

4 August 2011

Houghton v Saunders & Ors / Updating report for Feltex Carpets Limited claimants

1. This updating report is made by me as senior counsel for Mr Houghton (the named plaintiff in this proceeding) and the approximately 1800 qualifying shareholders he represents (the claimants).
2. In an interim judgment of French J dated 9.3.11 (as to key rulings) and a further reserved judgment dated 8.6.11 (giving full reasons) the interim stay of the Feltex proceeding has been lifted by the High Court, subject to provision for security for costs of \$200,000 being made on behalf of Mr Houghton. Payment of the required security was made to the High Court on 10 June 2011. Mr Houghton has applied for costs against the defendants in respect of this matter. This is opposed by them.
3. The representative order, whereby Mr Houghton represents all the other claimants in the proceeding as the named plaintiff, has been approved by the court. This means that Mr Houghton sues on behalf of all the claimants (ie the qualifying shareholders who have elected to opt-in to the proceeding). There remain four causes of action.
4. The second cause of action in the present statement of claim has been struck out by French J. This would have alleged (in its proposed amended form) that the Feltex directors (the first defendants) and Credit Suisse MP (the third defendant) had a duty to disclose to investors that they knew that the prospectus was false and misleading in material respects, but they failed to do so. It would have alleged that this had the effect of disguising the availability to the investors of their remedy under the Securities Act 1978 s37A (the Act) to give notices avoiding the allotment of shares to them and to obtain repayment of their subscriptions. No cross-appeal by Mr

Houghton against this ruling has been filed. It is not considered that this ruling significantly affects the overall thrust and strength of the claim.

5. In summary, the four other causes of action which remain are based on:
 - alleged misleading and deceptive conduct by all the defendants in the Feltex public offer, the prospectus and the allotment of the shares (the first cause of action)
 - alleged misleading and deceptive conduct by the first defendant Sam Magill (a director and the chief executive officer of Feltex) by his involvement in the practice alleged to have been engaged in by Feltex from around May 2003 of manipulating its earnings and revenue recognition in particular accounting periods and so distorting its financial statements for 2003 and 2004 (this will now become the second cause of action)
 - the prospectus allegedly containing untrue statements, both as to statements made in it and by material omissions, as a consequence of which it is claimed that all the defendants are liable to pay compensation to the investors in terms of the Act s56 (this will now become the third cause of action)
 - Alleged negligence by all the defendants in the public offer, the prospectus and the allotment of the shares (this will now become the fourth cause of action).
6. French J did not consider that she could resolve genuinely disputed facts or expert evidence at this stage. Nor that she could place any significant weight on the finding of the District Court in August last year whereby Feltex directors were acquitted on charges laid by the Ministry of Economic Development. Her Honour was satisfied there were serious questions to be tried arising from the claim brought by Mr Houghton. Also that the JAFI funding agreement with the qualifying shareholders, as amended and approved by the court in May 2010, is appropriate.
7. All the defendants have filed notices of appeal against French J's judgments variously challenging:
 - the lifting of the interim stay order

- the amount of the security for costs ordered and seeking an increased amount
 - the approval of the representative order
 - the dismissal of some defendants' applications to strike out various other paragraphs of the statement of claim.
8. A second amended statement of claim which deals with various matters arising from French J's judgments has now been filed. The defendants must now decide if they wish to pursue further their strike out application in respect of specific paragraphs of the statement of claim. Otherwise they will file statements of defence.
 9. The defendants have also now applied to have the proceeding transferred from Christchurch to the Auckland High Court for entry on the commercial list. This is strongly opposed by Mr Houghton.
 10. Discovery of documents and how this should be done will be considered further by counsel and the judge. On behalf of Mr Houghton (as the plaintiff) it has been proposed that discovery should be staged so that it is confined to Mr Houghton and only 20 representative claimants initially, selected randomly.
 11. After the statements of defence have been filed Mr Houghton (as the plaintiff) is to file an application that defined questions and issues as to liability should be determined first. The Court of Appeal signalled that it could be appropriate to have the issue as to the liability of the defendants determined first, with claims for individual's loss to follow later.
 12. Importantly, JAFIL has now concluded through a London based commercial litigation funder co-funding and adverse costs insurance agreements. These agreements are with associates of Harbour Litigation Funding Ltd (Harbour). Counsel considers that the agreements are sufficient to fund the case and to continue to satisfactorily protect the position of Mr Houghton and the qualifying shareholders he represents, including as to any adverse costs available that might reasonably be expected to be made in favour of the defendants if the claim was to fail. The agreements are also considered to meet the requirements specified in the previous relative judgments of French J and the Court of Appeal. The court will be supplied with all information required by it in regard to these agreements but otherwise it is important, and indeed a requirement of Harbour, that confidentiality in respect of the agreements is

preserved. Mr Houghton has applied to the court for confidentiality orders. The first funding tranche under these agreements has been made by Harbour. Harbour has also obtained an independent report on the merits of the claim from a Sydney QC.

Yours faithfully

A J Forbes QC

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