion expanded. It bought an insurance company, it was in shipping, it was in transport, travel and restaurants. But 1982 saw the slide of market confidence. Uncertainty about Hong Kong's future, deepened by Margaret Thatcher's trip to Beijing, turned the slide into a landslide. In October 1982 Carrion announced liquidity problems.

A rescue operation was mounted, with the merchant banks Wardley and Hambros working to find a formula. Some 70 banks had lent Carrian a total of \$US1.23 billion. It transpired, but not until later, that Bumiputra was in for \$US600-800 million.

One day in July 1983, a body was discovered in a banana plantation. It was that of Jalil Ibrahim, who had been acting for some months as assistant general manager of BMFL. During the murder investigation, a number of matters were uncovered which turned out to be relevant to the Carrian story.

The Carrian Group was found to be an internationally oriented group with a diversified investment portfolio. In 1977 it had been a small property concern. By the end of 1981 it had grown into an organisation of numerous companies employing funds of \$HK5.7 billion.

It financed its rapid growth largely through short and medium-term bank loans. During most of the group's expansion the property market was buoyant. Most of the subsidiaries of the Carrian Group were private companies. The shares of three, however, were quoted: Carrian Investments Limited, China Underwriters Life and General Insurance Company Limited, and Grand Marine Holdings Limited.

On November 7, 1983, the High Court of Hong Kong ordered the liquidation of Carrian Investments Limited and its parent, Carrian Holdings Limited.

During the investigation it was shown that Tan had used many private companies to conceal the manner in which the group operated. Many inter-company and inter-bank transactions were, to say the least, bewildering.

Carrian entered the property market with a flourish, purchasing a number of villa houses for just over \$HK20 million. Two days later it acquired the Metropolitan Bank building for \$HK268 million. Then, in January 1980, it bought Gammon House (renamed Bank of America Tower) for just under \$HK1 billion, \$HK280 million more than Hong Kong Land had paid for it one year earlier.

That transaction, Hong Kong's first billion-dollar deal, put Carrian on the front page throughout the world. Bankers were impressed. Some nine months later Carrian

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announced it had sold the building for \$1.68 billion to a company named Bylampson and Associates. CIL's share price started a meteoric rise. The sale of the building accounted for 92.4 per cent of CIL's 1980 reported profit before taxation. The problem was that soon after the announcement Bylampson found itself unable or unwilling to pay the balance of the purchase price.

A scheme was devised to ensure that the deal was completed. No actual cash changed hands on settlement. Announcements were made that the transaction had been completed. In 1981, it was announced that completion had taken place.

Whether the scheme amounted to crime or not has not yet been resolved, but whatever one thinks of it, it raises major questions about corporate morality and the methods of reporting profits.

During 1981 CIL indulged in a number of spectacular financial deals. One transaction, which accounted for about one-third of the 1981 profit, involved the sale of shares in a company called Union Bank. The transaction was completed within minutes of the close of the financial year.

Carrian had to keep up its profit in order to keep up its share-price in order to avoid margin calls from the banks. The Union Bank transaction represented \$HK313 million profit and found its way into the 1981 accounts by the execution of a sale-and-purchase agreement on or very close to the end of the financial year. There is a real question over the manner in which that profit found its way into the accounts. A number of other items of profit in those years' accounts were questionable. Some

concerned related party profit, and some concerned transactions which were contrived.

The Carrian case has resulted in a major public debate in Hong Kong about methods of investigating and prosecuting commercial crime.

The Australian experience, although uniquely Australian, has not been dissimilar. There has been a disregard by some people of their responsibilities to the public and perhaps a failure by regulators — and in that I include the stock exchange — to properly ensure that the public is fully informed.

The economic effects of commercial crime are hard to gauge. There is no doubt an immediate effect on shareholders and creditors, who lose money. There is an effect on morale and commercial confidence which we are seeing today. There is an effect on the providers of credit, who will re-assess their risks — and that could mean that even sound businesses will find it difficult to obtain credit. There is no doubt it has an effect on our international reputation and our ability to encourage investment.

It is easy to say that fraud has become too complicated and that it is the regulators' fault. But in a world of complex commercial transactions, where one is dealing with confusing company structures and inadequate legislation, no fraud can be simple. The responsibility for controlling commercial crime lies with us all: with governments, which must provide greater resources and more expertise; and with the marketplace, which must show to those who do not comply with basic commercial morality that they are outcasts, not heroes. □