IN THE SUPREME COURT OF VICTORIA AT MELBOURNE
COMMERCIAL AND EQUITY DIVISION
COMMERCIAL COURT

List A
S CI 2010 6249

BETWEEN

PATHWAY INVESTMENTS PTY LTD (ACN 072 420 065)

First Plaintiff

DOYSTOY PTY LTD (ACN 130 593 609)

Second Plaintiff

and

NATIONAL AUSTRALIA BANK LIMITED (ACN 004 044 937)

Defendant

DEFENCE

Date of document: 9 May 2011
Filed on behalf of: The Defendant
Prepared by:
Freehills
Lawyers
Level 38 MLC Centre, 19 Martin Place
Sydney NSW 2000

Solicitor's Code: 420
DX: 361 Sydney
Tel: +61 3 9288 1523 / +61 2 9225 5323
Fax: +61 3 9288 1567 / +61 2 9322 4000
Ref: Geoff Healy / Jason Betts
jason.betts@freehills.com

NOTE: A defined term used in this defence has, unless otherwise indicated, the same meaning as that assigned to it in the statement of claim.

To the plaintiffs' statement of claim dated 15 March 2011, the Defendant (**NAB**) says as follows:

A. PRELIMINARY

A.1 The Plaintiffs and the Group

1. In respect of paragraph 1, and to the extent that allegations are made against it, NAB:
   (a) does not admit sub-paragraphs (a) and (c);
   (b) denies sub-paragraph (b); and
   (c) says further that the group proceeding:
      (i) is an arrangement which constitutes a managed investment scheme within the meaning of section 9 of the CA and is required, inter alia, to be registered pursuant to Chapter 5C of the CA; and
      (ii) as a result, would be liable to be stayed as an unregistered managed investment scheme but for the operation of ASIC Class Order [CO 10/333], which expires on 30 June 2011.

2. It admits paragraph 2.

3. It does not admit paragraph 3.

4. It notes paragraph 4 but does not plead to it as no allegation against it is contained within the paragraph.

A.2 The Defendant

5. In respect of paragraph 5, it:
   (a) admits sub-paragraphs 5(a) to (d) inclusive;
   (b) admits that it had a number of controlled entities within the meaning of section 259E of the CA which, with NAB, constituted the NAB Group; and
   (c) otherwise does not admit sub-paragraph 5(e).

6. It admits paragraph 6.

7. It admits paragraph 7.

A.3 Relevant NAB personnel

8. In respect of paragraph 8, it:
   (a) admits that the persons identified in sub-paragraphs 8(a), (b) and (d) held the positions respectively identified in those sub-paragraphs in the period 1 January 2007 to 31 December 2008; and
   (b) says that Mark Joiner:
      (i) was NAB Executive General Manager from 1 September 2006 to 10 April 2007;
      (ii) was NAB Group Executive General Manager Development and New Business from 10 April 2007 to 6 December 2007;
      (iii) was NAB Group Chief Financial Officer from 6 December 2007 to 12 March 2009;
      (iv) has been Executive Director Finance since 12 March 2009.

A.4 Conduits and Collateralised Debt Obligations

9. In respect of paragraph 9, it:

(a) says that NAB provided liquidity facilities (**Conduit Liquidity Facilities**) to entities in the ABCP Conduits, including Centrestar 1, Centrestar 2 and TSL;

(b) says that the Conduit Liquidity Facilities were provided to Centrestar 1, Centrestar 2 and TSL pursuant to the following written agreements:

   (i) a securities liquidity facility agreement dated 12 July 2006 between Centrestar 1 and NAB, among others (as amended from time to time) (**Centrestar 1 Liquidity Facility**);

   (ii) a securities liquidity facility agreement dated 1 September 2006 between Centrestar 2 and NAB, among others (as amended from time to time) (**Centrestar 2 Liquidity Facility**);

   (iii) a liquidity asset purchase agreement regarding Davis Square dated 5 December 2006 between TSL and NAB (as amended from time to time);

   (iv) a liquidity asset purchase agreement regarding Duke Funding dated 6 July 2006 between TSL and NAB (as amended from time to time);

   (v) a liquidity asset purchase agreement regarding Fort Denison dated 14 February 2007 between TSL and NAB (as amended from time to time);

   (vi) a liquidity asset purchase agreement regarding Grand Avenue dated 26 October 2006 between TSL and NAB (as amended from time to time);

   (vii) a liquidity asset purchase agreement regarding GSC dated 25 January 2007 between TSL and NAB (as amended from time to time);

   (viii) a liquidity asset purchase agreement regarding Hudson Mezzanine dated 5 December 2006 between TSL and NAB (as amended from time to time); and

   (ix) a liquidity asset purchase agreement regarding Pacific Pinnacle dated 21 December 2006 between TSL and NAB (as amended from time to time),

   (the liquidity asset purchase agreements in sub-paragraphs (b)(iii) to (b)(ix) will be collectively referred to as the **TSL Liquidity Facilities**);

(c) says that the terms of the Centrestar 1 Liquidity Facility and Centrestar 2 Liquidity Facility are substantially the same;

(d) says that the terms of each of the TSL Liquidity Facilities are substantially the same;

(e) says that the primary purpose of the Conduit Liquidity Facilities was to provide standby, short term finance to the ABCP Conduits, including those referred to as Centrestar (**Centrestar Conduit**) and TSL, to enable them to redeem asset backed commercial paper issued by them at times of illiquidity in the asset backed commercial paper market; and

(f) otherwise does not admit paragraph 9.

10. In respect of paragraph 10, it:

(a) refers to and repeats paragraph 9 above;

(b) denies sub-paragraphs (a) and (b), and says that Centrestar 1 and Centrestar 2 are securities-owning, special purpose vehicles within the Centrestar Conduit; and

(c) admits sub-paragraph (c),

and says that hereafter a reference to **NAB Conduits** is a reference to both the Centrestar Conduit and TSL.

11. In respect of paragraph 11, it:

(a) refers to and repeats paragraphs 9 and 10 above; and

(b) otherwise admits the paragraph.

12. In respect of paragraph 12, it:

(a) says that TSL owned 66.67% of the Class A-b notes of Hudson Mezzanine Funding 2006-1 (**Hudson Mezzanine**); and

(b) otherwise admits the paragraph.

13. In respect of paragraph 13, it:

(a) says that the par value of Pacific Pinnacle was US$74,600,000; and

(b) otherwise admits the paragraph.

14. It does not admit paragraph 14.

15. In respect of paragraph 15, it:

(a) says that:

(i) the obligations of TSL to, among others, the holders of asset backed commercial paper issued by it were secured by a US-law governed security interest over TSL's assets including each of the Davis Square, Duke Funding, Fort Denison, Grand Avenue, GSC, Hudson Mezzanine and Pacific Pinnacle Conduit Notes; and

(ii) further, the security interest referred to in sub-paragraph (i) above was held by a third-party trustee for the benefit of, among others, the holders of asset backed commercial paper issued by TSL; and

(b) otherwise does not admit the paragraph.

16. In respect of paragraph 16, it:

(a) refers to and repeats paragraph 9 above; and

(b) otherwise admits the paragraph.

17. In respect of paragraph 17, it:

(a) admits that NAB was required to provide loans to Centrestar 1, Centrestar 2 and TSL in accordance with the terms of the applicable Conduit Liquidity Facility governing NAB's relationship with each NAB Conduit;

(b) says that:

(i) the primary purpose of the Conduit Liquidity Facilities was to provide standby, short term finance to the NAB Conduits to enable them to redeem asset backed commercial paper issued by them at times of illiquidity in the asset backed commercial paper market;

(ii) in the context of that primary purpose, the effect of the terms of the Conduit Liquidity Facilities was that the Conduit Loans were to be repaid once and to the extent that the NAB Conduits were again able to issue asset backed commercial paper following the relevant period of illiquidity;

Particulars

NAB refers to:

(1) clause 12(k) of the TSL Liquidity Facility regarding Fort Denison (and the equivalent clauses under the other TSL Liquidity Facilities); and

(2) clause 12 of each of the Centrestar 1 Liquidity Facility and Centrestar 2 Liquidity Facility, by which the repayment of advances under the facilities is subject to the terms of a "Securities Administration Agreement" dated on or around the date of the relevant facility agreement, and to clause 11.4 of each such Securities Administration Agreement.

(iii) further, the cashflows received pursuant to the terms of the Conduit Notes were to be applied against the Conduit Loans in accordance with the terms of the applicable Conduit Liquidity Facility;

Particulars

NAB refers to:

(1) clauses 4(a), 4(d) and 12(k) of the TSL Liquidity Facility regarding Fort Denison (and the equivalent clauses under the other TSL Liquidity Facilities); and

(2) clauses 11.4 and 11.5 of each of the Securities Administration Agreements dealing with the administration of Centrestar 1 and Centrestar 2.

(c) will refer to and rely on the terms of the applicable Conduit Liquidity Facility for their full force and effect; and

(d) otherwise does not admit the paragraph.

18. In respect of paragraph 18, it:

(a) refers to and repeats paragraph 15 above;

(b) says that NAB's obligation to provide loans to Centrestar 1, Centrestar 2 and TSL in accordance with the terms of the applicable Conduit Liquidity Facility ceased if the Conduit Notes to which the applicable Conduit Liquidity Facility related were downgraded below a rating prescribed in the facility;

Particulars

NAB refers to clause 2(a)(iv) of the TSL Liquidity Facility regarding Fort Denison (and the equivalent clauses under the other TSL Liquidity Facilities).

NAB also refers to clause 12 of the Centrestar 1 Liquidity Facility and Centrestar 2 Liquidity Facility, and clause 8.14(b) of the Securities Administration Agreement.

(c) says that it will refer to and rely on the terms of the Conduit Liquidity Facilities for their full force and effect; and

(d) otherwise does not admit the paragraph.

19. In respect of paragraph 19, it:

(a) refers to and repeats paragraphs 15, 17 and 18 above; and

(b) otherwise denies the paragraph.

20. In respect of paragraph 20, it:

(a) refers to and repeats paragraphs 94(b) and 99(d) below;

(b) says that the repayment of loans made by NAB pursuant to the Conduit Liquidity Facilities was governed by the terms of those facilities;

(c) will refer to and rely on the terms of the Conduit Liquidity Facilities for their full force and effect; and

(d) otherwise denies the paragraph.

21. It admits paragraph 21.

22. In respect of paragraph 22, it:

(a) says that during the Relevant Period the amount of the Conduit Loans was recorded as an asset on its balance sheet at the relevant reporting period; and

(b) otherwise denies the paragraph.

23. In respect of paragraph 23, it:

(a) refers to and repeats paragraph 17(b) above;

(b) says that at all times in the Relevant Period, NAB was only relevantly exposed to loss on the Conduit Loans and the Conduit Liquidity Facilities if and to the extent that the Conduit Liquidity Facilities remained drawn at the time any loss arising from impairment of underlying assets affected tranches held by the relevant NAB Conduits in the Conduit Notes;

(c) will refer to and rely on the terms of the Conduit Liquidity Facilities for their full force and effect; and

(d) otherwise does not admit the paragraph.

A.5 Reporting Requirements

24. In respect of paragraph 24, it:

(a) admits that it was required to comply with sections 296, 297 and 674 of the CA;

(b) admits that, pursuant to section 296 of the CA, NAB's financial reports were required to comply with accounting standards issued by the Australian Accounting Standards Board, including the Provisions Standard and Financial Instruments Standard;

(c) relies upon the terms of sections 296, 297 and 674 of the CA for their full force and effect; and

(d) otherwise does not admit the paragraph.

25. In respect of paragraph 25, it:

(a) admits that the Conduit Liquidity Facilities were, once drawn, financial instruments within the meaning of the Financial Instrument Standard;

(b) says that the Provisions Standard only applied to the Conduit Liquidity Facilities as "loan commitments" if and to the extent that those facilities had not been drawn;

(c) admits that the Conduit Loans made pursuant to the Conduit Liquidity Facilities were financial assets within the meaning of, and subject to, the Financial Instruments Standard;

(d) refers to and repeats paragraphs 97 and 98 below; and

(e) otherwise does not admit the paragraph.

26. In respect of paragraph 26, it:

(a) admits that NAB was required:

(i) in preparing and publishing its financial statements, to comply with Pt 2M.3 of the CA, including in particular sections 296, 297, 304 and 305; and

(ii) in relation to the disclosure of information not generally available which a reasonable person would expect, if it were generally available, to have a material effect on the price or value of NAB shares, to comply with Chapter 6CA of the CA;

(b) says that it will refer to and rely on the terms of those statutory provisions for their full force and effect; and

(c) otherwise does not admit the paragraph.

27. In respect of paragraph 27, it:

(a) refers to and repeats paragraphs 24 to 26 above and paragraph 106 below; and

(b) otherwise does not admit the paragraph.

B. NAB'S ALLEGED STATEMENTS IN THE RELEVANT PERIOD

B.1 Statements allegedly made to the Market

28. In respect of paragraph 28, it:

(a) admits that Mr John Stewart made the statements quoted in paragraphs 28(a), (b) and (c) on 28 August 2007; and

(b) says further that it will refer to and rely on the complete remarks made by Mr Stewart on 28 August 2007.

29. In respect of paragraph 29, it:

(a) admits that on 9 November 2007, NAB released its preliminary full year results report to the ASX;

(b) says that it released its 2007 annual financial report to the ASX on 7 December 2007 (**2007 Annual Report**); and

(c) otherwise does not admit the paragraph.

30. In respect of paragraph 30, it:

(a) refers to and repeats paragraph 29 above; and

(b) otherwise admits the paragraph.

31. In respect of paragraph 31, it:

(a) admits the paragraph; and

(b) says that it will refer to and rely on the terms of the *ASX Corporate Governance Council: Corporate Guidance Principles and Recommendations* for their full force and effect.

32. In respect of paragraph 32, it:

(a) admits that Mr Michael Chaney made the statements quoted in paragraphs 32(a) – (d) and says further that Mr Michael Chaney made the following statement at its Annual General Meeting held on 7 February 2008:

> "The second half [of the 2007 financial year] was particularly challenging as the emerging sub prime issue in the United States sparked ongoing global concerns.
>
> ...
>
> The strength of our balance sheet has allowed a business as usual approach during the recent financial market disruption.
>
> The focus of the bank and management remains on achieving superior long term returns to our shareholders and we believe we are well positioned to do that.

The events of the last few months in international financial markets have demonstrated the strength of the Australian banking system.

This is comforting, given the linkages that exist across global finance and the fact that problems in one area – in this case the US sub prime mortgage market – can have negative flow-on effects elsewhere.

The market turmoil has also provided a very good illustration of how unpredictable the future can be – and therefore how important it is for organisations like ours to maintain a strong balance sheet and diverse sources of funding.

It is widely expected that the US sub prime fallout still has some way to go and will continue to have an indirect impact on our economy and customers.

We saw that recently when Australian banks were forced to increase their variable interest rates on home loans.

In Australia we are faced with two factors exerting pressure on interest rates: The Reserve Bank's need to raise the official rate, as it did this week, in order to counter demonstrate inflationary pressures; and the higher rates being demanded by lenders in domestic and international money markets. The latter pressures have, if anything, increased over recent weeks.

These issues require strong focus and attention within all financial institutions. We need to remain alert to the negative flow-on effects that may continue to ripple through financial markets around the world. But it is important that, at the same time, we continue to evaluate opportunities that can help deliver long term growth";

(b) admits that Mr John Stewart made the statements quoted in paragraphs 32(e) – (f) at its Annual General Meeting held on 7 February 2008; and

(c) says that it will otherwise refer to and rely on the complete remarks made by Messrs Chaney and Stewart on that occasion.

33. In respect of paragraph 33, it:

(a) admits that the statements referred to appeared in an article in *The Australian* newspaper on 25 February 2008 as being attributable to Mr John Stewart; and

(b) otherwise does not admit the paragraph.

34. It admits paragraph 34.

35. In respect of paragraph 35, it:

(a) denies that it made the statement pleaded in sub-paragraph (a) and says that the 2008 Half Year Results contained the following statement:

> **"Operating Environment**
>
> Last year's volatility in international financial markets carried into the first half of 2008, as the uncertainty associated with the US sub-prime incident adversely affected global markets.
>
> nabCapital benefited from this deterioration in global markets, particularly in the Markets business where the investment in people, systems and products allowed the business to take advantage of this volatility, resulting in increased cross-sell activity and improved trading results. nabCapital's origination activity also increased as it continued to support clients' demands over this period and widening credit spreads contributed to revenue growth in the Portfolio Management business.
>
> Offsetting these positive aspects, nabCapital incurred higher bad and doubtful debt charges. In addition, distribution activities to manage nabCapital's capital position, including syndications and credit hedging, together with the ability to distribute commercial paper in nabCapital sponsored conduits, have been less effective in the current environment. These impacts to nabCapital's distribution activities contributed to the increase in risk weighted assets to $78.7 billion at

March 2008, from $62.2 billion at March 2007 and $73.5 billion at September 2007. This led to a reduction in the Return on Risk Weighted Assets (RoRWA) to 0.98%, from 1.12% at March 2007 and 1.11% at September 2007."

Particulars

The statement quoted above was made in the 2008 Half Year Results at page 65.

(b) admits that it made a statement in the 2008 Half Year Results to the effect pleaded in sub-paragraph (b), as follows:

"**nabCapital**

Financial Analysis

March 2008 v March 2007

Cash earnings increased by 10.4% on the March 2007 half to $373 million mainly due to improved earnings in Markets from risk management activities following recent market volatility. This was partially offset by a higher bad and doubtful debts charge largely in connection with the Securitisation business."

Particulars

The statement quoted above was made in the 2008 Half Year Results at page 67.

(c) admits that it made a statement in the 2008 Half Year Results to the effect pleaded in sub-paragraph (c), as follows:

"**Other items**

Asset Quality

Overall nabCapital's asset quality remains strong, with approximately 91% of exposures rated as investment grade (equivalent to AAA to BBB-) which is broadly consistent with the prior two half years. Recent market events have however affected certain liquidity facilities extended to conduits in the Securitisation business and caused two other client exposures to be rated as impaired.

The conduits were established as an efficient funding and capital management tool for our clients. This is integral to an effective OWD strategy. Apart from assisting clients with funding arrangements, other assets (including Collateralised Debt Obligations (CDOs), bonds, corporate loans and Collateralised Loan Obligations (CLOs), were acquired early in the life of the conduits to enhance returns for investors and assist with the distribution of commercial paper. These assets total $5.4 billion at March 2008. The remaining assets in nabCapital sponsored conduits represent nabCapital originated assets and total $8.5 billion at March 2008. Out of the total assets in nabCapital sponsored conduits at March 2008 of $13.9 billion, $8.7 billion of liquidity facilities drawn down by the conduits was funded on balance sheet at 31 March 2008.

nabCapital has approximately US$1.1 billion ($1.2 billion) of CDOs in nabCapital sponsored conduits whose assets have been downgraded by rating agencies. These conduits contain exposures to US sub-prime assets of $360 million. While all assets are performing at 31 March 2008, we have established a collective provision of $181 million against the liquidity facilities extended to this asset class. The remaining exposure to conduits ($12.7 billion) is recently rated and assets are of investment grade.

The level of gross impaired assets has increased by $101 million from the September 2007 position to $312 million at March 2008 mainly due to two facilities rated as impaired during the period. This also contributed to the increases in the specific provision to gross impaired asset ratio and the ratio of gross impaired assets to gross loans and acceptances.

The increase in the ratio of the bad and doubtful debts charge to credit risk weighted assets is largely attributed to the collective provision charge taken on the Securitisation business.

Overall, nabCapital's lending portfolio remains resilient and retains its high investment grade";

Particulars

The statement quoted above was made in the 2008 Half Year Results at page 68.

(d) says that it made a statement in the 2008 Half Year Results as follows:

"Outlook / Operating Environment

After a run of exceptional years, global economic growth is slowing to below-trend. Some of this softening reflects the end of a period of consumer-led expansion in big industrial economies. This expansion was fuelled by very low interest rates, rapid credit growth, low household savings, and asset price inflation. A high degree of risk tolerance underpinned this trend. The pendulum in market sentiment toward risk shifted in the opposite direction as markets entered an adjustment phase that began in mid-2007. This has been reflected in the marked widening in credit spreads, lack of liquidity and reductions in risk appetite for many asset classes. The economic effects of this disorderly path of adjustment have resulted in a long-expected slowing of economic and credit market activity back to more "normal" levels.

The economic implications of this structural slowdown and credit market instability are becoming increasingly apparent. Global growth should slow to 3.5% this year, well short of the 5% rate seen at the peak of the economic cycle during the first half of 2006. Conditions in key world economies are weakening, with the US near recession and slowdowns evident across Western Europe and Japan through 2008"; and

Particulars

The statement quoted above was made in the 2008 Half Year Results at page 9.

(e) will otherwise refer to and rely on the 2008 Half Year Results for their full force and effect.

36. In respect of paragraph 36, it:

(a) admits sub-paragraph (a);

(b) denies sub-paragraph (b) and says that the 2008 Half Year Results contained the following statement:

"Australian Securities Exchange Corporate Governance Council Principles and Recommendations (Second edition August 2007)
Consistent with recommendation 7.3 of the ASX Corporate Governance Principles and Recommendations (second edition August 2007), the Board has received assurance from the Group Chief Executive Officer and the Group Chief Financial Officer, that the Company's half-year financial report for the period ended 31 March 2008 is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to the financial reporting risks."

Particulars

The statement quoted above was made in the 2008 Half Year Results at page 72.

(c) admits sub-paragraph (c) and says further that the 2008 Half Year Results contained the following additional statements:

"This interim financial report does not contain all disclosures of the type normally found within a full annual financial report and therefore cannot be expected to provide as full an understanding of the financial position and financial performance of the Group as that given by the annual financial report. As a result, this report should be read in conjunction with the annual financial report for the year ended 30 September 2007."

and

"The preparation of financial statements in conformity with AIFRS [Australian equivalents to International Financial Reporting Standards] requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that such estimates are reliably measured, actual amounts may differ from those estimated. It is not anticipated that such differences would be material."

Particulars

The statements quoted above were made in the 2008 Half Year Results at page 79.

(d) otherwise refers to and repeats paragraph 35 above.

37. In respect of paragraph 37, it:

(a) admits that a statement to the effect of sub-paragraph (a) was made by Mr John Stewart at a presentation to analysts on 9 May 2008 (the **9 May Presentation**), as follows:

> "Last November I said to you that all of our businesses were in great shape. Now that is still the case";

Particulars

The statement quoted above is recorded on an audio recording of the 9 May Presentation which was posted on the NAB website. The recording differs in some respects from the transcript of the 9 May Presentation prepared by Thomson Financial, which was not verified by NAB.

(b) denies sub-paragraph (b) and says that Mr Mark Joiner in fact stated at the 9 May Presentation:

> "[O]n asset quality I want you to be assured that we have done many deep dives into our asset portfolio. We've looked at commercial property, we looked at credit cards, we've looked at conduits, we've looked at margin loans and we are finding nothing systemic in our portfolio at all. And but that doesn't mean that we are about to declare victory on this. We are going to stay extremely vigilant on asset quality and adjust our business settings as we go along in response to what we learn and what we find";

Particulars

NAB refers to and repeats the particulars sub-joined to sub-paragraph (a) above.

(c) admits that, at the 9 May Presentation, Mr Mark Joiner made a statement to the effect alleged in sub-paragraph (c), as follows:

> "As to bad and doubtful debts, in large part in a business as usual sense we're not seeing anything. As we get into talk about asset quality you'll see that we are seeing tiny, tiny changes in the quality of the assets in the underlying portfolios and the result we have is a very situational result. That's not to say that asset quality will be

sustained forever in the underlying portfolios but it's not showing through in any respect at the moment so we've operated over the last couple of halves at about 400 million. If you regarded as BAU this path, we'd be at 465, although this 400 does include some of the big name companies that have got into particular difficulties that you've been reading about, there are some provisions in here for there."

Particulars

NAB refers to and repeats the particulars sub-joined to sub-paragraph (a) above.

(d) denies sub-paragraph (d) and says that Mr Mark Joiner in fact stated at the 9 May Presentation:

"On the asset side, if you look into the NAB conduits, what you have is really two, two sets of assets. You have 9 billion dollars of NAB originated investment grade assets that are indistinguishable from other things in our balance sheet. You have 5 billion dollars of purchased assets that were put there to seed the conduits in the way that I was describing. These purchased assets after recent credit rating reviews are 80% to AAA/AA and are of no issue as far as we are concerned. 20% or, or 10 particular purchased assets were downgraded."

Particulars

NAB refers to and repeats the particulars sub-joined to sub-paragraph (a) above.

(e) denies sub-paragraph (e) and says that Mr Mark Joiner in fact stated at the 9 May Presentation:

"If you remember Standard & Poor's said in December that they were entirely comfortable with their methodology and didn't plan any changes and then at the end of January they announced 5,000 downgrades and 10 of our instruments were included in those downgrades. The downgrades, therefore, statistically drive some provisioning against the quality of the standby lines as an asset in our balance sheet.

Now, the models suggested that we should take a 56 million dollar provision based just statistically on the credit ratings of the underlying securities. Our response was to do a forensic deep dive into this portfolio and make sure we understood it at the individual credit level down below, which we have done. And that review showed to us that all the contractual obligations of the underlying credits are being met. Secondly, these are in a hold to maturity environment, not a mark-to-market environment and many have a decade or more to run. And so, they look to us to be in a good credits for a very long period of time and also within these portfolios there are various protection mechanisms that exist, so there are people who've taken first losses. There are insurance wrappers. There is, for example, 250 million of cash collateralisation and so forth.

So we've weighed all of that and stress test the assumptions and put some fairly bleak assumptions into the models and therefore decided to take the 181 as opposed to the 56 million that was indicated at the first pass. So that is how we have decided to do that and the idea is to take a strong provisioning position that protects our balance sheet against whatever may come out of these in a credit sense in the future."

Particulars

NAB refers to and repeats the particulars sub-joined to sub-paragraph (a) above.

(f) refers to and repeats, in response to sub-paragraph (f), sub-paragraph (e) above;

(g) refers to and repeats, in response to sub-paragraph (g), sub-paragraph (e) above;

(h) refers to and repeats, in response to sub-paragraph (h), sub-paragraph (e) above;

(i) admits that NAB made a statement at the 9 May Presentation to the effect alleged in sub-paragraph (i), as follows:

Stewart: "Look, it could go both ways because markets could get much worse and if markets got worse than what we're – yeah, I don't think they're going to, but if they did then you could have more downgrades in the underlying bonds and then the CDOs and if we have more downgrades we will go through it again and we will come to a certain number. Now, remember the number we came to was about mid-fifties. Wasn't it about 55? So we stress tested this when we put 181 in, so we feel we'll get a safety margin. On the other hand things could get much better. Now, remember every one of these bonds, every single one, has not defaulted. There's not one payment being missed for any of them. We've got quite a lot of protection on most of them. So you could end up that that is written back at some time, but it won't be anytime soon, right? Because these are hold to maturity, so we're not going to be jumping up and down and changing our provisioning. Do you want to add to that?

Joiner: "I think you summarized it perfectly. I mean if indeed we've passed the bottom and things trend upwards then we may, you know, progressively get more comfortable, but as John says if it's a false bottom and the market – and the world goes to hell in a hand basket then it's not only that part of our portfolio we'd worry about it's all parts of our portfolio, so it's very situational. It's hard to, you know, give any meaningful guidance on the thing, but we've decided to put a solid position in place to start, you know, in the hope that that will handle any volatility within reasonable bounds."

Particulars

NAB refers to and repeats the particulars sub-joined to sub-paragraph (a) above.

(j) will otherwise refer to and rely on the full recording of the 9 May Presentation for its full force and effect.

38. It admits paragraph 38.

39. In respect of paragraph 39, it:

(a) admits that in the 11 July Announcement it made statements to the effect of sub-paragraphs (a) – (e), as follows:

"As disclosed at 31 March 2008, the Group has an exposure of US$1.1 billion to collateral debt obligations (CDOs) via the provision of liquidity lines to conduit financing vehicles.

Given the uncertain economic environment and rating downgrades, a collective provision of $181 million was established at 31 March

2008 in respect of this exposure. Since that time the economic environment has deteriorated further.

These exposures are being actively managed to minimise the potential for loss. However, notwithstanding that these CDOs are currently meeting all principal and interest obligations, there continues to be a risk that further provisioning may be required.

This disclosure is being made as a requirement of National Australia Bank's underwriting agreement for the Dividend Reinvestment Plan.";

(b) will refer to and rely on the complete terms of the 11 July Announcement for their full force and effect.

40. It admits paragraph 40.

41. In respect of paragraph 41, it:

(a) admits that, in the 25 July Announcement, NAB made statements to the effect of sub-paragraphs (a) – (e), as follows:

"NAB makes provision in response to unprecedented global credit conditions

National Australia Bank today announced an additional provision of A$830 million to its portfolio of 10 Collateralised Debt Obligations of Asset Backed Securities (ABS CDOs).

These ABS CDOs contain US residential mortgages and are held in international conduit facilities used to finance customers.

The amount announced today is in addition to the $181 million charge taken in the Group's half year results to 31 March 2008.

The portfolio is now provisioned to a level of nearly 90%.

NAB Group CEO, John Stewart said: 'This provision reflects the unprecedented conditions in global credit markets and, in particular, the rapid deterioration in the United States housing market.

'Earlier this year CDOs were subject to rating agencies' downgrades that also affected thousands of similar investments, at which time appropriate provision was made.

'The continued deterioration in the US housing market has been further highlighted in recent weeks with foreclosures mounting and recovery rates from security in some categories falling to less than half of the loan value,' Mr Stewart said.

'Although current losses on the assets underlying the CDOs in our portfolio relating to the provision average approximately 2% of the total portfolio, our detailed analysis and recent default activity indicates the portfolio will continue to deteriorate.

'We believe it is prudent to take a full provision now, based on a worst case scenario,' he said.

'We have a specialist team based in New York that will continue to investigate all avenues for mitigating losses, including the effects of the recently passed American Housing Rescue and Foreclosure Prevention Act of 2008. No benefit for these is factored into the provisioning decision at this time.

'The remaining conduit assets are all performing in line with our expectations for corporate lending and will continue to be closely reviewed given the current economic cycle.

'As previously described, the purchase of CDOs was part of the initial development of nabCapital's securitisation business providing access to international debt markets for our customers. NAB's purchase of this type of ABS CDO ceased in March 2007.

'The CDOs were all rated AAA when liquidity facilities were put in place as part of the establishment of our securitisation business.

'These were sound commercial and credit decisions given the market and ratings data available at the time. The likelihood of default was independently assessed as being extremely small.

'All relevant processes are considered robust and were properly followed at the time.'

Mr Stewart said the final dividend will be unaffected by the creation of this provision. NAB remains comfortably within its target capital ranges.";

(b) will refer to and rely on the complete terms of the 25 July Announcement for their full force and effect.

42. In respect of paragraph 42, it:

(a) says that on 25 July 2008, NAB conducted a conference call for investors and analysts and provided electronic slides used in that conference call to the ASX;

(b) says that a recording of the remarks of Messrs Stewart, Joiner and Hooper on that occasion was made available on the NAB website (www.nabgroup.com);

(c) will refer to and rely on the complete remarks of Messrs Stewart, Joiner and Hooper for their full force and effect; and

(d) otherwise admits the paragraph.

43. It admits paragraph 43.

B.2 The alleged Representations

44. In respect of paragraph 44, it:

(a) admits the paragraph; and

(b) says further that the representations there alleged were true.

45. In respect of paragraph 45, it:

(a) refers to and repeats paragraphs 28, 32, 33, 35 to 39 above and 113 and 115 below; and

(b) otherwise denies the paragraph.

46. In respect of paragraph 46, it:

(a) says, in relation to sub-paragraph (a), that it:

(i) refers to and repeats paragraph 115 below;

(ii) admits that it represented on 9 May 2008 that the First Provision was a sufficient provision to make in respect of impairment losses on the Conduit Loans as at 31 March 2008;

(iii) says further that, for the reasons set out in paragraph 115 below, that representation was true;

(iv) otherwise does not admit sub-paragraph (a);

(b) says, in relation to sub-paragraph (b), that it:

(i) refers to and repeats paragraph 37 above and paragraph 115 below;

(ii) admits that it represented on 9 May 2008 that the First Provision was a reasonable and appropriate provision in the circumstances;

(iii) says further that, for the reasons set out in paragraph 115 below, the First Provision was a reasonable and appropriate provision to make in respect of impairment losses on the Conduit Loans as at 31 March 2008 and was made in compliance with the relevant accounting standard, being the Financial Instruments Standard;

(iv) otherwise does not admit sub-paragraph (b);

(c) says, in relation to sub-paragraph (c), that it:

(i) refers to and repeats paragraph 37 above and paragraph 115 below;

(ii) otherwise does not admit sub-paragraph (c);

(d) says, in relation to sub-paragraph (d), that it:

(i) refers to and repeats paragraphs 36 and 37 above;

(ii) otherwise does not admit sub-paragraph (d); and

(e) says, in relation to sub-paragraph (e), that it:

(i) refers to and repeats paragraph 37 above;

(ii) otherwise does not admit sub-paragraph (e).

47. In respect of paragraph 47, it:

    (a) refers to and repeats paragraph 46 above; and

    (b) otherwise denies the paragraph.

48. It denies paragraph 48 and says further that negative ratings actions and downgrades by ratings agencies were matters:

    (a) in the public domain and therefore generally available; and

    (b) in respect of which the market could, and did, inform itself.

49. In respect of paragraph 49, it:

    (a) refers to and repeats paragraph 48 above; and

    (b) otherwise denies the paragraph.

50. In respect of paragraph 50, it:

    (a) refers to and repeats paragraphs 36 and 37 above;

    (b) admits that on 9 May 2008, it represented by its statements referred to in those paragraphs that, as was the case, there had been no default in the payment of principal and interest due to the NAB Conduits under the Conduit Notes as at that date; and

    (c) otherwise denies the paragraph.

51. In respect of paragraph 51, it:

    (a) refers to and repeats paragraph 50 above; and

    (b) otherwise denies the paragraph.

52. It admits paragraph 52.

53. In respect of paragraph 53, it:

    (a) says that the 2008 Half Year Performance Representations:

        (i) were representations as to the financial position and performance of nabCapital and NAB Group, as the case may be, for the six months ending on 31 March 2008;

        (ii) were not representations as to the earnings or profits which had been or would be achieved by those entities in the period after 31 March 2008; and

(b) otherwise denies the paragraph.

C WHAT IS ALLEGED NAB KNEW OR OUGHT TO HAVE KNOWN

C.1 The US Subprime Mortgage Crisis

54. It does not admit paragraph 54.

55. In respect of paragraph 55, it:
    (a) admits that the S&P Case Shiller Composite 20-city index available on the S&P website indicated that single-family home price values fell every month from February 2007 to August 2008; and
    (b) otherwise does not admit the paragraph.

56. It does not admit paragraph 56.

57. It does not admit paragraph 57.

58. It does not admit paragraph 58.

59. In respect of paragraph 59, it:
    (a) admits that the Conduit Notes contained exposures to US sub-prime assets;
    (b) refers to and repeats paragraphs 94, 95, 96 and 106 below; and
    (c) otherwise denies the paragraph.

60. In respect of paragraph 60, it:
    (a) refers to and repeats paragraph 106 below; and
    (b) otherwise does not admit the paragraph.

61. In respect of paragraph 61, it:
    (a) refers to and repeats paragraphs 27, 54 to 60 above and paragraph 106 below; and
    (b) otherwise does not admit the paragraph.

62. In respect of paragraph 62, it:
    (a) refers to and repeats paragraph 61 above and paragraphs 94, 95, 98, 99 and 106 below; and

(b) otherwise does not admit the paragraph.

C.2 Liquidation Risk

63. In respect of paragraph 63, it says:

(a) according to the terms of each of the Conduit CDOs, upon the occurrence of an event of default (**EOD**) the controlling party or parties in respect of that Conduit CDO had the option to:

(i) waive the EOD;

(ii) declare the occurrence of an EOD and accelerate maturity of the Conduit CDO; or

(iii) declare the occurrence of an EOD and liquidate the collateral underlying the Conduit CDO;

(b) the controlling party or parties of each Conduit CDO varied, and in some cases, upon an EOD:

(i) the collateral underlying the Conduit CDO could not be liquidated without the consent of NAB; or

(ii) the nature of the controlling party and its interest in the security militated strongly against the likelihood of liquidation of the collateral underlying the relevant Conduit CDO;

Particulars

NAB refers to and repeats the matters set out in paragraph 64 below, including the particulars thereto, and will refer to and rely on the terms of the indenture of each of the Conduit CDOs for their full force and effect.

(c) even where an EOD occurred or was likely to occur in respect of a Conduit CDO controlled by a third party or parties, there were strategies available to NAB to mitigate the risk of liquidation of the collateral underlying the note, including:

(i) negotiation with the controlling party or parties to avoid a liquidation;

(ii) acquisition of the interest of the controlling party in the Conduit CDO; and

(d) otherwise does not admit the paragraph.

64. In respect of paragraph 64, it:

(a) says that NAB knew that:

(i) monoline insurers provided insurance in the form of a guarantee or credit default swap to the holder of the super senior tranche of some of the Conduit CDOs;

(ii) in such cases, the relevant monoline insurer had control over the liquidation of the collateral underlying the relevant Conduit CDO either in its own right or in conjunction with one or more other parties;

(b) says further that where a monoline insurer had control over the liquidation of a Conduit CDO either in its own right or in conjunction with one or more other parties, NAB reasonably expected that the likelihood of liquidation of the collateral underlying the relevant Conduit CDO was low;

(c) it refers to and repeats paragraph 106 below; and

(d) otherwise does not admit the paragraph.

65. It does not admit paragraph 65.

66. It denies paragraph 66.

67. It admits paragraph 67.

68. It denies paragraph 68.

69. In respect of paragraph 69, it:

(a) refers to and repeats paragraphs 27, 64 to 68 above and paragraph 106 below; and

(b) otherwise does not admit the paragraph.

C.3 Ratings Downgrades

70. It admits paragraph 70.

71. It admits paragraph 71.

72. It admits paragraph 72.

73. It admits paragraph 73.

74. In respect of paragraph 74, it:

(a) admits that on 30 January 2008, S&P placed the Davis Square, Duke Funding, Grand Avenue, GSC, Hudson Mezzanine, Longstreet, Pacific Pinnacle and South Coast Conduit Notes on 'CreditWatch Negative'; and

(b) does not admit that S&P placed the Altius Conduit Note on 'CreditWatch Negative' on that day.

Particulars

The Class A-1b-3 notes of Altius III Funding owned by Centrestar 1 were not included in the announcement by S&P particularised in paragraph 74 of the statement of claim.

75. It admits paragraph 75.

76. It admits paragraph 76.

77. It admits paragraph 77.

78. It admits paragraph 78.

79. It admits paragraph 79.

80. In respect of paragraph 80, it:

(a) refers to and repeats paragraphs 27, 70 to 72 and 79 above and paragraph 106 below;

(b) admits that it had available to it the information the subject of its admissions in paragraphs 70 to 72 above by 1 January 2008; and

(c) otherwise does not admit the paragraph.

81. In respect of paragraph 81, it:

(a) refers to and repeats paragraphs 27, 70 to 76 and 79 above and paragraph 106 below;

(b) admits that it had available to it the information the subject of its admissions in paragraphs 70 to 76 above by 9 May 2008; and

(c) otherwise does not admit the paragraph.

82. In respect of paragraph 82, it:

(a) refers to and repeats paragraphs 27, 70 to 79 above and paragraph 106 below;

(b) admits that it had available to it the information the subject of its admissions in paragraphs 70 to 78 above by 24 July 2008 or shortly thereafter; and

(c) otherwise does not admit the paragraph.

C.4 Conduit CDO Performance

83. In respect of paragraph 83, it:

(a) admits that at all relevant times it had or had access to some data concerning the performance of the Conduit CDOs and Conduit Notes, including:

(i) some data about repayments of principal and interest due to the NAB Conduits under the Conduit Notes;

(ii) some data about the occurrence of EODs in relation to the Conduit CDOs, including whether over-collateralisation or other EOD triggers had occurred;

(iii) limited data about the composition of, and rates of delinquency, default and foreclosure amongst, the Conduit CDOs' underlying assets;

(b) denies that, at all relevant times, it had or had access to comprehensive or complete data concerning the performance of the Conduit CDOs and Conduit Notes, including data with regard to the matters set out in sub-paragraphs (a)(i) to (iii) above;

(c) refers to and repeats paragraph 106 below; and

(d) otherwise does not admit the paragraph.

84. It does not admit paragraph 84.

85. It does not admit paragraph 85.

86. It does not admit paragraph 86.

87. In respect of paragraph 87, it:

(a) refers to and repeats paragraphs 94, 95, 97, 98, 99 and 102 below; and

(b) otherwise denies the paragraph.

88. In respect of paragraph 88, it:

(a) refers to and repeats paragraphs 94, 96, 97, 98, 100 and 103 below; and

(b) otherwise does not admit the paragraph.

89. In respect of paragraph 89, it:

(a) says that in late December 2007, an EOD was triggered in respect of the Fort Denison Conduit CDO, when it failed its over-collateralisation-linked EOD test;

(b) refers to and repeats paragraph 94, 95 and 96 below; and

(c) otherwise denies the paragraph.

90. In respect of paragraph 90, it:

(a) refers to and repeats paragraph 87 above and paragraphs 94, 95, 99 and 102 below; and

(b) otherwise denies the paragraph.

91. In respect of paragraph 91, it:

(a) refers to and repeats paragraph 88 above and paragraphs 94, 96, 100 and 103 below; and

(b) otherwise does not admit the paragraph.

92. In respect of paragraph 92, it:

(a) refers to and repeats paragraphs 27, 83, 84, 87, 89 and 90 above, and paragraph 106 below; and

(b) otherwise does not admit the paragraph.

93. In respect of paragraph 93, it:

(a) refers to and repeats paragraphs 27, 83, 85, 88 and 91 above, and paragraph 106 below; and

(b) otherwise does not admit the paragraph.

C.5 Alleged CDO Exposure and Loss Information

94. In respect of paragraph 94, it:

(a) refers to and repeats paragraphs 95 to 104 and 106 below;

(b) says that, at all times during the Relevant Period:

(i) there had been no default in the payment of principal and interest due to the NAB Conduits under the Conduit Notes;

(ii) because of the relatively senior position of the Conduit Notes held by the NAB Conduits in the Conduit CDO structures to which the Conduit Notes belonged, any loss arising from impairment of the underlying assets would be absorbed in the first instance by the subordinated tranches;

(iii) the existence and extent of any loss to the NAB Conduits or to NAB arising from impairment of the underlying assets would depend upon various factors including:

(A) the extent of that impairment;

(B) the degree of subordination of the relevant Conduit Note within its Conduit CDO structure;

(C) the occurrence of an EOD in respect of a given Conduit CDO allowing the controlling party in respect of that Conduit CDO to liquidate the underlying collateral;

(D) any decision by a controlling party in respect of a Conduit CDO to liquidate the underlying collateral following an EOD; and

(c) otherwise does not admit the paragraph.

95. In respect of paragraph 95, it:

(a) refers to and repeats paragraph 94 above and paragraph 106 below;

(b) says that, as at 1 January 2008:

(i) there had been no default in the payment of principal and interest due to the NAB Conduits under the Conduit Notes;

(ii) because of the relatively senior position of the Conduit Notes held by the NAB Conduits in the Conduit CDO structures to which the Conduit Notes belonged, any loss arising from impairment of the underlying assets would be absorbed in the first instance by the subordinated tranches, and would not necessarily result in any loss to the NAB Conduits or to NAB;

(iii) NAB did not expect any shortfall in repayment of the Conduit Loans; and

(c) otherwise denies the paragraph.

96. In respect of paragraph 96, it:

(a) refers to and repeats paragraphs 94 and 95 above and paragraphs 103, 106 and 115 below;

(b) says that on 9 May 2008, it announced a provision (being the First Provision) which it had recognised as at its reporting date of 31 March 2008 in respect of impairment losses it had incurred within the meaning of the Financial Instruments Standard in relation to the Conduit Loans by reason of impairment of the Conduit Notes;

(c) says that, by reason of the matters set out in paragraph 115 below, the First Provision was a reasonable and appropriate provision to make in respect of impairment losses on the Conduit Loans as at 31 March 2008 and was made in compliance with the relevant accounting standard, being the Financial Instruments Standard; and

(d) otherwise does not admit the paragraph.

C.6 Provisioning Information

97. In respect of paragraph 97, it:

(a) says that the Provisions Standard required a provision to be recognised by NAB when, and only when:

(i) it had a present obligation as a result of a past event; and

(ii) it was probable that an outflow of resources embodying economic benefits would be required to settle the obligation; and

(iii) a reliable estimate could be made of the amount of the obligation;

(b) says further that:

(i) in circumstances where the Conduit Loans were already fully drawn, NAB had no relevant obligation as a result of a past event, settlement of which would probably require a future outflow of resources embodying economic benefits;

(ii) the Provisions Standard therefore had no application to, and required no provision to be recognised in respect of, any probability that the Conduit Loans would not be repaid to NAB in full; and

(c) otherwise denies the paragraph.

98. In respect of paragraph 98, it:

(a) admits that the Financial Instruments Standard:

(i) required NAB to assess at each reporting date whether there was any objective evidence that a financial asset or group of financial assets was impaired and, if such evidence existed, to apply paragraph 63 of the Financial Instruments Standard for financial assets carried at amortised cost