IN THE COURT OF APPEAL OF NEW ZEALAND

CA578/2014
[2016] NZCA 493

BETWEEN	ERIC MESERVE HOUGHTON Appellant
AND	TIMOTHY ERNEST CORBETT SAUNDERS, SAMUEL JOHN MAGILL, JOHN MICHAEL FEENEY, CRAIG EDGEWORTH HORROCKS, PETER DAVID HUNTER, PETER THOMAS AND JOAN WITHERS First Respondents
	CREDIT SUISSE PRIVATE EQUITY INC Second Respondent
	CREDIT SUISSE FIRST BOSTON ASIAN MERCHANT PARTNERS LP Third Respondent
	FIRST NEW ZEALAND CAPITAL Fourth Respondent
	FORSYTH BARR LIMITED Fifth Respondent

Hearing: 11–14, 18 April 2016

Court: Ellen France P, Randerson and Winkelmann JJ

Counsel: C R Carruthers QC, P A B Mills and G R Abdale-Weir for Appellant
A R Galbraith QC, D J Cooper and S V A East for First and Third to Seventh named First Respondents
T C Weston QC for Second named First Respondent
J B M Smith QC, A S Olney and C J Curran for Second and Third Respondents
D H McLellan QC and J S Cooper for Fourth Respondent
A C Challis and D P Turnbull for Fifth Respondent

Judgment: 12 October 2016 at 11 am

Reissued: 6 December 2016

Effective date of Judgment: 12 October 2016

JUDGMENT OF THE COURT

A The appeal is dismissed.

B Costs memoranda to be filed in accordance with [314]–[317] of the judgment.

REASONS OF THE COURT

(Given by Winkelmann J)

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[1] Feltex Carpets Ltd (Feltex) was a carpet-manufacturing company. On 5 May 2004 it issued a combined investment statement and prospectus for an initial public offer for the sale of shares (IPO). Mr Houghton, the appellant, subscribed for and was allotted shares in the IPO. In September 2006 Feltex went into receivership and in December 2006, liquidation, leaving the shares Mr Houghton had purchased effectively worthless. Mr Houghton commenced proceedings in a representative capacity for himself and for others who had also been allotted shares in the IPO. He claimed he and other shareholders had invested on the faith of a misleading prospectus and that they should be able to recover their full investment. He brought claims against all respondents under the Securities Act 1978 (SA) (the legislation then regulating the issue of prospectuses and allotment of shares), the Fair Trading Act 1986 (FTA) and in negligence.

[2] Mr Houghton sued Feltex's directors (the first respondents). He sued Credit Suisse First Boston Asian Merchant Partners LP (CSAMP) as vendor and issuer of the majority of shares offered in the IPO. He sued the following parties alleging they were promoters of the prospectus: Credit Suisse Private Equity LLC[1] (CSPE, listed in the prospectus as promoter), CSAMP (as noted, the vendor), and First NZ Capital Ltd (First NZ) and Forsyth Barr Ltd (Forsyth Barr). These latter two were appointed organising participants and joint lead managers of the IPO by Feltex. We refer to them collectively as the JLMs.

[3] In a judgment dated 15 September 2014, Dobson J found that Mr Houghton's primary cause of action, the FTA claim, could not succeed because the application of the FTA was excluded by the SA.[2] He dismissed the negligence claim. He found that the relationships between investors in the IPO and the defendants was not such as to give rise to a duty of care being imposed in tort.[3]

[4] As to the claims under the SA, the Judge said that although a number of the criticisms of the prospectus had some justification, in no case had Mr Houghton made out materially misleading content or omissions triggering liability under the

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1 Formerly, and at the time of the IPO, Credit Suisse First Boston Private Equity Inc.
2 *Houghton v Saunders* [2014] NZHC 2229, [2015] 2 NZLR 74 [HC judgment] at [629].
3 See [689]–[690] and [694]–[695].

SA.[4] And the Judge said if he had found that the prospectus was materially misleading, the defendants may still have been able to avail themselves of the defence under the SA that they exercised due diligence in the preparation of the prospectus.[5]

[5] On appeal Mr Houghton argues that the Judge was wrong:

(a) in his interpretation of provisions in the SA which create liability for "untrue statements" (ss 55 and 56) and in his interpretation and application of the concept of prudent investors;[6]

(b) in his interpretation of the term "promoter" as it appears in s 2 of the SA;

(c) in key factual findings;

(d) in his conclusion that the due diligence defence is available where statements are known by the directors to be untrue;

(e) in concluding that the SA excludes the application of the FTA in this case; and

(f) in findings he made in relation to reliance and loss.

Relevant background

Credit Suisse buys interest in Feltex

[6] In 1996 Mr Peter Thomas was head of Credit Suisse First Boston's (CSFB) Asian-Pacific private equity division. He became aware of an opportunity to purchase shares in Feltex from its then principal shareholder, a company understood by Mr Thomas to be in receivership.[7] His recommendation that CSFB acquire Feltex was accepted and in December 1996 CSAMP, which was controlled by CSFB,

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4 See the Judge's summary of his findings at [50].
5 At [52].
6 See Securities Act 1978, s 38D.
7 BTR Nylex, the Australasian division or subsidiary of the British company BTR plc.

acquired 85 per cent of the shares in Feltex with the balance of shares acquired by senior Feltex executives. Mr Thomas was appointed as a director of Feltex and continued in that role through the time period material to this proceeding.

[7] CSAMP is constituted as a limited partnership in the United States under the laws of Delaware. Its investment in Feltex was managed by the second respondent, CSPE, a company incorporated in the United States also under the laws of Delaware. There is an issue on the appeal as to the exact nature and effect of the relationship between CSAMP and CSPE but, other than where that issue falls for consideration, we refer to them jointly as Credit Suisse for the purposes of this judgment.

Feltex's trading history

[8] Feltex experienced mixed trading results for the years immediately following the acquisition by Credit Suisse. In May 2000 Feltex purchased the Australian operations, Shaw Industries Australia Pty Ltd (Shaw), of United States carpet company Shaw Industries Inc. The directors of Credit Suisse and the board of Feltex believed that the purchase of Shaw would create value through the opportunity to access its parent company's expertise, technology and products, and through greater access to the Australian market.

[9] Shaw's managing director, Mr Magill, was appointed joint managing director of Feltex. Following the acquisition he spear-headed the process of merging the two companies including bringing the Australian business under the Feltex name. Although for a time after this acquisition Feltex struggled to grow its sales and profitability, by early 2003 there were signs that Feltex's prospects were brighter with some uplift in sales and a more substantial uplift in EBITDA.[8]

[10] By late 2003 Credit Suisse had resolved to sell Feltex as part of a broader strategy to dispose of certain classes of international investments. No particular timetable was set but, according to Mr Thomas, it was clear that Credit Suisse would not invest further capital in Feltex and would look to sell the company if the opportunity arose.

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[8] Earnings before interest, tax, depreciation and amortisation. EBITDA is not a substitute for net profit but is a useful tool for assessing a company's operating cash flow.

The decision to make an initial public offering of shares

[11] So it was that on 16 March 2004 Credit Suisse requested and authorised Feltex to proceed with an IPO and the Feltex board resolved it would do so. The board approved the appointment of a due diligence committee (DDC) to oversee the preparation of the prospectus. The membership of the DDC comprised the chairman of the board of directors, Mr Saunders; Mr Thomas as a representative of the Credit Suisse entities; Mr Tolan, the chief financial officer of Feltex; John Kokic, the chief operating officer; and legal advisors for both CSFB and Feltex.

[12] As well as formal members, many others attended meetings of the DDC as observers including other Feltex executives, representatives of First NZ and Forsyth Barr, and accountants from Ernst & Young, Feltex's auditors.

The prospectus is registered: 5 May 2004

[13] On 5 May 2004 Feltex registered and issued a combined investment statement and prospectus for the IPO of all of the 113,523,100 shares in Feltex, owned at that time by Credit Suisse. In addition, Feltex offered a further $50 million worth of shares, the exact number to be issued depending upon the final price. The IPO would then enable Credit Suisse to sell its investment in Feltex and enable Feltex to raise a further $50 million in capital.

[14] The prospectus contained historical financial information for the period from 1 August 1998 to 31 December 2003. The six-month period ending December 2000 represented the first full six-month period following the acquisition of Shaw. As Feltex balanced on 30 June each year,[9] the six months ending 31 December 2004 was the most recent complete six-month trading period before the registration date for the prospectus.

[15] The financial information showed that Feltex had experienced difficult trading conditions for much of the period covered in the historical financial information. Sales fell through 2001 and into 2002 with some improvements in sales

[9] Following the acquisition of Shaw in May 2000, Feltex changed its year end to 30 June.

thereafter but, it would be fair to say, no strong improving trend. EBITDA also fell through 2001 and the first half of 2002 but with a significant recovery in the second half of 2002 and thereafter.

[16] The extent of the improvement in EBITDA was not fully reflected in the profit figures because the owner of Feltex, Credit Suisse, maintained high debt levels thereby incurring high interest costs. It was intended that the money raised through the IPO would be applied to reduce debt by accelerating repayment of an existing bond issue, which was otherwise due to mature and be repaid in 2008.

[17] The prospectus also included prospective financial information in the form of a forecast for the financial year ending 30 June 2004 (FY04) and a projection for the financial year ending 30 June 2005 (FY05).

[18] The forecast for FY04 was prepared using actual sales figures until the end of March 2004 and then forecast sales for April, May and June 2004. Mr Houghton says the FY04 forecast revenue figure was unreasonable because, by the time the prospectus was registered, the directors knew it would not be achieved.

[19] The FY05 projections were prepared using a financial model. Mr Houghton claims the FY05 projected revenue figure was also unreasonable; it was unrealistic and failed to factor in the underachievement of the FY04 forecast revenue figure. There was no basis upon which the directors and the DDC could have concluded that the projected increase in Feltex's share of the market, an assumption underlying the FY05 projection, could be achieved.

[20] Mr Houghton also criticises how the prospective financial information was presented, which he claims owed more to marketing than to standard accounting practice.

[21] The prospectus, as required by the SA, contained a list of the risks associated with the investment. Mr Houghton complains that some risks were not highlighted for investors and that material information was otherwise omitted from the prospectus.

Due diligence

[22] Feltex did not meet the sales figure for the month of April 2004 used to calculate the sales forecast included in the prospectus for FY04. However, the prospectus was registered and distributed without amendment on 5 May 2004.

[23] Shares under the IPO were allotted on 2 June 2004. Prior to the allotment, the board of directors and the DDC knew that the sales revenue for May also fell short of that month's forecast and that Feltex would fall short of the total sales forecast for FY04. Again the decision was made not to correct that information in the prospectus and to proceed with the allotment of shares.

Feltex's performance post allotment

[24] FY04 ended shortly after the allotment of securities. Audited financial performance for FY04 showed that while revenue was $7.4 million (2.3 per cent) behind the forecast contained in the prospectus, EBITDA was above forecast by $0.5 million or 1.2 per cent. Net surplus was also higher by $1 million or 10.6 per cent.

[25] The beginning of FY05 continued this general trend. On 23 February 2005 Feltex made its preliminary results announcement for the first six months of FY05. It reported a net surplus for the six months of $12.2 million and EBITDA of $24.6 million. This was a 7.1 per cent improvement in profit on the equivalent period in the previous year and a 6.9 per cent improvement in EBITDA. But while profit and EBITDA were strong, total sales were below the level projected in the prospectus for FY05 and below the level for the six months ending December 2003. In its announcement accompanying the preliminary results, Feltex ascribed these aspects of its performance to a continuing shift of products sold toward the higher-price and higher-margin end of the market, and also to an adverse trend in the exchange rate.

[26] The New Zealand dollar was consistently stronger than the assumptions used in modelling for the projections for the FY05. This had a negative impact on Feltex's financial performance. Most of Feltex's sales occurred in Australia and so were in Australian dollars but were then reported in the company's financial

statements in New Zealand dollars. When the New Zealand dollar was stronger than expected against the Australian dollar, that reduced the reported level of revenue. Feltex's interim report published on 2 March 2005 ascribed $6.9 million of the reduction in revenue to the effect of these adverse movements in the exchange rate.

[27] Prior to the April 2005 trading update shares in Feltex were trading at $1.50. They dropped to 88 cents in the following two days.

[28] The second half of FY05 was worse for Feltex with a plummet in Australian consumer confidence affecting the Australian market and increasing material costs. These factors resulted in falling sales, EBITDA and profit. Feltex did not achieve the projections contained in the prospectus for FY05.

[29] The directors provided revised guidance to the market on 20 June 2005. This guidance caused a further prompt drop in the share price from 70 cents to 44 cents, before recovering to 63 cents.

[30] Feltex took various measures to address its poor performance. It changed its management team and restructured in order to take costs out of its operation. Feltex held discussions with various parties interested in investing in Feltex. If these talks had been successful this would have provided the additional capital Feltex's bank was by 2006 insisting it provide. However, none of these talks reached fruition before Feltex's bank appointed receivers on 22 September 2006. Feltex's assets were then sold to an Australian competitor, Godfrey Hirst, one of the parties the directors had been negotiating with as a potential investor.

[31] Feltex was placed in liquidation on 13 December 2006. As Dobson J said:[10]

> Given the relatively rapid transformation of fortunes, it is unsurprising at an intuitive level that shareholders who purchased shares in the IPO would protest that the business must have been oversold in the prospectus, and that they had not been warned adequately of the risks of losing their investment.

[10] HC judgment, above n 2, at [13].

High Court proceedings

[32] The parties agreed to a split trial in the High Court on the following basis.[11] First, Mr Houghton's claim should be tried in its entirety, both as to liability and loss. Issues common to all members of the representative claim would also be tried and findings on these issues would be binding on all members of the class.

[33] A second hearing was contemplated at which individual aspects of the claims of all qualifying shareholders would be heard and decided. Stage one proceeded to a three-month hearing commencing in March 2014, with judgment delivered in September 2014. Unless Mr Houghton is successful on appeal there will be no need for the second stage of the hearing.

Case on appeal

[34] The case Mr Houghton advances on appeal has shifted significantly from that at trial. The claim in negligence has been abandoned. In the High Court, the FTA was the primary focus of Mr Houghton's claim. On appeal it is the SA. The scope of the alleged misleading content and omissions in the prospectus has also narrowed considerably.

[35] Although in the High Court Mr Houghton advanced numerous criticisms of the content of the prospectus, they reduced to five broad headings of criticism on appeal.[12] While various other legal issues are pursued on appeal, the five allegedly misleading statements lie at its heart. If Mr Houghton does not carry the day in respect of at least one of these five allegations, his appeal cannot succeed.

[36] Mr Houghton argues that the Judge's failure to find that these statements were misleading was caused, at least in part, by his misapplication of ss 55 and 56 of the SA (which governed the civil liability of the respondents for untrue statements in the prospectus) and his characterisation of the behaviour of the notional prudent but non-expert investor (the notional investor), who stands as the yardstick for assessing

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11 *Houghton v Saunders* HC Christchurch CIV-2008-409-348, 9 December 2011 [Minute of French J] at [1]. The common issues were set out in a memorandum dated 20 January 2012.

12 Dobson J had estimated that if the particulars in support of the pleaded criticisms of the prospectus were given status as separate criticisms, they would have totalled approximately 80 criticisms. See HC judgment, above n 2, at [42].

whether a statement is untrue. It is logical therefore to address these issues before addressing the alleged untruths.

Grounds of appeal relating to test under ss 55 and 56 of the SA

[37] Section 55 of the SA provides:

> **55 Interpretation of provisions relating to advertisements, prospectuses, and registered prospectuses**
>
> For the purposes of this Act,—
>
> (a) a statement included in an advertisement or registered prospectus is deemed to be untrue if—
>
> (i) it is misleading in the form and context in which it is included; or
>
> (ii) it is misleading by reason of the omission of a particular which is material to the statement in the form and context in which it is included:
>
> (b) a statement is deemed to be included in an advertisement or registered prospectus if it is—
>
> (i) contained in the advertisement or registered prospectus; or
>
> (ii) appears on the face of the advertisement or registered prospectus; or
>
> (iii) contained in any financial statements, report, memorandum, or document that accompany, or are incorporated by reference or referred to in, or distributed with, the advertisement or registered prospectus:
>
> (c) a certificate registered under section 37A(1A), and any financial statements that accompany that certificate, shall be deemed to be included in the registered prospectus to which the certificate relates.

[38] Section 56(1) is the civil liability provision:

> **56 Civil liability for misstatements in advertisement or registered prospectus**
>
> (1) Subject to the provisions of this section, the following persons shall be liable to pay compensation to all persons who subscribe for any securities on the faith of an advertisement or registered prospectus

> which contains any untrue statement for the loss or damage they may have sustained by reason of such untrue statement, that is to say:
>
> (a) where the issuer is an individual, the issuer of the securities:
>
> (b) in the case of an advertisement, every person who is a director of the issuer at the time that the advertisement is distributed or who has authorised himself or herself to be named and is named in the advertisement as a director of the issuer or as having agreed to become a director either immediately or after an interval of time:
>
> (c) in the case of a registered prospectus, every person who has signed the prospectus as a director of the issuer or on whose behalf the prospectus has been so signed, or who has authorised himself or herself to be named and is named in the prospectus as a director of the issuer or has agreed to become a director either immediately or after an interval of time:
>
> (d) every promoter of the securities.

[39] The Judge rejected arguments advanced for Mr Houghton that:

(a) the s 55 definition of what constitutes an untrue statement is not an exhaustive one;[13] and

(b) a plaintiff need not show that any particular statement in the prospectus was untrue and rather could rely upon an overall impression created by the prospectus, for example, where the allegation is that the entire prospectus is rendered misleading by the absence of relevant information.[14]

[40] On appeal, Mr Carruthers QC for Mr Houghton repeats these arguments.[15] Mr Carruthers argues the Judge was led into error when rejecting these arguments by a mistaken view as to the policy of the SA. That error is encapsulated in the following paragraph from the judgment:

> [56] New Zealand securities legislation does not seek to limit the extent of risk to which investors may be exposed when making particular investments. Rather, the aim is to require adequate and accurate disclosure of matters relevant to the nature of the risks involved in an investment, to

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13 HC judgment, above n 2, at [65].
14 At [70] and [74].
15 We note that Mr Carruthers was not counsel for Mr Houghton in the High Court proceeding.

> enable potential investors to make fully informed decisions. That is reflected in a requirement for those promoting investment in either debt or equity securities to do so by means of a prospectus registered with the Companies Office. Since 2 September 1996,[16] the essence of the narrative description of an offer might also be conveyed in the shorter form alternative of an investment statement. Such documents have to refer to the availability of a registered prospectus.

[41] Mr Carruthers says this mistaken view of the policy and purpose of the SA led the Judge to read down the ordinary meaning of ss 55 and 56, giving them a narrower meaning than the ordinary words of the provisions conveyed. We therefore address this policy argument first.

Policy of the SA

[42] The appellant says that the Judge's analysis of the policy of the SA set out in [56] of his judgment cannot stand in the face of Court of Appeal and Supreme Court authority to the effect that the SA is investor-protection legislation and, accordingly, its provisions should not be read down beyond their ordinary meaning. The Supreme Court in *Hickman v Turn and Wave Ltd* said that the SA is investor-protection legislation, designed to ameliorate the vulnerability of investors.[17] The Court said that feature was relevant to the interpretation of the SA. Mr Houghton argues that the Judge was wrong to say the SA requires "adequate disclosure" because the investor-protection purpose of the legislation requires "full disclosure". On that basis, the statement-by-statement approach taken by the Judge cannot be right. Mr Houghton cites in support the following passage of Richardson J's judgment in *Re AIC Merchant Finance Ltd*:[18]

> It is perhaps true to say that the premise underlying the Securities Act, as with much commercial law, is that the best protection of the public lies in full disclosure of the company's affairs and of the security it is offering. That then allows the investor to make an informed investment decision, which in turn facilitates the functioning of financial markets.
>
> It is, I think, for reasons of that kind that the Act places such emphasis on clear and accurate disclosure and that the key provision, s 33(1), prohibits the making of an offer of securities to the public unless it is made in or is accompanied by a registered prospectus that complies with the Act and all regulations made under the Act. The obligations are placed on issuers and

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16 Securities Amendment Act 1996.

17 See *Hickman v Turn and Wave Ltd* [2012] NZSC 72, [2013] 1 NZLR 741 at [41]–[46].

18 *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA) at 392. See also *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [36].

> neither directly nor indirectly are existing or potential subscribers required to check whether an issuer has met its statutory responsibilities.

Analysis

[43] We agree with the Judge's description of the aim of New Zealand's securities legislation as embodied in the SA. His reference to "adequate" disclosure was to disclosure in accordance with the legislative scheme, which includes the detailed disclosure regime contained in the Securities Regulations 1983 and the requirement, contained in s 34 of the SA, to disclose adverse circumstances. The Judge's reference to accurate disclosure, in turn, links to the SA's requirement that prospectuses not include untrue statements.[19] The SA creates a comprehensive regime for disclosure, detailing to some level of exactitude what is required to be disclosed. There is no support in the case law for the appellant's submission that full disclosure is required if, by that, he means disclosure above and beyond that which is required by the SA.

[44] The Judge's description of the aim of this legislation is, we consider, consistent with the statements of this Court in *Re AIC Merchant Finance Ltd,* relied upon by Mr Houghton, and with how this Court described the purpose of the SA in *Hickman v Turn and Wave Ltd*:[20]

> … The purpose of the Act is the protection of the investing public against the risk that the issuer of a security may not be able to fulfil the contractual obligations it assumes under the security. The interpretation and application of the Act is to be approached from the investor's viewpoint. The principal means by which the Act achieves its objective is to insist that adequate and accurate information be provided to subscribers through a prospectus or by other means, such that investors may make informed decisions and better appreciate the risks they may be taking.

[45] Counsel for Mr Houghton also criticises the Judge's observation that the purpose of the SA is not to limit the extent of risk. Again we consider the Judge's approach was correct. The cases have consistently recognised that disclosure is the

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[19] See Securities Act, ss 55 and 56.

[20] *Hickman v Turn and Wave Ltd* [2011] NZCA 100, [2011] 3 NZLR 318 at [311] (footnote omitted). Although the decision was reversed on appeal, this point was not disturbed by the Supreme Court.

means by which investors are protected under the SA.[21] The legislation does not seek to limit the level of risk to which investors may be exposed, but rather to ensure that investors receive adequate and accurate information so that they are able fully to understand and evaluate that risk for themselves. We note the comments of the Hon David Thomson, then Minister of Justice, when speaking during the second reading of the Securities Advertising Bill, which later became the SA:[22]

> The purpose of the Bill is to consolidate and amend the law relating to the raising of investment money from the public, with a view to increasing the protection of investors. I say protection advisedly, because the purpose of the Bill is not to insure investors against loss. Risk is an inseparable part of an investment, and the Bill in no way purports to alter that. But I do not regard as legitimate that part of the risk attributable to irresponsibility or mismanagement.

The Minister's speech accords with the view we have expressed as to the purpose of the SA. Legitimate risk if adequately disclosed, even if very substantial, will not be caught under any of the SA's provisions concerning liability.

Meaning of "untrue statement" and the materiality requirement

[46] We next address the issue raised for Mr Houghton as to what can amount to a statement under the SA.

Judgment

[47] The Judge said that s 55 reflected a policy that the preparers of offer documents are to be held to account on a relatively specific basis.[23] The Judge said:

(a) The terms of s 55 contemplate that the assessment of whether a statement is untrue will be undertaken on a statement-by-statement basis, although the assessment of whether a statement is untrue may require an assessment of context.[24]

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21 *Hickman v Turn and Wave Ltd*, above n 20, at [311]; *Jeffries v R* [2013] NZCA 188 at [82]; and *Boyd Knight v Purdue* [1999] 2 NZLR 278 (CA) at [50] per Blanchard J.

22 (27 September 1978) 421 NZPD 3934.

23 HC judgment, above n 2, at [75].

24 At [68].

(b) The assessment of context may require consideration of multiple passages in the prospectus where the particular topic is addressed.[25]

(c) The statutory test therefore requires a plaintiff to identify the passages from the prospectus that are alleged to address a material point in misleading terms.[26]

(d) The result of this is that a plaintiff cannot plead generally that the overall impression given by the prospectus is misleading merely because additional information ought to have been given.[27] Where the allegation is that a statement is untrue because of omissions, the plaintiff has to identify particular content which is rendered misleading because of the absence of other relevant information

[48] In the context of a discussion as to whether the plaintiff had to show reliance upon the statement for the purpose of establishing liability under s 56, the Judge said that the legislative intent was to create liability in respect of misleading content or omissions where that content materially contributed to a claimant's decision to invest.[28]

The argument on appeal

[49] Mr Carruthers argues the Judge was wrong to treat s 55 as an exclusive definition of an "untrue statement". It is not expressed as such and properly read, it is argued, is no more than a deeming provision. It deems true statements to be untrue by reference to certain tests. Outside the operation of deemed untruths, the expression "untrue statement" should be given its ordinary meaning. That means a prospectus can in itself be an untrue statement and a prospectus can be misleading by reason of an omission, even if that omission cannot be tied to a specific statement said to be rendered untrue by the omission.

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25 At [69].
26 At [70].
27 At [74].
28 At [118].

[50] As to the Judge's analysis that s 56 requires a plaintiff to show that a statement was material, he says this was an unjustified reading-down of that provision. He cites in support the Supreme Court decision *Hickman v Turn and Wave Ltd*,[29] which he says establishes a principle that "extremely broad primary provisions [in the SA] are to be given their ordinary meaning" where there are specific exemptions from those primary provisions in the SA. There are such exemptions from liability under s 56(1). It follows, he says, s 56 should be read to create civil liability when a plaintiff proves that the prospectus contains an untrue statement. There is no added requirement of materiality.

Discussion of s 55

[51] We consider s 55(a) is an exhaustive definition of the term "untrue statement" so far as it relates to statements in a prospectus. In terms of s 55(a)(i), the definition includes any untrue statement if it is misleading in the form and context in which it is included. This means a statement that is literally true when read in isolation may nevertheless be deemed untrue for SA purposes if it is misleading in context. Conversely, it also means that a statement that is literally untrue when read in isolation may not be untrue for the purposes of the SA if it is not misleading in context. Section 55(a)(ii) also extends the meaning of "untrue" to include a statement that is misleading by reason of the omission of a material particular.

[52] Counsel for Mr Houghton argues the Judge's interpretation departed from the ordinary meaning of untrue statement because there is nothing in the statutory language to limit the length of what may amount to a statement, so that the whole of the prospectus may amount to an untrue statement. But the ordinary meaning of statement would not encompass a 150-page document containing hundreds if not thousands of individual statements. In making this argument Mr Houghton also disregards references in ss 55 and 56 to a statement being "included" or "contained" in the prospectus. As the respondents submit, both sections treat "statements" as sub-components of the prospectus, not the entire prospectus.

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[29] See *Hickman v Turn and Wave Ltd*, above n 17, at [45]–[46].

[53] The appellant's linked submission is that omission of information may create an untrue statement if the omission makes the overall impression created by the prospectus misleading, rather than one statement misleading. But the definition of untrue statement makes clear the need to link an omission to a particular statement rendered untrue by that omission.[30] The need to identify the particular untrue statements in a prospectus for which liability under s 56 is alleged to arise is a well-established requirement.[31]

[54] We have considered whether the overall scheme of the legislation supports the appellant's arguments in relation to the meaning of s 55. We think not. It must not be overlooked that the definition in s 55 of a statement applies not just to alleged civil liability but also to criminal liability.[32] If an untrue statement could consist of a global impression (such as the impression created by a prospectus that generally portrays a falsely upbeat tone as to the company's prospectus) which is said to be untrue, that would be unworkable as a test for criminal liability. We agree with the Judge that the policy of the SA is that the preparers of offer documents are to be held liable on a relatively specific basis.

[55] We also note that the SA expressly provides for liability for omissions which need not be tied to a particular statement. Section 34(1)(b) prohibits the distribution of a prospectus if the prospectus is "false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances (whether or not it became so misleading as a result of a change in circumstances occurring after the date of the prospectus)". Sections 37A–37G create a detailed regime for relief and liability in respect of breaches of this prohibition. Treating s 55 as an exclusive definition does not, therefore, create any gaps in coverage inconsistent with the purpose of the SA to ensure that investors have adequate and accurate disclosure.

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30 This has been the approach in all cases decided on this issue. See *R v Petricevic* [2012] NZHC 665, [2012] NZCCLR 7 at [212]; *R v Moses*, above n 18, at [44]; and *Graham v R* [2013] NZSC 104 at [14] where the Supreme Court declined leave for a conviction appeal because the lower Courts had correctly identified particular statements in the prospectus rendered untrue by an omission.

31 *Graham v R*, above n 30, at [14(a)]; and *Jeffries v R*, above n 21, at [88].

32 Securities Act, s 58(1).

[56] Finally we note, as the respondents submit, Mr Houghton pleaded a case based on specific statements which he alleged were deemed to be untrue by the SA.

Discussion of s 56

[57] The appellant argues that the Judge erred when he imported into s 56 a requirement that the untruth has to be material to trigger civil liability. He says this is an unjustified reading-down of s 56(1) inconsistent with the Supreme Court's guidance that, as the SA is investor-protection legislation, these extremely broad primary provisions are to be given their ordinary meaning.[33]

[58] The appellant says s 56(1) should be read to create civil liability for the respondents if he proves that the prospectus contains an untrue statement, particularly where there are statutory defences. He does not have to prove the misleading content was material to the decision to invest or that the particular statement caused him loss; it is sufficient if it is untrue. This is especially so as s 33(1) of the SA prohibits in absolute terms the marketing of a security in a registered prospectus other than one which complies in all respects with the SA.[34] If the prospectus contains an untrue statement, it does not comply with the SA and therefore should not have been distributed.

[59] The Judge considered it was necessary for the appellant to show the untrue statement was material because, in terms of s 56(1), he had to show he had invested "on the faith of" a registered prospectus. He said:[35]

> [117] Despite the focus on specific reliance in parliamentary materials, I do not treat the requirement that an investment had been made "on the faith of" a registered prospectus as requiring the same reliance on particular passages as arises, for example, in a tortious claim for reliance on a negligent misstatement. Had the legislature intended that closeness of connection, then the link between the prospectus and the investor's decision to invest would instead have been expressed in terms of reliance on the content found to be misleading.
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> [118] I consider that the legislative intention was to create liability in respect of misleading content or omissions where that content materially contributed to a claimant's decision to invest. The untrue statement or

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33 See *Hickman v Turn and Wave Ltd*, above n 17, at [45]–[46].
34 Securities Act, s 33(1)(c).
35 HC judgment, above n 2.

> statements must be sufficiently material that, if corrected, it would then have been more likely than not that the investment would not have been made. That proposition assumes that the claimant makes out reliance on the prospectus in general, and that his or her assessment of the risks of investment would more likely than not have been reversed if the untrue statement or statements were corrected. It also involves rejection of the plaintiff's broader claim that indirect reliance, merely on the existence of a prospectus, would be sufficient.

[60] We do not consider the appellant's reliance upon the Supreme Court decision in *Hickman* assists him. The Court was there concerned with whether it should read down the words of broadly expressed provisions. That issue does not arise in this case. The Judge's finding that the untrue statement must be material before a plaintiff may succeed in a claim under s 56 did not flow from a reading down of s 56(1) but rather from the express requirement that a plaintiff show it suffered loss "by reason of such untrue statement". If an untrue statement is immaterial, it is difficult to see how a plaintiff can have suffered loss by reason of it. Moreover, as the Judge observed, the policy of the SA accords with this approach.[36]

[61] Mr Carruthers attempts to meet this point with a "but for" argument constructed as follows. The SA prohibits registration of a prospectus which contains an untrue statement. This prospectus contains an untrue statement and should not then have been registered. If the prospectus had not been registered, Mr Houghton would not have invested and would not have suffered loss.

[62] There are two fallacies in this argument. The first is that there is no absolute prohibition on the registration of a prospectus which includes an untrue statement. The focus of the legislation is on ensuring the accuracy of material information. Thus s 34(1)(b) prohibits distribution of a prospectus if it is "false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances (whether or not it became so misleading as a result of a change in circumstances occurring after the date of the prospectus)". The prohibition in s 34(1)(b) would not apply if the untrue statement was not material.[37]

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36 At [118] and [120].

37 See also s 37A(1)(b) of the Securities Act which provides that no allotment of a security to the public for subscription shall be made if, at the time of allotment, the prospectus is known by the issuer to be false or misleading in a material particular.

[63] The second fallacy is that, as Mr Houghton frames his argument, the loss is caused by the distribution of the prospectus and not the untrue statement. Section 56 is clear in its terms that liability is only established when a plaintiff shows it suffered loss by reason of the untrue statement.

[64] Does a plaintiff have to show reliance upon the untrue statement to establish loss by reason of it? This issue is resolved by the terms of s 56.

[65] The first element is that the plaintiff must establish that the investment was made "on the faith of" the prospectus. This requirement excludes those who invest other than in response to the prospectus.[38] However, the use of the expression "on the faith of" suggests something more than merely investing after reading the prospectus. It has the connotation of an investor trusting in the truth of the statements in the prospectus and subscribing in reliance on those statements. In that sense, the expression "on the faith of" may be seen as a necessary first part of establishing that the untrue statement was material to the decision to invest.

[66] The second element is that the plaintiff prove it suffered loss by reason of the untrue statement. How does a plaintiff go about satisfying this element of the s 56 cause of action? The Judge said that the plaintiff must establish that its assessment of risk was likely to have been reversed absent the untrue statement.[39] But again, how does a plaintiff do that? There are valid objections to resting this assessment upon the evidence of the plaintiff as to what it would have done. It is an easy thing for a plaintiff, with the hindsight knowledge that the investment was bad, to characterise the untrue statement as decisive in their decision to invest. Such evidence would be difficult for a defendant to test and, if measured on its own, difficult for a court to assess.

[67] This difficulty was described in *Broome v Speak* by Buckley J as follows:[40]

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[38] See *Saunders v Houghton* [2009] NZCA 610, [2010] 3 NZLR 331 at [85]–[86] where this Court expressly reserved its opinion on the scope of reliance required in relation to the claim. It contemplated, however, general reliance on the prospectus being sufficient.

[39] HC judgment, above n 2, at [118].

[40] *Broome v Speak* [1903] 1 Ch 586 (Ch) at 604 (footnote omitted).

> It is unintelligible to say that a person relied upon a fact which he was not told, or relied on his not being told a fact, and when you call a man after the event to say whether, if he had known a further particular fact, he would have done something or not, speaking for myself, it is so difficult to say exactly what a few years ago you would have done under different circumstances, that I should regard that evidence as of very little value. Be the man the most honest man possible, it is so easy to be wise after the event, that it is difficult for any man to say what he would have done under circumstances which did not arise. It is too much to expect of him that he should be able to say fairly what he would have done under those altered circumstances. The test I think to be applied is—it has been so stated by Lord Halsbury, and was so stated in *Smith v Chadwick,* and will be found in many cases—that if you find that the matter withheld is such as that if disclosed it reasonably would deter or tend to deter an ordinarily prudent investor from applying for the shares, then is he entitled to relief.

[68] A related difficulty is the artificiality of an exercise in assessing how one particular statement acted upon the mind of the plaintiff when the decision to invest is made on the faith of the whole prospectus, an observation made by Lord Halsbury LC in *Arnison v Smith*:[41]

> It is an old expedient, and seldom successful, to cross-examine a person who has read a prospectus, and ask him as to each particular statement what influence it had on his mind, and how far it determined him to enter into the contract. This is quite fallacious, it assumes that a person who reads a prospectus and determines to take shares on the faith of it can appropriate among the different parts of it the effect produced by the whole. This can rarely be done even at the time, and for a shareholder thus to analyse his mental impressions after an interval of several years, so as to say which representation in particular induced him to take shares, is a thing all but impossible. A person reading the prospectus looks at it as a whole, he thinks the undertaking is a fine commercial speculation, he sees good names attached to it, he observes other points which he thinks favourable, and on the whole he forms his conclusion. You cannot weigh the elements by ounces.

[69] In our view the proper approach is this. It is a question of fact whether an investor suffered loss by reason of an untrue statement. There may be evidence that satisfies the court that a particular investor was not affected in their investment decision by the untruth, for example, if the investor knew the true position but proceeded to invest. But if there is no such evidence, in reaching a view as to whether the plaintiff's investment decision was affected by the untrue statement, the court must ask itself whether the notional investor would have invested if they had known the true position. The materiality of the statement is obviously critical at this

[41] *Arnison v Smith* (1889) 41 Ch D 365 (CA) at 369.

point. This test includes both subjective and objective elements. The court asks first if the notional investor's investment decision was more likely than not to have been influenced by the untrue statement. If the answer is yes, the element is made out unless the evidence establishes that the particular investor did not rely upon the untrue statement.

[70] We note that this is the general approach taken by the English courts concerning misleading material within a prospectus. In *Arnison v Smith* Lord Halsbury LC put the matter as follows:[42]

> It was said, and I think justly, by Sir *G Jessel* in *Smith v Chadwick*, that if the Court sees on the face of the statement that it is of such a nature as would induce a person to enter into the contract, or would tend to induce him to do so, or that it would be a part of the inducement to enter into the contract, the inference is, if he entered into the contract, that he acted on the inducement so held out, unless it is shewn that he knew the facts, or that he avowedly did not rely on the statement whether he knew the facts or not.

[71] *Arnison* was a case involving an allegation of fraudulent misrepresentation or deceit, but we do not consider that the approach to causation set out there is to be limited to such cases. A year after that decision the earliest ancestor in the particular statutory family tree in which s 56 has a place was enacted in the United Kingdom: s 3 of the Directors Liability Act 1890 (UK).[43] Section 3(1) of that Act provided:[44]

> **Liability for statements in prospectus**
>
> Where after the passing of this Act a prospectus or notice invites persons to subscribe for shares in or debentures or debenture stock of a company, every person who is a director of the company at the time of the issue of the prospectus or notice, and every person who having authorised such naming of him is named in the prospectus or notice as a director of the company or as having agreed to become a director of the company either immediately or after an interval of time, and every promoter of the company, and every person who has authorised the issue of the prospectus or notice, shall be liable to pay compensation to all persons who shall subscribe for any shares, debentures, or debenture stock on the faith of such prospectus or notice for the loss or damage they may have sustained by reason of any untrue statement in the prospectus or notice, or in any report or memorandum

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42 *Arnison v Smith*, above n 41, at 369 (footnote omitted).

43 A year later a similar provision was brought over to New Zealand in s 3 of the Promoters' and Directors' Liability Act 1891. It was subsequently inserted into s 76 of the Companies Act 1903, s 76 of the Companies Act 1908, s 48 of the Companies Act 1933, s 53 of the Companies Act 1955 and finally in s 56 of the SA.

44 Directors Liability Act 1890 (UK) 53 & 54 Vict c 64, s 3.

> appearing on the face thereof, or by reference incorporated therein or issued therewith …

[72] The fundamental effect of s 3 was to remove the requirement that a plaintiff prove actual fraud against a director in an action for misrepresentation in a prospectus.[45] Nevertheless, the *Arnison* approach to causation continued to be applied under the Act.[46]

[73] Section 56 of the SA, although more simply expressed, continues to utilise the same key concepts as s 3 of the Directors Liability Act. The investor must show it invested "on the faith of" the prospectus. It must show that it suffered loss by reason of any "untrue statement" in the prospectus. The carrying forward of these key phrases shows an intention to carry forward the common law that had developed around those provisions. We therefore consider that the approach described in *Arnison* is equally applicable to s 56. We would add one gloss to it, which derives from the statutory framework in which s 56 operates. It seems to us that, when applying the objective part of the test described in *Arnison*, the relevant standard should be the standard provided for in the SA: that of the notional investor as we now discuss.[47]

Did the Judge err in his application of the prudent non-expert investor test?

[74] It is common ground that what is misleading for the purposes of ss 55 and 56 is to be assessed by reference to an objective standard: the prudent but non-expert investor. Section 38D(a) provides that the prudent but non-expert person (again, the notional investor) is the audience for investment statements. In a number of decisions the notional investor has also been held to be the appropriate standard against which statements in prospectuses are to be measured, when considering whether they are misleading for the purposes of s 55 of the SA.[48]

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45 After the decision of the House of Lords in *Derry v Peek* (1889) 14 App Cas 337 (HL). See comments in *Bundle v Davies* [1932] GLR 379 (SC) at 381; and *Clark v Urquhart* [1930] AC 28 (HL) at 56.

46 See for example *Drincqbier v Wood* [1899] 1 Ch 393 (Ch) at 404; *Greenwood v Leather Shod Wheel Co* [1900] 1 Ch 421 (CA) at 433; *Broome v Speak*, above n 40, at 604–605; and *Broome v Speak* [1903] 1 Ch 606 (CA) at 623.

47 See Securities Act, s 38D(a).

48 *R v Moses*, above n 18, at [63]; *R v Petricevic*, above n 30, at [224]–[225]; and *R v Graham* [2012] NZHC 265, [2012] NZCCLR 6 at [25].

[75] On appeal Mr Carruthers, while accepting the applicability of the notional-investor standard, argues that Dobson J erred in adding to the statutory scheme a requirement that the notional investor is required to seek advice in matters they do not understand. He argues that since s 38D states that one of the purposes of an investment statement is to provide "certain key information that is likely to assist a prudent but non-expert person to decide whether or not to subscribe for securities", the key information should not be provided in a format that can only be understood by the expert investor, prudent or otherwise.

Judgment

[76] The Judge noted that, in an earlier decision concerning finance companies, he had declined to confine the characterisation of the notional investor to those who would be guided in their consideration of investment statements by advice from investment advisors.[49] But, he said, the investment decision in relation to Feltex shares was relatively more complex than that confronting potential investors in debt securities issued by finance companies.[50] Whilst he adhered to the view that some notional investors would make decisions after considering a prospectus without taking advice, he acknowledged that the more complex any prudent evaluation of an investment decision needs to be, the less scope there exists to measure misleading content for prudent non-expert readers on the assumption they did not get advice.[51] He said:

> [98] Accordingly, the notional investor, through whose eyes I will test whether the prospectus had misleading content or omissions, is a non-expert who has at least a basic understanding of all the narrative content of the prospectus. Such a reader is able to understand and evaluate the risks described in the "What Are My Risks?" section of the prospectus. The notional investor may not understand the significance of financial statements. Certainly, such readers will be unlikely to have the skills to analyse the financial data set out in the prospectus, in order to form a view about the attributes of the investment, independently of the narrative descriptions of the business and its prospects as they are set out in the prospectus.
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> [99] This notional investor will, for the most part, recognise the content of the prospectus that he or she does not understand. To the extent that passages not understood are perceived as material to his or her decision, then

[49] HC judgment, above n 2, at [82].
[50] At [88].
[51] At [93].

> prudently he or she will not invest in the company before seeking clarification on the meaning of such passages.
>
> (Footnote omitted.)

Analysis

[77] The appellant's argument entails the proposition that only information comprehensible by the notional investor without professional assistance may be included in a prospectus.

[78] There is nothing in the SA or the Securities Regulations requiring that conclusion. The standard for consideration is the ordinary prudent investor. A prudent investor will of course seek clarification when they realise they do not understand something. The notional investor could therefore be expected to seek advice when they realise they are unable to understand information contained in the prospectus.

[79] This approach is consistent with the broader statutory scheme, which requires the offeror to provide key information likely to assist the notional investor to decide whether or not to invest. It is also consistent with the requirement that every investment statement set out at the front the following statement:[52]

> Investment decisions are very important. They often have long-term consequences. Read all documents carefully. Ask questions. Seek advice before committing yourself.

[80] Mr Carruthers argues this approach places a burden upon the notional investor that is inconsistent with a statutory scheme which places the burden of compliance upon the issuer. We do not agree. The SA's scheme proceeds upon the basis that the audience for a prospectus and investment statement is a notional investor who exhibits certain characteristics. Applying the standard of that notional investor when determining whether or not a statement is misleading, does not amount to imposing an obligation on the investor to ensure the issue is compliant.

[81] The Judge did not assume that every investor would seek advice, only the investor who realises they do not understand the material they are presented with but

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[52] Securities Regulations 1983, sch 3D cl 1(1).

still perceives it to be material to the investment decision. The Judge went on to refine this exception further:[53]

> [100] I have to allow for exceptions where a prudent, non-expert investor reasonably does not appreciate that he or she does not understand particular misleading content, and proceeds in reliance on that misunderstanding. Such exceptions are context-specific, requiring an assessment of whether a prudent, non-expert reader would reasonably appreciate that he or she had misunderstood the particular point being conveyed. This makes for an unwieldy test that should hopefully be unnecessary in other cases, but which I am satisfied is necessary to correctly apply the statutory test to the diffuse criticisms in this case. It is particularly appropriate where the alleged misleading content or omission would not mislead a sophisticated reader of the prospectus.

[82] To conclude:

(a) The Judge was correct to hold that the purpose of the SA is to protect investors by ensuring they have adequate and accurate disclosure to enable them to assess the risks entailed in the investment. The purpose is not to protect investors from risk. "Full" disclosure, above and beyond that mandated by the SA, is not required.

(b) For the reasons we have set out above, the definition provided in s 55 of "untrue statement" can be treated as an exclusive definition. An entire prospectus cannot, for the purposes of the SA, be an untrue statement. The need to identify particular untrue statements in a prospectus for which liability under s 56 is alleged to arise is a well-established requirement. Any omission must be linked to a specific statement said to be untrue.

(c) We consider there is a materiality requirement in s 56. To succeed in a claim, a plaintiff must prove an untrue statement, that they read and considered the prospectus, and that the notional investor's decision to invest was more likely than not to have been influenced by the untrue statement (unless the evidence establishes the particular plaintiff did not rely on the untrue statement).

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[53] HC judgment, above n 2.

(d) Lastly, the Judge did not err in his application of the "prudent, non-expert investor" standard.

Grounds of appeal relating to factual findings

[83] Mr Carruthers argues that several of the Judge's factual findings were against the weight of the evidence, some of these influenced by the errors of law contended for by Mr Houghton and addressed earlier. The untruths Mr Houghton pursues on appeal are as follows:[54]

(a) The forecast revenue figures for FY04 and projected revenue figures for FY05 were untrue because the respondents could not reasonably have believed they would be achieved either at the time the prospectus was issued or at the time of the allotment of securities under the prospectus.

(b) The statements in the prospectus in relation to Australian Government grants (referred to as SIP grants) were untrue because they were misleading. They failed to disclose the extent of the contribution SIP grants made to the net surplus attributable to shareholders, and therefore the extent of Feltex's reliance upon them.

(c) The consolidated statement of prospective financial performance for FY04 and FY05 contained a line labelled "Net surplus attributable to Shareholders" and below that a line labelled "Net surplus attributable to Shareholders (before amortisation, write-offs and Early Redemption Amount)". This latter line is referred to in these proceedings as the second bottom line. Mr Houghton alleges it is misleading as it sits in the place the profit figure is normally found.

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[54] The written submissions recorded several alleged errors of fact which were not pressed during oral argument. Errors falling into this category are "Dobson J recorded his view that Feltex was a long established manufacturer of carpets" and "Dobson J records that the respondent Mr Magill, in his capacity as Chief Executive Officer of Feltex, was a member of the Due Diligence Committee". Mr Houghton does not, however, contend that any of these factual errors on their own were material to the outcome before Dobson J and we therefore do not consider them further.

It would, he says, confuse the notional investor into having a falsely positive view of the company's future profitability.

(d) The statement on page 21 of the prospectus, that Feltex will use funds raised from the issue of shares to fund redemption of the bonds, was said to be misleading because some ($3.5 million) of those funds were used to pay part of the FY04 dividend of $9 million. During the hearing of the appeal an alternative argument was formulated: the prospectus should have included a statement that the size of the IPO had been increased to enable the payment of a dividend of $9 million.

(e) The prospectus contained statements regarding the purchase of 6,476,900 shares outside the offer by directors and senior managers. Mr Houghton alleges that those statements were untrue. They represented that directors would pay consideration equivalent to the retail price for the shares when the price paid was much less than retail. The statements also represented that directors would fund the purchase out of their own resources when, in reality, the purchase was 100 per cent funded by the proceeds of the sale of shares by CSAMP to the public through the IPO.

Undisclosed adverse trends and revenue forecast for FY04

Appellant's argument

[84] It was argued for Mr Houghton before Dobson J that the revenue forecast for FY04 was unreasonable given Feltex's trading history and was therefore an untrue statement for the purposes of ss 55 and 56 of the SA, and misleading for the purposes of s 9 of the FTA.

[85] The appellant says that by 5 May 2004, the date of the registration of the prospectus, daily sales reports for April received by the chief financial officer, Mr Tolan, who sat on the DDC, and by Mr Magill, the chief executive officer, showed a significant shortfall for sales against the forecast which had been utilised in preparing the FY04 forecast in the prospectus.

[86] Following registration of the prospectus there was a second month of underperformance. Sales for May were also significantly behind forecast. By the time of the allotment of securities in June 2004 the board of directors knew there had been two months of shortfall in sales. They therefore knew that the forecast figures for FY04 were incorrect and, on Mr Houghton's case, untrue statements in terms of s 55. Yet the company proceeded to allot securities.

Factual background

[87] The prospectus included consolidated statements of prospective financial performance, prospective cash flows and prospective financial position for FY04. The figures utilised were based upon actual performance by the company for the nine months ending 31 March 2004 and forecast financial performance for the last three months of FY04: April, May and June 2004. Mr Tolan was in charge of preparation of the forecast. He said it was substantially complete by 8 April 2004 but the team continued to make minor changes to it throughout April and the final version was completed by 30 April 2004.

[88] Mr Tolan's evidence was that the FY04 forecast in the prospectus did not include actual sales results for the month of April because, although he would have had reasonably accurate sales figures by that time, he would not have had available to him all other financial figures for the month such as costs and rebates to allow his team to produce an accurate monthly trading report. There is nothing to contradict that evidence.

[89] Nevertheless, before the prospectus was registered, the board was aware that there would almost certainly be a shortfall in sales for April. The 27 April board minutes record "April is forecast to be a difficult sales month but the shortfall will be picked up in May and June." There is no mention of the shortfall in the minutes of the DDC meeting on 4 May 2004, the day before registration of the prospectus, and the minutes of that meeting record that no material items had arisen since the last meeting on 30 April 2004. The minutes for the 30 April DDC meeting also contain no discussion of the shortfall in sales for April.

[90] The final DDC meeting was held on 2 June 2004. The purpose of the meeting was to check whether any "material adverse circumstances" had arisen since the prospectus was issued on 5 May 2004. By the time of the meeting it was known that sales figures for April and May had fallen short of the figures used to compile the forecast for total sales for FY04. The forecast for FY04 had been prepared on the basis of April sales figures of $29,828,000, whereas actual sales were $24,271,000. The forecast had included a figure of $32,959,000 for May,[55] whereas actual sales were $26,657,000. By the time of the 2 June DDC meeting the projection was for an anticipated shortfall of approximately 2.8 per cent against forecast annual sales.

[91] At the 2 June 2004 meeting, Mr Tolan, the chief financial officer, presented information to the DDC recorded as follows:

> The only number in the forecast that may not be achieved is the sales number and there should not be an issue with any of the other forecast amounts. Des [Tolan] confirmed that the Company's balance sheet should be in line with the forecast balance sheet. Des indicated that the sales shortfall would be between $7.5 million and $9 million for the year ending June 2004, which translates to a shortfall of approximately 2.8 % of annual sales. Sales for the fourth quarter were currently down around 10 % but the feedback from the market indicates that June will be a strong month as the retailers push for their quarterly rebates.
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> Des confirmed that in his view, he did not consider the Company not meeting the sales forecast was a material adverse circumstance as the Company should still achieve its EBITDA and Net Profit After Tax forecast numbers.

[92] The DDC and all of the observers present, including representatives from Feltex's auditors, Ernst & Young, agreed that in the circumstances the sales shortfall was not material. This was then discussed at a full board meeting later the same day. The board resolved that there was no material adverse circumstance which required disclosure before it could proceed with allotment.

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[55] Although we note that Mr Cameron, an expert engaged by the respondents, said the May 2004 forecast was for sales of $34,054,000.

Judgment

[93] Dobson J reviewed the evidence, including expert evidence called for both sides as to the significance of the failure to meet forecast sales figures for April and May 2004. He summarised the case for Mr Houghton before him as follows:[56]

> [176] Mr Forbes [counsel for Mr Houghton in the High Court] argued that an anticipated failure to meet the forecast sales revenue to 30 June 2004 would have been important to readers of the prospectus for a number of reasons. First, it would signal that the forecast performance for FY2004 may not be achieved. Secondly, it would cast doubt on the reliability of the assumptions used, or the method for producing the forecast, given that those preparing it had actual figures for the first nine months of the 12 month period. Thirdly, readers were likely to treat the projection for FY2005 as being based on, or at least influenced by, the forecast for FY2004 and a doubt about the reliability of the forecast would also send a cautionary signal as to the reliability of the projection for the following year. Fourthly, it would enable readers of the prospectus to assess the reliability of positive claims about Feltex that were made in the prospectus, from a better informed perspective.
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> [177] In addition, Mr Forbes argued that the way the analysis of Feltex's prospects was structured in the prospectus both explicitly and implicitly rated the extent of sales revenue as an important criterion. Mr Forbes argued that that importance was further heightened by Feltex's sensitivity to high break-even costs. He cited an acknowledgement by Mr Magill in cross-examination to the effect that if Feltex did not achieve sufficient sales revenue, then because of the high break-even costs it would obviously go into losses. Mr Magill acknowledged that he had explained this point to brokers and in institutional presentations prior to the IPO. The point can therefore be seen as having some importance, at least to analysts.

[94] The Judge said the defendants' case was that Mr Houghton was cherry-picking parts of only one feature of the management reports and that, when assessed overall, the data available to the directors at the time the prospectus was registered and when the securities were allotted did not create any cause for concern that the forecast revenue should be qualified or changed.[57]

[95] The Judge, however, was of the view that the "concerted responses in evidence from and on behalf of the defendants", denying the importance of Feltex's

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56 HC judgment, above n 2 (footnote omitted).

57 At [178].

failure to meet the gross revenue forecast and sales targets to 30 June 2004, involved an element of overstatement.[58] He said:[59]

> The contemporaneous documents do support the directors' focus on other measures of performance, but that cannot entirely eliminate the relevance of the trend in sales for a manufacturing company.

[96] He continued:

> [187] I do not accept entirely the defendants' claim that the variance in gross sales revenue was not relevant. However, I am not persuaded that, on the statistics that were available on 5 May 2004, they unreasonably rejected a negative signal that should have been acknowledged in relation to the level of gross revenue from sales and volume of carpet sold. I agree with the directors that it was not tenable for the plaintiff to criticise them for accepting management's advice that the variance was not material, when the FY2004 result subsequently confirmed that their analysis was accurate.

[97] He then proceeded to assess what alternative courses of action were available to the directors:

> [188] One alternative to the course the directors adopted would have been for them to adjust the gross revenues downwards, but to improve the margins achieved on relatively smaller sales to produce comparable EBITDA and net profit after tax (NPAT) forecasts for FY2004. A second alternative might have been to leave the numbers in the forecast as they were, but to amend the commentary to acknowledge the apparent extent by which actual gross revenue might not match the forecast number. Any such comment could legitimately cite the analysis provided for the directors, to the effect that although gross sales revenues were unlikely to achieve the forecast number, improved margins meant that the directors adhered to the forecast for EBITDA and NPAT. That is effectively the message that shareholders received in August 2004 when the result for FY2004 was announced. As Professor Cornell emphasised, the lack of reaction in terms of the share price at that time tends to confirm that the difference was not material.

[98] He concluded that these courses of action available to the directors tended to demonstrate the lack of materiality of the variances in sales and revenue.[60]

Discussion

[99] The Judge correctly stated the legal test for whether the information contained in the prospectus as to the forecast FY04 revenue figure amounted to a

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58 At [186].
59 At [186].
60 At [192].

misrepresentation.[61] The inclusion of this material as a forecast is, in effect, an inclusion of a statement of the directors' opinion as to the likely performance of the company through to the end of the financial year. Different considerations apply when considering whether a statement of opinion as to future events is untrue as when considering a statement of existing fact. The expression of an opinion can only amount to misrepresentation if the maker of that statement:

(a) did not honestly believe the opinion being expressed; or

(b) had no reasonable basis for that belief.

[100] Although the Judge applied the correct legal test to determine whether the forecasts for FY04 were misrepresentations, it seems to us that the truth or otherwise of the forecast operating revenue was not at issue at trial and certainly is not on appeal.[62] This is because the directors did not claim that, as at June 2004, they had a reasonable basis to believe the forecast total operating revenue for FY04 included in the prospectus would be achieved. Rather, their defence was that, within the context of the company's overall performance, that shortfall figure was immaterial.

[101] In our view the evidence establishes that while the directors may have continued to believe that the forecast was correct as at 5 May 2004, by the time of allotment they knew there would be a shortfall in total operating revenue against that forecast. They decided it was not a material shortfall in itself or in the overall context of the company's performance. Having reached that view, they concluded that the prospectus did not require correction. Their approach was undoubtedly guided by the statutory framework which requires that a prospectus not be distributed if it is false or misleading in a material particular[63] and that securities not be allotted if, at the time of the allotment, the prospectus is known by the issuer or any director to be false or misleading in a material particular.[64] Their conclusion, in substance, was that an investor would not regard the shortfall as material in determining whether or not to proceed with their investment in the company.

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61 At [126].

62 See [124]–[126] citing *David v TFAC Ltd* [2009] NZCA 44, [2009] 3 NZLR 239 at [43]; and *Jagwar Holdings Ltd v Julian* (1992) 6 NZCLC 68,040 (HC) at 68,077.

63 Securities Act, s 34(1)(b).

64 Section 37A(1)(b).

[102] We proceed upon the basis that the statement of prospective total operating revenue for FY04 included in the prospectus was, as at the date of the allotment, an untrue statement. But Mr Houghton must also show that the untrue statement was material in the sense we have described at [69] above. We have to consider whether the notional investor was more likely than not to have taken a different view on their investment decision if the total operating revenue forecast for FY04 had been corrected.

[103] We ask ourselves, as did the directors at the time, how would an investor view this information? Before addressing this point in detail we mention a point taken by the respondents. The information in question was stated in the prospectus to be a forecast only, prepared on the basis of "assumptions as to future events that the Directors reasonably expect to occur associated with the actions the Directors reasonably expect to take as at the date the information was prepared". The investors were advised that there was no present intention to update the information. Investors, say the respondents, would therefore expect variation from forecast and would not expect to be told of minor variations. That analysis is accurate but we consider that it does not take the matter very far. The statutory scheme placed an obligation on the issuer to ensure prospective investors were notified of any material adverse circumstance, including a change of circumstance in the time between registration of the prospectus and allotment of securities. The issue in this proceeding is whether the shortfall was material.

[104] There are a number of factors which have led us to conclude that the shortfall in sales was not material for the purposes of ss 34 or 37A, and that it was also not material in the sense that it would more likely than not have caused an investor to take a different view of their prospective investment in Feltex. We refer to the following factors.

[105] This was a two-month sales shortfall. There was ample evidence that sales figures can fluctuate significantly from month to month and there were explanations for that shortfall which suggested the downturn was temporary. If the market had been provided with the information regarding the shortfall, it would also have been provided with the explanations for it as understood at the time. These included that

March had been a strong month but retailers were taking some time to sell that product through; scheduled plant closures had resulted in Feltex not being able to deliver certain sales orders by the required delivery dates; and unexpected production difficulties, now resolved, had resulted in a $3 million shortfall on sales.

[106] The information that Feltex management was obtaining from retailers caused them to believe that June would be a good month so that the shortfall as against forecast was likely to be partially recovered by a strong performance in June.

[107] The shortfall in sales would not in any event result in a shortfall in EBITDA or net profit after tax.[65] This was in part due to the success of a strategy of changing Feltex's "product mix" away from lower-priced and lower-margin products in favour of higher-priced and higher-margin products. In other words, what was important to the company's performance was not only how much carpet was being sold but what type was being sold. Feltex could make more profit from lower total revenue with the right product mix and although Feltex's sales revenue increased by 3.9 per cent from FY03 to FY04, over that same period the margin earned on sales increased by 13.3 per cent. The Judge commented on this aspect of Feltex's performance:[66]

> [181] In his evidence-in-chief, Mr Thomas produced a table of comparisons with the prior year which showed a 21 per cent increase in premium/mid-product sales for FY2004, an 8.9 per cent reduction in mass sales, and an improvement in margins of 13.3 per cent. The plaintiff did not challenge the evidence given by Mr Thomas and others of this strategy to change Feltex's product mix to improve the margin on goods sold. The extent of those changes reduces the relevance that could otherwise be attributed to the gross sales data in terms of revenue generated and volume of products sold. It means that the company's targets were altered so that comparisons with the prior year were not on a fully like-for-like basis. The relevance of a variance on the opening item in a forecast is lessened by countervailing variances in subsequent items, which mean that the final outcome more or less accords with what was forecast.

[108] The appellant says that investors would have discounted this positive EBITDA figure if they had known it was to be achieved by extraordinary and unsustainable cost-cutting measures: the removal of bonuses for sales staff. But the evidence does not bear that out. The contractual entitlement to bonuses was linked

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65 There was expert evidence supporting the view that EBITDA was the more helpful measure for the prospective investor.

66 HC judgment, above n 2.

to the budget revenue figure. Because the budget revenue figure was not met, the bonuses did not become payable. They were not then removed as part of a cost-cutting measure.

[109] Another argument was that investors would have discounted the positive aspects of Feltex's performance if they had known it was achieved by "emergency-style" sales techniques. It was argued that offering extended credit to retailers was adopted as a strategy to boost or accelerate sales, giving a false impression of how well sales were going — false because they were unsustainable. Because the offering of extended credit was a new practice, it was argued, the results for FY04 were not comparable to any other period.

[110] However, this argument is unsustainable in light of the evidence of Mr Tolan and Mr Magill that the offering of extended credit was not a new practice. Mr Tolan said it was going on when he joined Feltex in 2002. Mr Magill's evidence was that it was a practice that had been employed at Shaw and was brought across to Feltex.[67]

[111] The two-month sales shortfall has also to be seen within the context of a generally improving picture for Feltex in terms of financial performance. At the half-year point at 31 December 2003, Feltex had achieved sales around $5.3 million ahead of the same period the previous year, its EBITDA was ahead by $8.9 million and its profit by $10.2 million. The third quarter to March is also relevant. The actual figures for this quarter were included in the prospectus. They also showed very positive variances to the same point in time in the previous year.

[112] Nor was this, as events transpired, a falsely cheery picture painted by management. June was a good sales month and a good part of the shortfall on sales was made up. More fundamentally, FY04 financial performance showed that EBITDA was 101.2 per cent of the forecast level (42.151 million actual versus 41.641 forecast) and net surplus was 111 per cent of the forecast level (11.183 million actual versus 10.113 forecast).

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[67] The evidence of Messrs Tolan and Magill actually refers to the forward dating of invoices. The appellant says that is a different thing to extended credit sales. We accept the respondents' submission that it is not.

[113] In this context we do not consider that the notional investor would have taken a different view of the investment if advised of the two-month shortfall in sales. They would more likely than not have placed the information within the broader financial picture of a business on an improving trend in terms of margins, EBITDA and profitability, and proceeded with the investment.

[114] The reaction of the market to the announcement of Feltex's full results provides a useful cross-check on this assessment. Expert witnesses Mr Cameron and Professor Cornell gave evidence of the absence of material adverse market reaction to Feltex's 24 August 2004 announcement of the actual sales outcome. Although there was a downward movement in share price, it was small — only four per cent over a two-day period. And there were other aspects of the announcement which could have had this effect. Feltex announced a six-cent dividend per share but also announced it would not carry imputation credits.

[115] Perhaps more significantly, the announcement included a statement that the outlook was for a slow-down in the residential market in the new housing and apartment segments. Certainly, as Mr Cameron records, market analyst reports released after the announcement noted the sales outcome but the analysts did not treat it negatively or alter their earnings forecasts. The appellant called no evidence on this point and did not challenge Mr Cameron or Professor Cornell.

[116] To conclude, by the time of allotment, the statement of prospective total operating revenue for FY04 was an untrue statement for the purposes of s 55. But the Judge had a proper evidential basis for his finding that the notional investor would not regard that shortfall as material in determining whether or not to invest in Feltex.

FY05 projection

[117] The appellant also contends that by June 2004 the directors knew that the factual basis upon which they had completed projections for FY05, included in the prospectus, was wrong. This was because the projected increase in operating revenue for FY05 assumed a one-per-cent growth in the market. But the appellant says the directors knew they had to make up the FY04 shortfall before Feltex even

got to the starting point for the projection of an increase in market share. The board had information that Feltex's share of the Australasian market had been in decline for some time and that FY04 was to be its sixth consecutive year of decline in market share. Given these facts, combined with Feltex's history of falling market share, the directors had no reasonable basis for a belief that the projections would be achieved.

Factual background

[118] The consolidated statements of prospective cash flows and prospective financial position included revenue figures for FY05 that were based entirely on projections. The prospectus qualified the information as follows:

> The prospective financial information for the year ending June 2005 … constitutes a projection as defined in New Zealand Financial Reporting Standard No. 29 … and has been prepared on the basis of a number of hypothetical but realistic assumptions that reflect possible courses of action that the Directors reasonably expect to take as at the date the information was prepared. A projection is not a forecast. The projection was prepared as at 4 May 2004 for use in this Offer Document. … There is no present intention to update this prospective financial information or to publish prospective financial information in the future. No actual results have been incorporated into the projection.

[119] The prospectus stated a number of general assumptions underlying the projection which included an industry assumption that the size of the carpet market in New Zealand and Australia, measured by volume of linear meters sold, would grow over the projected period by approximately one per cent, below the average growth rate over the past 10 years. In relation to Feltex-specific assumptions, under the heading "revenue", the projections were said to have assumed that Feltex's market share would increase by approximately one per cent over the projected period.

Judgment

[120] The Judge reviewed the evidence in relation to how the FY05 projection was prepared and the expert evidence on the validity of that projection. He said:[68]

> [329] From the defendants' perspective, the anticipated shortfall in revenue for FY2004 was not material, and therefore did not trigger a need to

[68] HC judgment, above n 2 (footnote omitted).

> re-assess the reasonableness of the FY2005 projection. Instead, from the directors' perspective, the FY2005 revenue projection had its own integrity, having been built up from thorough work undertaken by management, in light of their reasonable anticipation for Feltex's trading in the ensuing financial year. The work done included taking expert external advice on the market conditions likely to be encountered in FY2005. That advice comprised reports presented at a meeting on 1 April 2004 by BIS Shrapnel, economic forecasters on the Australasian building sector, the Melbourne Institute of Applied Economics on Australian consumer sentiment and from McDermott Miller on consumer confidence in New Zealand.

[121] He noted in particular Mr Houghton's expert Mr Meredith's evidence, which remains a cornerstone of Mr Houghton's case on appeal, that given the continuing decline in Feltex's market share, the directors could not reasonably have held the opinion that the market share would continue to increase. As to this the Judge said:

> [335] As noted, Mr Meredith opined that Feltex's assumption that it would grow market share was not reasonable as a matter of common sense. In cross-examination, Mr Meredith accepted that he had not considered the reasons advanced by defendant witnesses for assuming Feltex would increase its market share in FY2005 and he had not undertaken any analysis of the effect of new tufting equipment that Feltex had acquired, the productivity of which was relied on by those making the assumptions of increased market share. Nor had he considered the 8 April 2004 presentation on the assumptions then being developed for the FY2005 projection, so he was unable to analyse the matters that were taken into account by those who formulated the assumptions.
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> [336] Mr Meredith's opinion could not stand against the thorough defence of the basis on which the projection was formulated in evidence from various defendant witnesses who were subjected to cross-examination about it. In cross-examination, Mr Meredith conceded a lack of appropriate expertise, and that those involved were in a better position to make assessments on the relevant factors.
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> [337] Having regard to all of the information available to the directors at the time the prospectus issued, and in light of the relative thoroughness of the process undertaken to arrive at those projections, I am satisfied that the assumptions relied on, and the projected numbers in the FY2005 projection, were reasonably open to the directors. It follows that they were not misleading.
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> (Footnote omitted.)

Analysis

[122] In our view, the Judge's reasoning cannot be faulted. Mr Meredith had not had the opportunity to consider the evidence as to the way in which the FY05 projections were prepared. Mr Tolan described the modelling approach to the

projections as utilising a bottom-up approach, starting with historical figures and then adjusting those for assumptions. Forecasting data tools were used, based on up to three years of history as to actual volumes sold and a range of assumptions. All data was carefully reviewed by responsible sales managers including for adjustment in relation to assumptions based on actual or anticipated trends which had or were expected to develop. A final review was then performed by senior management of sales-volume value and margins. Mr Tolan explained that when he presented this information to the board in April 2004 the reasons he gave for the projected increases and decreases were:

(a) A projected increase in volume in tufted-wool, rich-blend carpets due to the introduction of new technology, ranges and styles. This was associated with a range of consumer marketing initiatives to improve brand awareness and an increased emphasis on customer support.

(b) A projected increase in volume in solution-dyed nylons, to be produced from four upgraded tufting machines.

(c) A projected decrease in volume in printed and fluid-dyed nylons, as part of a continuing trend toward a shift in volume from lower-end nylon toward textured polypropylene product.

(d) A projected increase in volume in polypropylene carpet. Feltex planned to achieve this by supplementing internal capacity constraints with imported yarn, introducing new textured polypropylene product targeted at the top end of the market and improving methods of production.

[123] Mr Tolan said that, in preparing the FY05 projection, the board also looked at the likely trends of the building sector and consumer confidence. He was asked by the board to arrange independent advice on that from expert economists and that advice gave a generally optimistic view of economic trends over the period covered by the FY05 projection.

[124] Mr Carruthers argues that the Judge failed to consider that, because of sales ground lost in FY04, Feltex had to increase market share by 1.5 per cent, not the stated one per cent, to meet the projections for FY05. This hurdle must be viewed against a background of falling carpet sales, measured in both volume and revenue. But, as the respondents submit, the process utilised in setting the FY05 projections was one of estimating future sales rather than applying a percentage increase to the FY04 figures. The Judge's assessment of Mr Meredith's evidence was fair. As he conceded, he had done no analysis of the business strategies which were the basis on which Feltex was projected to achieve increased sales, of Feltex's production capabilities, or of the information in relation to markets that management took into account. Since he had no knowledge of the process by which the projection had been set, or the information that had been weighed in that process, he could not helpfully comment upon it.

Tufting machines

[125] Before we leave the issue of the truth or otherwise of the FY05 projections, we address one last issue raised on behalf of Mr Houghton. Mr Carruthers argues on appeal that, in coming to his decision that the FY05 projections were not untrue for the purposes of s 55, Dobson J did not analyse or consider significant parts of the evidence. In particular, although the Judge noted that the FY05 projections were built in part upon Feltex's "anticipation of having a market advantage derived from new technology in the tufting machines that were being acquired",[69] he ignored the evidence regarding the failure of the SESS tufters to produce woollen carpet, which is the high-margin product that Feltex needed to increase market share, revenue, margins and profit.

[126] The appellant's case is that the chief executive knew that the SESS tufters were not suitable for the production of wool-mix carpet and he knew this by early 2004. He says Mr Magill referred to it, if only obliquely, in his management interview in April 2004 and again in the DDC meeting on 2 June 2004.

[69] HC judgment, above n 2, at [310].

[127] The appellant says the evidence establishes that in FY04, the first SESS tufter (number 57) was forecast, in the three-month forecast period in the prospectus, to make AUD 1,385,000 from woollen carpet alone. However, in that three-month period, it generated only AUD 868,602 in sales revenue from synthetic carpet. It did not make any woollen carpet in that period.

[128] The appellant says the projection for FY05 for tufter number 57 was for AUD 7,178,000 from woollen carpet. In fact, for that year, it generated only AUD 3,986,000 in sales revenue and then only from synthetic carpet.

[129] In accepting the reasonableness of the FY05 projections, the Judge referred to the directors' assumption of increased market share which relied on changes in Feltex's business and anticipated having a market advantage derived from new technology in the tufting machines that were being acquired.[70] In doing this, it is argued, the Judge ignored the evidence regarding the failure of the SESS tufters to produce woollen carpet.

[130] Mr Carruthers acknowledges that there was no express pleading in relation to the allegation concerning the tufters but says that this was because it was only during the cross-examination of Mr Thomas that the extent of Feltex's reliance upon the tufting machines to meet its sales forecast became apparent.

[131] Mr Carruthers was not, of course, counsel for Mr Houghton in the High Court. On appeal he pulls together several threads of evidence to make this case. He refers to the following passage, which appears in the cross-examination of Mr Magill, in response to a question as to any discussion he recalled at the bring-down DDC meeting on 2 June 2004 regarding the implications of the shortfall in sales for FY04 for the sales revenue projections for FY05. Mr Magill replied:

> I can't remember Mr Forbes but I think Des Tolan might have mentioned somewhere in his evidence that that shortfall was primarily because of two factors Your Honour. One was the new SESS machine, we had technical problems with the first machine. Basically all of the parts, the individual serve motors had to be replaced by the manufacturer and that slowed down product moving to the market, and it was of the order of about $3 million.

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70 See [335].

> So the $3 million of that 7.5 to nine evolved due to that technical difficulty with the machines.

[132] The appellant seeks to link this to a document dated 17 November 2005 in which the author notes that, in October 2005, two SESS tufter machines were used less than five per cent of the time.

[133] The difficulty that Mr Houghton faces with this claim is that he did not plead this allegation. There is no adequate explanation for his failure to do so. His suggestion is that the point only emerged during Mr Thomas' cross examination but the significance of the tufters to the FY05 projections was clear in the written evidence of Mr Tolan, which Mr Houghton had in advance of trial.

[134] The appellant points to some paragraphs in the fourth amended statement of claim as some sort of a foundation for the allegation, the inclusion of which minimises the prejudice to the respondents. But none of the paragraphs referred to comes close to an allegation that the FY05 projection relied upon an unreasonable expectation regarding Feltex's manufacturing capacity, unreasonable because of known difficulties with the SESS tufters.[71]

[135] We have decided not to allow Mr Houghton to pursue this issue on appeal. We acknowledge that the fact a matter is not pleaded is not always an insurmountable barrier to the issue being pursued on appeal. It is, after all, possible to obtain leave to amend a pleading at the appeal stage. No application to amend was made in this case but even if application had been made we would not have allowed it. This is because we are satisfied that to do so would cause unfair prejudice to the respondents. We say that because of the unsatisfactory way in which this issue was advanced at trial and, as a consequence, the unsatisfactory nature of the evidence in relation to the issue.

[136] Mr Houghton's counsel in the High Court did not refer to the issue in opening and no evidence was led in relation to it for Mr Houghton. In preparing their evidence for trial, the respondents had no notice of the issue and therefore no

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71 In oral argument before us, Ms Mills for Mr Houghton directed our attention to [36.1], [42.2], [59], [64.1] and [64.6] of the fourth amended statement of claim.

opportunity to prepare evidence on the point. That is particularly significant where the respondents were giving evidence about events which had occurred 10 years earlier.

[137] Mr Carruthers relies in part on the following answer that Mr Magill gave in evidence in relation to the SESS tufters:

> … [Mr] Tolan might have mentioned somewhere in his evidence that that shortfall was primarily because of two factors Your Honour. One was the new SESS machine, we had technical problems with the first machine. Basically all of the parts, the individual serve motors had to be replaced by the manufacturer and that slowed down product moving to the market, and it was of the order of about $3 million. So $3 million of that 7.5 to nine evolved due to that technical difficulty with the machine. And if my memory [serves] me correct Your Honour, the other difference was translational effects in converting Australian sales into New Zealand dollars.

[138] But in the passages relied upon, Mr Magill refers to problems with servicing the machines and commissioning them. Mr Houghton now seeks to make the point that the tufters were not fit for the purpose for which they were acquired: to meet a new and emerging market. These are two quite separate issues.

[139] The three witnesses who could best give evidence on the issue, Mr Magill, Mr Tolan (the person with primary responsibility for the projections) and Mr Tootell, were not cross-examined on the relevance of performance issues with the tufters to the projections for FY05, nor in relation to the November 2005 document which is now a focus of this argument. Mr Tootell was a senior Feltex manufacturing manager who gave evidence on Feltex's manufacturing strategies.

[140] Mr Tolan's unchallenged evidence was that two new high-tech tufters were installed and commissioned in June 2003 and FY05 was to be their first full year of production. He said both were capable of producing woollen and synthetic carpet.

[141] When the issue was first put squarely, it was during the cross-examination of the non-executive directors: Ms Withers, Mr Horrocks and Mr Hunter. Their answers in that cross-examination do not assist Mr Houghton.

[142] The Judge referred to this criticism of the FY05 projections in his judgment[72] and at a later point in his judgment said:

> [325] Counsel for the plaintiff tested, throughout the hearing, a variety of criticisms relating to the FY2005 projection in a manner that evolved as the hearing progressed. In a number of respects, issues that ought to have been tested with Messrs Magill and Tolan as those closest to the preparation of the projection were not put to them, but were only raised with later witnesses who were quite reasonably unable to respond in detail because of lack of personal involvement in the detailed preparation of the projection.

[143] It is also worth observing that, were we to allow amendment, the state of the evidence is so unsatisfactory that it does not provide a basis for concluding the directors knew that the factual basis upon which they proceeded in relation to the FY05 projections was wrong. The evidence is confused. The November 2005 document is missing every second page and much of the evidence on the point is simply unhelpful to Mr Houghton.

[144] Accordingly, having not pleaded this allegation against the directors, Mr Houghton is now not able to pursue it upon appeal.

SIP grants and page 85 of the prospectus

Factual background

[145] The grants in question were received from the Australian Government under the Strategic Investment Program (SIP) and were included in the prospective financial statements as revenue by Feltex. The SIP was an initiative designed to assist manufacturers faced with a reduction in tariffs and the threat of an increase in imports. The Government helped manufacturers invest in new technology by providing a cash rebate of approximately 40 per cent of eligible capital expenditure and approximately 90 per cent of eligible innovation expenditure, reducing to 80 per cent from 1 July 2005.

[146] Page 50 of the prospectus includes the following information in relation to the SIP grants:

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[72] HC judgment, above n 2, at [316].

> **SIP GRANTS**
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> Feltex has benefited from the Strategic Investment Program, an Australian Government funded scheme designed to foster the development of sustainable, competitive textile related industries in Australia. The Australian Government has announced that the program will extend to 2010. The scheme provides a cash rebate of approximately 40% of eligible capital expenditure and approximately 90% (decreasing to 80% from 1 July 2005) of eligible innovation expenditure incurred in the previous financial year. The cash rebates received by Feltex are included in operating revenue. Feltex received SIP payments of $0.8 million in both of the financial years ended 2002 and 2003 and a further $4.7 million in the 2004 financial year.

[147] Mr Carruthers submitted that the omission to disclose the fact that SIP grants made up to 58.28 per cent of the forecast net surplus (before tax) for FY04 rendered page 85 of the prospectus misleading. He says that, since essentially half of the forecast profit for FY04 was from SIP grants, that fact should have been expressly stated in the prospectus. Although he accepts that all the factual material included in relation to the SIP grants was accurate, the extent of the grants was, on his argument, highly material as it showed that Feltex was heavily dependent upon government grants.

[148] The Judge accepted the directors' argument that the extent of the SIP Grants had to be measured against total revenue and not as a proportion of forecast net surplus as Mr Houghton had argued. The grants made up only 1.4 per cent of total revenue as forecast for FY04. As to that the Judge said:[73]

> [405] The test for disclosure from para 5.5(b) of FRS-29 that was relied on by the plaintiff does relate to contributions to operating revenue. If the SIP grants were assessed in that context, they would clearly not be material. The directors asked rhetorically where disclosure obligations would stop if a 1.4 per cent contribution, albeit unusual, had to be disclosed.

Analysis

[149] Mr Houghton complains that the Judge did not consider the argument advanced that Feltex was reliant upon the grants. But, in our view, the Judge's analysis in relation to this argument cannot be faulted. Mr Houghton's argument is illogical as it compares two quite separate things: a revenue item (SIP grants) and the surplus. As the respondents submit, the same argument for reliance could be made

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[73] HC judgment, above n 2.

with respect to any revenue item, for example one large order of carpet. The materiality exercise that Mr Houghton argues for has to be undertaken on the basis of comparing that revenue item to the overall total forecast revenue for FY04. If that exercise is undertaken, SIP grants constitute only 1.4 per cent.

[150] The disclosure included in the prospectus is thorough and accurate. The disclosure drew attention to the inclusion of SIP grants in operating revenue. And there was no particular reason to highlight these grants as a risk to Feltex's profitability in either the near or medium-term future when, as the prospectus recorded, the grants programme had been extended until 2010.

Second bottom line

[151] Page 85 of the prospectus sets out prospective financial information for FY04 and FY05. As noted, the page contains a line "Net surplus attributable to Shareholders" and below that a line "Net surplus attributable to Shareholders (before amortisation, write-offs and Early Redemption Amount)". It is this latter line which is referred to as the "second bottom line".

[152] Mr Houghton argues on appeal that the Judge was wrong to find that the second bottom line on page 85 was not an untrue statement for the purposes of ss 55 and 56. The expected or standard presentation of financial information of this type is for the bottom line to be net surplus attributable to shareholders, referred to colloquially as statutory profit.

[153] The appellant relies upon the evidence of Professor Newberry that the use of the second bottom line did not comply with Financial Reporting Standards (FRSs). She referred to FRS29 which requires prospective financial information to be presented in the same "format expected to be used in the future for reporting historically oriented" financial statements. None of Feltex's financial statements for the period 2000 to 2005 includes this line. She also said that the use of the line did not comply with FRS2 which states:

> A statement of financial performance contributes to the objectives of general purpose financial reporting by disclosing the net surplus (deficit) and the components of the net surplus (deficit), arising from activities or events

> during the given period that are significant for the assessment of both past and future financial performance.

[154] According to Professor Newberry, this statement and the rest of the presentation and disclosure principles set out in FRS2 make the "net surplus (deficit)", that is to say the first bottom line, the focus of attention. But the setting-out employed by Feltex shifted that focus to the second bottom line. That was inconsistent with the requirements for financial statements and illogical.

[155] It is argued that the second bottom line runs against the logic of the statement of financial performance. The logic involves working down from the revenue figures to see what has been deducted as expenses before reaching the "net surplus (deficit) attributable to shareholders" figure of $10,113,000. Having already shown the expense items deducted in reaching that $10,113,000 net surplus figure, on page 85 the $12,194,000 total of these items[74] has been added back to achieve a second bottom line of $22,307,000.

[156] It is in this context, argues the appellant, that the second bottom line is untrue. It is presented in the place where the statutory profit should be yet is not the statutory profit. It is also untrue because it implies this is the amount attributable to shareholders when it is an amount which can never be attributable to shareholders.

[157] The evidence was that the inclusion of the calculations reflected in the second bottom line had been suggested by one of the JLMs. An email dated 7 April 2004 from Carolyn Steele, one of the team at Forsyth Barr, commented on the prospective financial information in the draft prospectus as follows:

> … it will assist the marketing of the Offer to include normalised EBITA and NPAT figures. We recommend including an EBITA line prior to the Amortisation expenses and also a "Net surplus (deficit) attributable to shareholders of the company (before Amortisation and Bond Call Premium)" as the last line item in the P&L to show a Normalised NPAT figure.

[158] There was no commentary accompanying the table explaining the rationale for inclusion of the second bottom line. Mr Thomas gave evidence that there would have been little point in a footnote explaining the rationale because any reader of the

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[74] Amortisation, write-offs and the early redemption amount.

prospectus who needed an explanation about the inclusion of the second bottom line would be unlikely to go to a footnote.

[159] As to the justification for its inclusion, the respondents' position is that the table on page 85 would have been misleading without it because the penultimate line, showing the forecast FY04 net surplus attributable to shareholders in unadjusted form, would suggest that Feltex was thereafter on a path of very substantial growth when compared with the comparable projected figure for FY05. Taking out one-off costs incurred because of the IPO could reduce that effect and enable the reader of the financial data to better compare the core operating revenues and expenses likely to be generated by Feltex's business on a year-on-year basis.

Judgment

[160] The Judge noted that Mr Houghton's evidence on the second bottom line reflected confusion about the description of what the second bottom line represented and also the difference between the first and second bottom lines. However, he was satisfied that, had this confusion been material to Mr Houghton at the time, a "reasonably careful consideration of the items on page 85" would have led him to understand how the different numbers had been calculated.[75] The Judge said:

> [352] For any reader of the table considering the detail of how the second bottom line differed from the first bottom line, the elements contributing to the second bottom line were sufficiently identifiable. The reference to the items added back as "before" sufficiently signals that the amount specified will involve adding back the amount of the specified items. In this case, it was a matter of adding to the net surplus attributable to shareholders specified in the first bottom line the following amounts:

Amortisation of goodwill	$1,958,000
Write-off of bank facility fee	341,000
Write-off of bond issue costs	4,881,000
Early redemption amount	5,014,000
Subtotal	$12,194,000
Added back to the net surplus attributable to shareholders (First Bottom Line)	10,113,000
Total (Second Bottom Line)	**$22,307,000**

75 HC judgment, above n 2, at [351].

[161] The Judge rejected the contention advanced for Mr Houghton that the presentation on page 85 breached any relevant accounting standard.[76] He also accepted the evidence of a number of defence witnesses that the second bottom line was helpful to sophisticated readers of the prospectus because it reflected a calculation that they would be likely to undertake in analysing the prospective financial information.[77]

[162] The Judge concluded on this issue as follows:

> [369] I accept the criticisms advanced by plaintiff's experts that the inclusion of the second bottom line created a risk of misleading cursory readers of that table in the prospectus. Certainly, the rationale for the inclusion of the second bottom line would have been made much clearer by a footnote describing what had been done in its presentation, and why. I do not accept Mr Thomas's reason for rejecting such an addition, and I am satisfied that the table would have had more utility for unsophisticated readers if a footnote explained that the second bottom line constituted a form of adjusted or normalised earnings for Feltex, and that the items added back were either non-recurring, or a non-cash item.
>
> [370] However, the standard by which the prospectus is to be judged is not that of the highest clarity or greatest understandability. I am not satisfied that the inclusion of the second bottom line would mislead the notional investor as I have characterised that audience for the prospectus. A majority of careful non-sophisticated investors would at least understand how the number had been arrived at, even if they did not appreciate (without taking advice) why it had been done. The category of those who could be misled is therefore confined to readers less careful than the notional investor.

[163] The Judge also accepted an argument advanced for the directors that any content of page 85 required a basic level of accounting skills for the information to have any utility to the reader, for example, the concept of amortisation.[78] The Judge continued:[79]

> I accept that as a further point supporting an assessment of this criticism by the standard of readers who either have sufficient understanding of the presentation of financial statements to understand the rationale for the second bottom line, or are sufficiently careful in their consideration of that page to seek advice as to what was conveyed by the second bottom line, to the extent that they did not understand it.

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76 At [356].
77 At [362].
78 At [371].
79 At [371].

Analysis

[164] We are not persuaded that there is any basis upon which the second bottom line could be characterised as misleading. It might have been better to include an explanation of the rationale for its inclusion and that might have provided useful context, as the Judge observed. But the issue is not whether a statement is expressed in the most understandable form. Rather, it is whether it is untrue.

[165] As the Judge said, the material presented in the table on page 85 is self-explanatory. It is factually accurate. Mr Houghton's case is really that because "bottom line" is an everyday expression, and the last line on a set of accounts is usually where that bottom line is set out, the second bottom line is untrue as misleading in this context. But that argument assumes a reader who does not read the description alongside the line — a cursory reader. The cursory reader is not the standard against which the truth or otherwise of a statement is to be judged. The notional investor was given enough information in the accounts themselves to accurately and adequately convey to them what was set out in the second bottom line.

[166] The evidence also does not support the appellant's submission that the only reason for the inclusion of the second bottom line was the marketing angle. Mr Thomas was clear that one of the reasons for its inclusion was a concern that the prospectus would have been misleading without its inclusion, as it would have given an impression of a 230 per cent increase in earnings and profit from FY04 to FY05. We see the logic in this.

[167] We also consider that, on balance, the expert evidence supports the Judge's view that the use of the second bottom line did not breach accounting standards. Professor van Zijl, a former chair of the Financial Reporting Standards Board, gave evidence that the inclusion of a second bottom line complied with the relevant accounting standards. In fact Professor van Zijl said that accounting standards endorse the use of normalised profit figures, citing in particular NZ IAS 1, the general standard governing presentation of financial statements which provides: "Additional line items, headings and subtotals shall be presented on the face of the

income statement when such presentation is relevant to an understanding of the entity's financial performance." Professor van Zijl said, if he were preparing the accounts, he would have included the second bottom line and made further adjustments to further normalise the figures. As to the particular way in which the information was depicted, he expressed the opinion that a person who was going to benefit from reading the material could not possibly be confused by it.

[168] Mr Cameron described a number of other prospectuses in which adjustments were made to the historical information to remove from it the financial impact of events that were either one-off or discontinued. He said this normalisation allows a more useful comparison between historical performance and the projections of future performance. The appellant says it is telling that none of the prospectuses that Mr Cameron referred to uses the second bottom line in the form it was utilised by Feltex. We do not see that as telling. Mr Cameron describes various depictions and explanations of normalised figures. There appears to be a wide variety. There is no one standard applied.

[169] The appellant's expert, Professor Newberry, made clear in the course of cross-examination that she did not, at that point, view the inclusion of the second bottom line as a breach of the financial standards. She said, however, it was not in keeping with the spirits of those standards, a view with which Professor van Zijl disagreed. The Judge was entitled to prefer Professor van Zijl's evidence on this point, in light of his very particular expertise in the area.

[170] Professor van Zijl also rejected any notion that presenting the information by way of the second bottom line was illogical. For the reasons we have set out earlier, we are satisfied he is correct in this. There was good reason for its inclusion and the manner in which it was set out in the table made it easy to understand how it was arrived at.

[171] As to the criticism that the second bottom line was not and could never be attributable to shareholders, that much was plain on the face of the explanation as to how the figure was arrived at. And there is also some force in the respondents' observation that the unadjusted net surplus figure is not used as the basis of

dividends. The extent to which surplus is available for distribution is determined by the dividend policy. Feltex's was set out at page 124 of the prospectus. It was to the effect that, subject to consideration of various matters including current and projected operating performance and Feltex's capital requirements, "the Board intends to declare dividends in the order of 75% to 80% of the net surplus after income tax (before amortisation and equity earnings of [associated companies])".

[172] Finally we comment on the ground of appeal which flows from the Judge's description of the behaviour to be expected of the notional investor. We do not consider that the Judge's findings turned upon his expectation that the notional investor would seek clarification if confused. The Judge said while the cursory reader might be misled by it:[80]

> [a] majority of careful non-sophisticated investors would at least understand how the number had been arrived at, even if they did not appreciate (without taking advice) why it had been done.

[173] The point is the fact the notional reader may not understand why information has been included does not make it misleading, the issue is whether they were misled by it. The Judge's finding was that they would not have been. It is a finding we have also reached.

JLMs' proposal to pay $9 million dividend for FY04

[174] Mr Houghton's argument on this point has evolved throughout this proceeding. There is no allegation in the fourth amended statement of claim that the prospectus contained an untrue statement in relation to the plan to pay a $9 million dividend in September 2004 following the IPO. But it was nevertheless argued at trial that the following statement included within the prospectus, describing how funds raised through the IPO were to be used, was untrue:

> Feltex will use the funds received from the issue of Shares by Feltex pursuant to the Offer to assist in funding the redemption of the Bonds.

[175] This statement was untrue, it was argued for the appellant, because the size of the IPO was increased to fund a larger dividend than originally proposed during the

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80 HC judgment, above n 2, at [370].

initial planning stages of the IPO. It follows, goes the argument, that if the IPO had to be increased to enable the dividend to be paid, then the increased amount is being used to fund the dividend, rather than to repay bonds.

[176] Dobson J found that the statement in the prospectus was not untrue as the funds raised on the IPO were used to redeem bonds.[81] He also rejected the argument for Mr Houghton that the IPO was increased to fund the increase in the dividend.[82]

[177] On appeal Mr Houghton maintains the argument that the amount to be raised on the IPO was raised from $40 million to $50 million to fund the increased dividend. In his counsel's written submissions, the focus of argument is that the prospectus omitted information that Feltex planned to utilise funds raised from the primary offer to pay the proposed $9 million dividend in September 2004. This was a critical point, he argues, as no investor would want to fund their own dividend.

[178] In argument before us, Mr Carruthers did not expressly eschew the argument that funds raised on the IPO were used to fund the dividend but nevertheless focused upon the causal connection between the decision to increase the dividend and the decision to increase the IPO. Because of that causal connection, it was said, there should have been disclosure that the IPO was increased by $10 million to enable the dividend to be paid. That omission rendered the prospectus misleading.

[179] The respondents maintain the objection they raised in the High Court: this allegation was not pleaded and this Court should not deal with it. In any case, they say that none of the appellant's arguments that the IPO funded or at least was increased to fund the dividend, and that the statement in the prospectus was misleading, has merit.

Discussion

[180] The respondents are correct that there is no pleading of this particular allegation. The fourth amended statement of claim included a factual narrative in

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81 At [457]–[458].
82 At [462].

relation to the payment of the dividend but the relevant part of the pleading related to allegations about the role played by the JLMs. An allegation of this nature, that the directors and JLMs were party to and should be liable for an untruth, should have been expressly pleaded. The failure of Mr Houghton to plead the allegation meant that the issue was not addressed by the witnesses in their evidence-in-chief and only covered in cross-examination. Given the serious nature of the allegation, that was unsatisfactory. Mr Houghton did not seek leave to amend the pleading in the High Court.

[181] We have no doubt that the directors would have been prejudiced in their ability to address fairly this issue in their evidence, given the lack of notice of the issue and the time gap between the events on which they were cross-examined and the hearing. We consider that Mr Houghton should not have been able to argue this point without a pleading to which it could be moored. We mean no criticism of Dobson J when making this observation. As he makes clear in his judgment, the plaintiff's case shifted considerably during the course of the hearing and the Judge was attentive to the need to ensure that both Mr Houghton and the respondents received a fair hearing. As it happened, on the view he took of the facts, the respondents were not prejudiced in the outcome by the failure to plead the point.

[182] The point is now pursued on appeal, again without a pleading. We record our view that, even if Mr Houghton had sought leave to amend his pleading on appeal, leave would not have been granted. We say this because the allegation is without merit; the statement Mr Houghton highlighted as untrue, set out above, accurately describes how the funds raised in the IPO were applied. The bonds were repaid around the date of the allotment: 2 June 2004. By that date the money raised in the IPO was effectively spent and on the very thing the prospectus represented it would be spent.

[183] The information included in the prospectus in connection with the dividend was also accurate and described all material information. We adopt Dobson J's summary of that information:[83]

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[83] HC judgment, above n 2.

> [446] At page 11, the prospectus included a table headed "… FY2005 Projected Implied Multiples and Yield". A note to that table set out the projected interim and final dividends for Feltex's 2005 financial year. That note added:
>
>> In addition, a cash dividend of $9.0 million is projected to be paid in October 2004 in respect of the year ending 30 June 2004.
>
> [447] That component of the projected dividends was not relied on in calculating the implied multiples and yield in the table.
>
> [448] In the statement of prospective cash flows at page 86, the FY2004 forecast indicated that there would be no dividend paid to the shareholders before 30 June 2004 and the FY2005 projection indicated dividends of $16.806 million. The notes to prospective financial information including that prospective cash flow stated, at page 92:
>
>> A dividend of $9.0 million in respect of the period ending June 2004 is projected to be paid in October 2004. Thereafter dividends are assumed to be declared in line with the Feltex dividend policy as set out under the heading 'What returns will I get?' on pages 123 to 125 of this Offer Document. An interim dividend of $7.8 million in respect of the year ending June 2005 is projected to be paid in March 2005.
>
> [449] The "Answers to Important Questions" section of the prospectus under the heading "Dividend Policy", specified:
>
>> Feltex's dividend policy is to declare dividends after due consideration of the current and projected operating performance, financial position, cash flows and capital requirements of Feltex at the time of declaration of the dividend. Subject to these considerations, the Board intends to declare dividends in the order of 75% to 80% of the net surplus after income tax (before amortisation and equity earnings of associates) …
>>
>> The Board of Directors reserves the right to amend the dividend policy at any time.
>
> [450] The statement in respect of dividend policy also acknowledged a constraint imposed by the ANZ Bank as Feltex's banker that the company would not pay a dividend without the bank's consent if the ratio of total debt to EBITDA exceeded 3.2 times at any time in or before June 2007, and that Feltex was also constrained from paying a dividend if it was in default of its banking facilities.
>
> (Footnote omitted.)

[184] We also consider the Judge was correct to find that the evidence does not establish, as the dominant reason for the increase in the IPO, the need to fund the increase in dividend. The background to this issue is as follows. Mr Thomas' evidence was that the JLMs were keen for a dividend to be paid for the period to 30 June 2004 because that would assist the marketing of the issue. In April 2004

Feltex's board proposed a dividend of $5,500,000 payable in September 2004. However, in the course of discussion in April among the JLMs, the chairman of the board and CSFB, the September/October proposed dividend was increased to $9 million. Mr Thomas' evidence was that this proposed dividend of $9 million was consistent with Feltex's dividend policy explained in the prospectus.

[185] Mr Houghton relied upon an email sent by Mr Saunders to all other board members following the board meeting on 27 April 2004, to support his contention that the IPO was increased to fund the increased dividend. That email included the following:

> Ron [Mr Millard of Credit Suisse] and I were convinced that there is merit in paying the 2004 related dividend at the $9 million level recommended by the JLMs. Following intense discussion of the possible source for the increased dividend, and a firm position by Feltex that it would not be possible or appropriate to increase debt, it was agreed that the size of the primary offering would be increased from $40 million to $50 million. A decision was required immediately, in order to process the changes to the numbers in both the road show slides and the prospectus. In order to prevent a delay to the IPO, and with the concurring view of the shareholder, I agreed to the strategy last night without the ability to discuss the decision with the Board.
>
> The impact on the balance sheet and financial pos[i]tion of Feltex is relatively unchanged. Paying a $9 million dividend and raising $10m of additional equity leaves Feltex with $1 million more equity. When that is netted against the costs that Feltex is paying for the brokerage associated with the primary (of $1.75 million) the result is $750 thousand of increased debt. The CFO is comfortable with this increase in debt and also comfortable that ANZ will not object to the increase.

[186] Mr Thomas was cross-examined in relation to this email. He said that Mr Saunders was wrong: "he's been a bit quick in his statement that we need to lift the primary offer by $10 million to pay a dividend is just wrong". Mr Thomas' evidence was that Feltex had the debt capacity to meet the dividend so that they did not have to increase the IPO to meet the dividend. His evidence on that point was not challenged. He claimed to have supported the increase in the primary offer because he wanted to get the debt-to-equity ratio below 2:5. Mr Thomas also made the point that there was no logic in increasing the IPO by $10 million to fund an increase in the size of the dividend of $3.5 million.

[187] When Mr Saunders was cross-examined in relation to the email, he made clear he did not accept that it accurately recorded the connection between the increase in size of the dividend and the increase in size of the IPO. He said there were two different meetings, and Mr Thomas had already negotiated an increase in the size of the IPO and briefed him on it before Mr Saunders attended the meeting with the JLMs and agreed to the increase in dividend.

[188] The Judge accepted Mr Thomas' evidence on this point. He said that since the increase in the dividend was only $3.5 million it was unnecessary to raise the size of the IPO by $10 million to facilitate funding for the increase.[84] He accepted Mr Thomas' recollection that the size of the IPO was increased to enable further reduction in Feltex's debt, which would have the effect of strengthening its balance sheet. We agree with this finding, and for the reasons the Judge gave.

[189] Dobson J also observed that even if the $10 million increase was, in part, to fund the increased dividend by creating additional head-room that was not material information which required disclosure as it could have made no difference to an investor.[85] He said:

> [464] If there had been an amended statement to the effect that Feltex would use the funds raised in the IPO to repay debt raised by the prior bond issue, and for working capital purposes, that would not have made the investment proposition materially different. Money is fungible, and there was no suggestion that a portion of the proceeds would be earmarked in early June for use to pay dividends in October 2004. The notional investor would not treat the investment proposition differently whether advised simply that the proceeds of the offer would be used to repay the bonds, or that the proceeds would be used for that purpose, and to reduce other debt, or for working capital purposes.

[190] We agree that, even if it were true that the size of the IPO as initially planned was increased to fund an increased dividend, there would be no need for the promoters of the IPO to acknowledge this. The narrative of how the IPO came to have its particular shape is not part of the required disclosure and for good reason. The investment proposition made in the prospectus has to be assessed on its own

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[84] HC judgment, above n 2, at [457].

[85] At [461].

terms. The fact that investment might have been offered on different terms is irrelevant and the inclusion of such a history of the IPO could only create confusion.

Equity incentive plan

[191] Directors and senior employees of Feltex had, prior to the IPO, been participating in a long-term equity incentive plan (EIP) whereby performance was incentivised by the allocation of shares. It was proposed that participants in that scheme could acquire shares from the vendor under the IPO. The implications of this for prospective investors in the IPO were described in the prospectus as follows:

> Under the Offer, 113,523,100 Shares will be sold to members of the public in New Zealand, Bondholders with New Zealand addresses and institutional investors in New Zealand, Australia and potentially elsewhere. Conditional on the Offer closing, the remaining 6,476,900 Shares held by the Vendor will be acquired (directly or indirectly through associates) by Directors (except for Ms. Joan Withers) and Senior Managers of Feltex (the 'Participants') for **consideration equal to the Retail Price**. Such Shares are not available for application under the Offer. Accordingly the Participants and Senior Managers (or their associates) will collectively acquire a minimum of approximately 5.4% of the Shares currently held by the Vendor.
>
> The Participants have been participating in a long term equity incentive plan ('the Plan') with the Vendor. The Plan is realisable in the event of a trade sale or IPO of Feltex. Pursuant to the Plan, the Participants can receive from the Vendor proceeds which will exceed the cost of the Shares that each Participant will acquire from the Vendor.
>
> Therefore, the Shares to be acquired by the Participants will be **purchased** from the **acquiror's own cash resources** or **from the proceeds received from the realisation of the Plan**, or, alternatively, **the consideration for the Shares may be satisfied by conversion of rights under the Plan**. The Participants will collectively acquire Shares with a value equal to approximately half of the benefit received by them, collectively, from the Plan.

[192] We have bolded the particular statements Mr Houghton says are untrue. He says the consideration participants in the scheme had to pay for shares was not "equal to the Retail Price". The retail price for the shares was fixed (through the book-build process) at $1.70, but the manner in which directors and senior managers acquired the shares allocated to them through the EIP meant the cost to them of taking up the shares in the IPO was 33.87 cents, not $1.70.

[193] Mr Houghton also says it is untrue that directors and senior managers were intended to or did purchase the shares with their own cash resources, or from proceeds realised in the plan or conversion of rights under the EIP. The settlement that was reached with the directors in respect of the purchase of the shares was, according to Mr Houghton, carefully structured to avoid disclosure that the share-purchase transaction, and the cash proceeds of $7,734,773 required for it, was 100 per cent funded from the proceeds of the sale by the vendor of Feltex shares to the public.

[194] This was material as the prospectus thereby overstated the level of commitment that directors and senior staff were making to Feltex post IPO, clearly a material consideration for prospective investors.

Judgment

[195] Dobson J rejected Mr Houghton's argument that the participants in the EIP were paying a different amount to the price paid by the public for the shares acquired in the IPO.[86] He also rejected the argument that the directors were not in reality paying the same amount as the other shareholders because their commitment was funded for them by Credit Suisse.[87] He said that while funds flowed from Credit Suisse, that was in respect of entitlements which the directors and senior management had earned and for which they had previously contracted with Credit Suisse.

[196] The Judge was satisfied there was no scope for finding that the notional investor would be materially misled as to the relative strength of the directors' commitment by the description of the proposed share purchases.[88]

Discussion

[197] Mr Thomas' explanation of the operation of the EIP was not challenged in cross-examination. It was as follows:

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86 HC judgment, above n 2, at [494].
87 At [480].
88 At [494].

> The options held under the plan had a value equal to the value of a Feltex share, less the exercise price under the option which was payable by the option holder. So at an issue price of $1.70 and a post-split exercise price of $0.1625, each option had a value to the option-holder of $1.5375. This was the option-holder's return from the option plan. When an option holder converted the option for a share, the consideration for the conversion was therefore equal to the offer price – consisting of the exercise price of $0.1625 plus the value of the option of $1.5375. Alternatively, where the options were cancelled, the option-holder received an equivalent cash payment per option with a deduction for IPO costs. This is why the prospectus states at page 59 that the shares acquired under the option plan would be acquired "for a consideration equal to the [Retail] Price" and goes on to explain that "the consideration for the Shares may be satisfied by conversion of rights under the Plan".

[198] In the face of this unchallenged evidence, the appellant's argument that directors and senior managers paid a lesser price than subscribers to the IPO cannot be sustained.

[199] The allegation that the directors and senior managers did not pay for the shares from their own resources is also without foundation. This proposition derives from an email from Mr Saunders to Mr Mangini at CSFB. Issues had arisen between the directors and CSFB regarding the JLMs' requirement that directors commit to holding shares they were to acquire in Feltex for a period following the IPO. Directors had agreed to that requirement but were concerned they would have to pay for the shares before they received a payout of their options under the EIP and with no certainty as to when they would receive that payout. In the email Mr Saunders records an agreement reached between directors and CSFB to resolve these issues. It was agreed that CSFB would utilise funds received as vendor of shares through the IPO to pay for the purchase of each director's options. The funds for each purchase were to be paid into a trust account in the name of each director, controlled by the solicitors for CSFB. The solicitors would then have the director's irrevocable authority to use the funds to subscribe for shares under the IPO. Any remaining funds would be paid to the director.

[200] This arrangement does not mean that the purchase price was "funded by Credit Suisse". As Mr Saunders said under cross-examination, "I don't think funded by Credit Suisse is the right term sir. I think Credit Suisse owed us money, under the

plan, part of the funds of that plan we agreed that they would go into shares, nothing more than that."

[201] The arrangement that Mr Saunders describes in his email and in his evidence is no more and no less than the directors paying for the shares but by means of directing that money owed by CSFB to them pursuant to the EIP was to be applied in satisfaction of the share purchase. This arrangement was the directors' money being applied in satisfaction of the share price.

[202] In any case, as the respondents submit, the evidence at trial was that some directors paid for the shares or paid the exercise price in cash from their own resources outside these arrangements. Mr Thomas converted all his rights under the plan to shares. Mr Horrocks' evidence was that he paid the entire purchase price for his shares from his own resources.

[203] In short, there is nothing untrue in the statements in the prospectus in relation to the EIP. Nor do we consider that anything should have been added to make the position clearer. The position as recorded in the prospectus was accurate and complete.

Conclusion on factual grounds of appeal

[204] Having considered each of the alleged bases upon which the prospectus contained untrue statements, we have reached almost the same conclusion as did the trial Judge. The only point upon which we differ from him is that we do not consider that the statement in relation to forecast revenue for FY04 can be characterised as a true statement (if indeed that was what the Judge found). In our view the statement was untrue but, we add, the untruth of that statement does not assist the appellant's case as it cannot be said to be a material misstatement in the sense described above at [69]. On this last point we agree with the Judge.

Ground of appeal: Due diligence defence

[205] In the High Court, the directors relied on s 56(3)(c) of the SA in respect of liability under s 56(1). Section 56(3)(c) provides as follows:

> (3) No person shall be liable under subsection (1) in respect of any untrue statement included in an advertisement or registered prospectus, as the case may be, if he or she proves that—
>
> …
>
> (c) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he or she had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true; …

[206] This point was argued as a fallback to their primary argument that there were no untrue statements in the prospectus. Section 56(3)(c) was colloquially referred to in the proceeding as the due diligence defence.

[207] Although the Judge said that the plaintiffs had failed to establish any untrue statements, he would record his views on the defence because of the substantial argument he had heard on the point.[89] He said:

> [534] The application of the due diligence defence would require a case-by-case consideration of the reasonableness of the belief claimed by each defendant, in relation to any particular content that was found to be misleading. That is not a step I need to take. At a level of generality above that specific consideration, however, I take the view that all the relevant components of the process by which the prospectus was settled were undertaken sufficiently thoroughly, and with the application of genuine consideration by those involved, so as to justify findings that the defendants could indeed prove that they had reasonable grounds for belief in the accuracy of what was produced.

[208] Ms Mills for the appellant argues that the Judge was wrong to find that the defence would have been available to the defendants. The respondents had to show positively they had reasonable grounds to believe an untrue statement was true on 5 May 2004, when the prospectus was issued, and still believed it was true as at 2 June 2004 when the offer closed and the shares were allotted. Taking as an example the shortfall on revenue forecast for FY04, it cannot be disputed that as at the date of the allotment of securities under the prospectus the directors had no reasonable grounds for believing that the forecast revenue for FY04 would be met. In those circumstances, the appellant argues the directors could never make out the case that they believed the statements were true.

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[89] HC judgment, above n 2, at [542].

[209] We agree the s 56(3) defence is not, by its very terms, available to those who know a statement is untrue but fail to correct or withdraw it because they believe it to be immaterial. Section 56(3) only provides a defence to those who believed at the relevant time that the statement was true and had reasonable grounds for that belief. If the defendant knew the statement to be untrue but wrongly considered it immaterial, then s 56(3) has no application. A defendant cannot escape liability if he or she knew a statement to be untrue, even if the defendant had reasonable grounds to believe it immaterial.

[210] This approach is consistent with the overall scheme of the legislation. For example, s 58 which creates an offence for misstatement in an advertisement or prospectus, provides that a person shall not be convicted of an offence under s 58 if they prove "*either* that the statement was immaterial or that he or she had reasonable grounds to believe … that the statement was true".[90]

[211] Ms Mills also argues that the respondents' consideration of issues connected with the allegedly untrue statements was inadequate to provide them with reasonable grounds for belief in the truth of the statements. As the Judge observed, it is not possible to meaningfully address the availability of the defence in the hypothetical. Although we have found one allegation made out that a statement was untrue (concerning the forecast revenue for FY04), we also found that untruth was not material and so could not give rise to liability under s 56.

[212] The appellant's point is well made that, when considering the defence, it is important to focus upon the substance of what a defendant knew and the steps they took to satisfy themselves as to the truth of a particular statement. We also accept the submission that a due diligence process, however sophisticated and perfect in conception, may not suffice unless it is rigorously applied to the content of the prospectus and with a proper understanding of and focus upon the purpose of the process.

[213] We observe, however, that our review of the evidence suggests a due diligence process which was thorough in both its conception and execution. The

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90 Securities Act, s 58(2) (emphasis added).

evidence we have seen suggests the process was engaged in wholeheartedly and with a clear understanding of its purpose by the members of the DDC, those they interviewed and engaged with in the course of the process, and the board. Whether this process was sufficient to provide a "reasonable grounds to believe" defence is an issue we cannot sensibly consider in the absence of a proved material untruth.

Ground of appeal: Judge erred in definition of promoter

[214] Section 56 of the SA extends liability for misstatements in a registered prospectus to "every promoter of the securities".[91] Promoter is defined in relation to securities offered to the public as follows:[92]

> **promoter**, in relation to securities offered to the public for subscription,—
>
> (a) means a person who is instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public; and
>
> (b) where a body corporate is a promoter, includes every person who is a director thereof; but
>
> (c) does not include a director or officer of the issuer of the securities or a person acting solely in his or her professional capacity

[215] Mr Houghton alleged that each of First NZ and Forsyth Barr (the JLMs) and CSAMP were promoters, and now on appeal contends that the Judge erred in holding otherwise.

[216] Promoters are required to be named in the prospectus.[93] CSPE was named as the promoter in this prospectus.

JLMs' role

[217] The JLMs were formally engaged by letter of 4 May 2004 "to provide investment banking and broking services". There was evidence that the terms of the letter of engagement were typical for an IPO transaction.

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91 Section 56(1)(d).
92 Section 2.
93 Section 41(b)(ii).

[218] The JLMs' role was to act as organising brokers to the listing. As part of those services the JLMs were to provide listing services. NZX Listing Rules at the time required that an application for listing on NZX be made through a primary market participant and the JLMs, as authorised primary market participants, were appointed organising brokers for that purpose. The JLMs were also to advise on regulatory requirements and liaise with regulatory authorities.

[219] The JLMs were to provide investment-banking services which included assisting in defining a structure for both the listing and the offering of the securities "that satisfies the issuers' requirements, conforms to applicable legal and regulatory requirements and is acceptable to investors". This role included:

(i) Providing input into the content and structure of the prospectus and investment statement.

(ii) Assisting the issuer to plan and coordinate a due diligence investigation of Feltex. The JLMs were to attend meetings of the DDC as observers only.

(iii) Advising and assisting in connection with the structuring of the offering, including the structuring of a proposal and process to exchange bonds for securities issued through the IPO. This was referred to in the prospectus as the "enhanced priority offer" and entitled bondholders to exchange all of their bonds for shares in the IPO at a price of 95 per cent of the retail price. The JLMs were also to advise and assist in structuring the process by which existing bondholders exercise their existing rights to subscribe for securities in the IPO, referred to as the "priority offer".

(iv) Managing the book-build process and providing final recommendation to the issuer on price.

[220] The letter also recorded that :

> … the Issuers will remain solely responsible for the underlying business decision to proceed with the Listing and the Offering.

[221] Each JLM agreed to take a firm allocation of shares. In addition they agreed to take a further allocation, which was referred to as the "bond shortfall amount" (BSA), up to a maximum of $30 million. The BSA was calculated by deducting from the outstanding principal amount of all bonds, both the principal value of bonds to be exchanged in the enhanced priority offer and the aggregate price of all securities subscribed for by bondholders pursuant to the priority offer. This was, in substance, a commitment to make up a shortfall if bondholders did not elect to convert their bonds for shares or subscribe for securities in the IPO at the desired rate.

[222] The JLMs were compensated for their services and the firm-allocation commitments (including the further commitment to take the BSA) by the payment of fees, brokerage and the payment of a discretionary incentive fee. The lead-management fee was fixed as a percentage (0.75 per cent) of the aggregate amount of securities allotted pursuant to the IPO, excluding securities allotted to directors and senior management. The self-explanatory firm-allocation fee and bondholder-priority-offer fees were fixed by reference to a percentage of securities allotted pursuant to the firm allocations and the priority offers.

[223] CSAMP and Feltex also agreed to indemnify the JLMs for any losses, claims, damages, fines or penalties arising out of the JLMs' performance of the agreed services, or the acts or omissions of CSAMP or Feltex or any entity acting on their behalf.

[224] Either party could terminate the agreement with or without cause and at any time.

[225] The JLMs were listed in the directory to the prospectus as "Organising Participants and Joint Lead Managers".

Judgment

[226] As to the definition of promoter and its application to the JLMs the Judge said:[94]

> I consider that the wording of the definition contemplates both a relatively close measure of personal involvement, and a level of authority enabling any promoter to have, or at least to share, a measure of control over decisions as to the form and terms on which the offer of securities is made. Those who participate at the direction of others are likely not to be instrumental in formulating the plan for the IPO if their advice on material points of the plan can be rejected by the vendor or the issuer. As submitted for ForBar, a person who is "instrumental" will generally have been an important contributor to the offer being initiated, exercise significant decision-making power, and have responsibility over the form and execution of the offer.

[227] The Judge then found that, because the JLMs did not share the power to make relevant decisions, they were outside the "contemplation of the primary element of the definition of promoter, namely those who were 'instrumental'".[95] Their involvement was limited to making recommendations and they always had to take instructions from Credit Suisse and Feltex.[96] Some of their recommendations were rejected. He saw their role as "organising participants" as irrelevant, since that was simply a requirement of the NZX Listing Rules.[97] The existence of the indemnity did not indicate that they saw themselves as promoters. There were numerous prospects for liability to arise beyond the risk of being labelled a promoter.[98]

[228] He said there was an additional reason the JLMs were not promoters: in helping to design the offer to the public they were acting solely in their professional capacity, one of the statutory exclusions in the definition of "promoter".[99]

Argument on appeal

[229] Ms Mills for the appellant argues that the definition of the word promoter in the SA turns upon the concept of instrumentality not decision-making power and that, by settling upon the latter, the Judge applied a narrower definition than the plain

94 HC judgment, above n 2, at [580].
95 At [583].
96 At [581].
97 At [584].
98 At [585].
99 At [596].

meaning of the SA requires. To be instrumental does not require decision-making power or even control. Rather, the emphasis from the ordinary meaning of the word is on participation in pursuing a goal, which clearly was the JLMs role. In terms of the approach to interpretation described by the Supreme Court in *Hickman,* the existence of specific exemptions to liability is a clear indicator that a narrow approach to interpretation of the definition should not be adopted.

[230] The appellant argues that the JLMs were clearly instrumental in formulating the plan or programme through which securities were offered to the public. They helped develop the plan, and assisted in designing its structure and the marketing strategy accompanying it. Their participation was critical to the formulation of the offer because of their firm commitment to each acquire $40 million of shares (on the basis they could each find buyers for them) and their partial underwrite of priority offers to holders of the existing bonds that had been issued in 2003.

[231] The appellant says that, in reality, the nature and extent of the JLMs' participation in the formulation of the plan was such that they did, in any event, exercise de facto control over the shape and structure of aspects of the offer. They achieved de facto control because their participation was critical to the offer. A threat to withdraw, unless the offer was structured in accordance with their wishes, could be just as effective a means of control as the more direct control exercised by the directors of Feltex. When the JLMs' advice was not initially accepted on what they saw as critical matters, they threatened to withdraw their participation unless their advice was followed. Ms Mills points to the following part of an email from Mr Thomas to the other directors on 22 February 2004 as evidence of the use of a threat to withdraw:

> The Lead Managers have placed a requirement on the IPO proceeding that at least 50% of the shares that Participants (employees and Directors) obtain under the CSFB existing plan, via the exercise of their options, be held by the Participants for at least 12 months.

[232] Similarly, around 22 February 2004, Mr Thomas wrote to Mr Horrocks saying:

> The brokers are prepared to proceed with the IPO if Participants hold 50% of the shares that they acquire from the exercise of their options against CSFB …
>
> This is an issue for the Participants. If they want an IPO to proceed they are going to have to address the brokers concerns.

[233] The prospectus then recorded the resulting agreement between the JLMs and directors, by which directors agreed to a "lockup" of the shareholding they acquired through exercise of their options under the EIP:

> Each non-executive Director has agreed (directly or indirectly through associates) with the Joint Lead Managers that, for 12 months until 2 June 2005, these Shares may not be transferred without the prior written consent of the Joint Lead Managers …

[234] The appellant argues further that the professional-advisor exception does not and cannot apply to the JLMs. It cannot apply because, from the statutory language employed, it is clear that the professional-advisor exclusion only applies to natural persons and not companies. Further, it does not apply because the JLMs were not acting solely in their professional capacity; they were financially interested in the outcome through the firm commitment they had made and through the underwrite. They were commercially indispensable to the entire scheme and because of this they were able to, and did, exercise control through the threat of withdrawal from it.

[235] Mr McLellan for the JLMs supports the Judge's reasoning. He says it is reasonable to assume Parliament had in mind the long-standing judicial interpretations of the term promoter when it enacted the definition in s 2 of the SA and that it intended the term to be interpreted in a manner consistent with the existing case law, to the extent that is permitted by the natural and ordinary meaning of the statutory definitions. The JLMs say the traditional common-law concept of promoter is that of someone who has a sufficiently influential role in the creation of a company that it is appropriate for them to assume similar duties and obligations to those of a director. This approach is supported by the fact that the scheme of the SA places equivalent obligations and liabilities on promoters as it does on directors and individual issuers. This is consistent with someone who has a measure of control over decisions as to the form and terms on which an offer is made.

[236] In this case the initiative for the IPO came from Credit Suisse and all major decisions were made by Feltex and Credit Suisse. Although the JLMs advised on various aspects of the offer, Feltex and Credit Suisse could, and on occasion did, reject that advice. The DDC was responsible for the due diligence process in respect of the prospectus and offer but the JLMs attended DDC meetings in an advisory capacity only.

[237] The JLMs say no weight should be placed upon the lockup issue because the emails cited by Mr Houghton[100] were not put to the JLM witnesses at trial and the JLMs' purported influence concerning the lockup was not pleaded as a particular of why the JLMs were alleged to be promoters.

Discussion

The concept of promoter at common law

[238] This issue is primarily one of statutory interpretation. But because the respondents invoked what they refer to as the "traditional" concept of promoter in support of their preferred interpretation, we took some time to trace the development of that concept in the common law, prior to its statutory definition. Having done so, we agree with the JLMs that the current definition must be read in light of its common law antecedents.

[239] The use of the label "promoter" in company law is of long standing. As the learned authors of *Morison's Company and Securities Law* state:[101]

> … the creation of a rule rendering promoters liable at common law was designed to fill the gap which existed because a person could behave in the same way as a director of a company before its incorporation.

[240] Farrar and Russell write:[102]

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100 Above at [231] and [232].

101 Andrew Beck and others *Morison's Company and Securities Law* (looseleaf ed, LexisNexis) at [4.1] (footnote omitted). The relevant chapter was written by Andrew Beck and Peter Watts.

102 John H Farrar and Mark W Russell *Companies Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985) at 26.

> In the period 1860–1920 there were a number of company promoters in England who perpetrated frauds. The Courts sought to combat these by means of the development of specific fiduciary duties.

[241] Because of the variety of circumstances in which the concept could be brought into play to determine issues of liability, and prior to the emergence of statutory attempts at definition, courts avoided closely defining just who was and was not a promoter, proceeding no further down that path than general discussion of the role. This approach is apparent in the following often-cited passages. In *Erlanger v New Sombrero Phosphate Co* Lord Blackburn said as follows:[103]

> I proceed to consider the first of these questions. Throughout the *Companies Act*, 1862 (25 & 26 Vict. c. 89), the word "promoters" is not anywhere used. It is, however, a short and convenient way of designating those who set in motion the machinery by which the Act enables them to create an incorporated company.

[242] In *Emma Silver Mining Co Ltd v Lewis* Lindley J said:[104]

> With respect to the word "promoters", we are of opinion that it has no very definite meaning … As used in connection with companies the term "promoter" involves the idea of exertion for the purpose of getting up and starting a company (of what is called "floating" it) and also the idea of some duty towards the company imposed by or arising from the position which the so-called promoter assumes towards it.

[243] In *Whaley Bridge Calico Printing Co v Green* Bowen J said:[105]

> The relief afforded by equity to companies against promoters, who have sought improperly to make concealed profits out of the promotion, is only an instance of the more general principle upon which equity prevents the abuse of undue influence and of fiduciary relations. The term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence. In every case the relief granted must depend on the establishment of such relations between the promoter and the birth, formation and floating of the company, as render it contrary to good faith that the promoter should derive a secret profit from the promotion.

[244] Three reasons for the reluctance to define the role were postulated by Joseph Gross writing in the *Law Quarterly Review* as follows:[106]

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[103] *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218 (HL) at 1268.
[104] *Emma Silver Mining Co Ltd v Lewis* (1879) 4 CPD 396 (Comm Pleas) at 407 (citations omitted).
[105] *Whaley Bridge Calico Printing Co v Green* (1879) 5 QBD 109 (QB) at 111.
[106] Joseph H Gross "Who is a Company Promoter?" (1970) 86 LQR 493 at 498 (footnotes omitted).

> 1. A promoter's conduct falls to be considered by the courts when misfortune or fraud has brought the company into difficulties. In such circumstances the judges have been satisfied that secret profits are inequitable, and that anyone who has made them is a promoter. It is this view that has brought the term promoter itself into disrepute. Dewing, in his book *Corporation Finance*, describes the situation thus: "Unfortunately there has appeared in fiction, in newspapers and even in the public consciousness the impression—often verging on a conviction, that the promoter is an impecunious silvery tongued vendor of worthless shares in mining and oil projects."
>
> 2. One school of thought insists that promoter is best left as a business term rather than a legal one. It sums up "a number of business operations familiar to the commercial world by which a company generally is brought into existence."
>
> 3. The courts have intentionally failed to set down a definition in a formal sense. If such a definition were laid down it might be possible for persons concerned in the promotion of companies to avoid its limitations and take advantage of their fiduciary positions without incurring liability as promoters.

[245] We therefore proceed upon the basis that, prior to statutory definition, the term promoter was not closely defined. This was because of the need to ensure that the law was sufficiently flexible to capture those who, in equity and good conscience, should be liable to disgorge secret profits or for fraudulent misstatements made in the course of promoting an offer of securities. However, we consider that the definition attempted by Joseph Gross is helpful. Gross endorsed the definition given by Lindley LJ in *Lindley on Companies* of promoters as "those persons who bring the company into existence by taking an active part in forming it and in procuring persons to join it as soon as it is technically formed".[107] Gross continued:[108]

> The term "promoter," as a business expression, covers a wide range of persons; but one need not undertake the whole of the work involved in getting the company going; the work may be divided among the members of a group, and each one of them may be a promoter.

[246] Our review of the case law also suggests a focus upon whether the nature of the role played by the alleged promoter is such that they should be liable for the particular wrong.

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[107] At 507 citing Lindley *on Companies* (5th ed, United Kingdom, 1889) at 346.
[108] At 507.

[247] Therefore the definition was broader than that proposed by the Judge:[109]

> … a person who is "instrumental" will generally have been an important contributor to the offer being initiated, exercise significant decision-making power, and have responsibility over the form and execution of the offer.

We say it was broader because there is nothing in the case law to suggest that decision-making power is a necessary characteristic of a promoter, although of course decision-making power may be a good indicator of the centrality of the defendant's role in the "getting-up" of the company. There are, however, instances of defendants being held liable as promoters who did not have such power (for example, in *Emma Silver Mining Co Ltd*).

The concept of promoter in the SA and its legislative history

[248] As to statutory definitions, the definition appearing in s 2 of the SA has a pedigree stretching back to s 3(2) of the Promoters' and Directors' Liability Act 1891 which provided:

> A "promoter" in this section means a promoter who was a party to the preparation of the prospectus or notice, or of the portion thereof containing such untrue statement, but shall not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the existing company.

[249] This definition was carried forward in substantially identical terms to s 76(3) of the Companies Act 1903, s 76(3) of the Companies Act 1908, s 48(4) of the Companies Act 1933 and s 55(5)(a) of the Companies Act 1955.

[250] After the enactment of the SA, regulation of the content of a prospectus passed from the Companies Act 1955 to the SA. The definition in s 2 of the SA, as originally enacted in 1978, was as follows:

> "Promoter", in relation to a security, means a person who is instrumental in the formulation of a prospectus relating to the security; and, where a body corporate is a promoter, includes every person who is a director thereof; but does not include a director or officer of the issuer of the security or a person acting solely in his personal capacity

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[109] HC judgment, above n 2, at [580].

[251] The current definition of promoter was inserted by s 2(9) of the Securities Amendment Act 1982.

[252] As is apparent from this history, the 1978 definition of promoter was the first self-contained definition, in the sense that it did not include the expression "promoter means a promoter …". The earlier definitions were defining a sub-category of promoter, namely a promoter who was also party to the preparation of the prospectus in some way.

[253] Another aspect of the development of the definition worth noting is the absence of any requirement in the post-1978 definition that the promoter be party to the preparation of the prospectus or the part containing the untrue statement.

[254] In our view, the timing and nature of this amendment suggests it was to accommodate other amendments made by the 1982 Amendment Act enlarging the means by which securities may be offered to the public, so that s 3(4) of the SA now defines an "offer of securities to the public" as follows:

> Any reference in this Act to an **offer of securities to the public** shall be construed as including a reference to distributing an advertisement, a prospectus, a registered prospectus, or an application form for the subscription of securities

Our interpretation

[255] We begin with the statutory language. The existence of the definition makes plain that a person may be a promoter even though they are not named as such in the prospectus. Applying the ordinary meaning of those words, someone is instrumental in the formulation of a plan or programme pursuant to which securities are offered to the public if they are a means by which the plan or programme is formulated. However, we accept the JLMs' argument that the continued use of the common-law concept of the promoter throughout the legislative history of this section suggests an intention to carry forward the common-law concept of what a promoter is.

[256] We consider that in this context therefore, a promoter is one who brings a plan into existence by taking an active part in forming the plan pursuant to which the

shares are offered to the public through the distribution of a registered prospectus. We also proceed on the basis that the promoter must have been party to the preparation of the registered prospectus or the impugned part thereof. Although the express requirement relating to involvement in the prospectus was removed by the 1982 Amendment Act, as we have noted, this amendment is likely to have been effected to accommodate the different ways in which offers could be made. If a person or company has taken an active role in the ways identified, this provides the justification for holding that person liable as a promoter in the context of liability for untrue statements in a registered prospectus. This is consistent with the approach at common law referred to at [247] above.

[257] As noted, a decision-making role in formulating a plan may be good evidence that a defendant was a promoter but we do not consider it is a necessary element of promotership. We agree with the appellant there is nothing in the statutory language or the common law to suggest a *requirement* of control or decision-making power in connection with the preparation of the prospectus. The exception for those acting solely in their professional capacity suggests rather to the contrary. If those acting in their professional capacity, typically an advisory capacity, are not otherwise caught by the definition, then it is difficult to see the point of the exclusion from liability.

[258] Moreover, issuers and directors of issuers are already exposed to liability for misstatements in a prospectus.[110] These are the decision-makers in respect of an offer of securities. If decision-making power is a defining characteristic of a promoter, there would seem little reason for extending the liability provisions to promoters since they will already face liability as either a vendor, issuer or director of an issuer.

[259] We consider that the interpretation we set out above is also supported by the statutory history of the provision. Under the Companies Act 1955, and prior to the enactment of the SA, the definitions of promoter did not include decision-making power as a characteristic. It was enough for liability to attach if the defendant was a promoter and was "party" to the offending part of the prospectus.

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110 Securities Act, s 56(1)(a) and (b).

[260] It is relevant to consider whether there is there anything in the scheme of the SA which suggests the narrower interpretation adopted by the Judge. The possibility of exposing a more broadly defined class to criminal liability would be a potent contra-indicator. There are three provisions which expose a promoter to criminal liability. Section 58 creates criminal liability for misstatements in an advertisement or registered prospectus. However, that liability extends only to those who have signed the prospectus. Although s 41(b) requires the promoter to sign the prospectus, liability under s 58 is limited to those who do sign. This means that those who unknowingly fall within the definition of promoter would not be caught by s 58.

[261] A promoter is also potentially liable under s 59 for offering or distributing a prospectus in contravention of the SA. However, it is a defence if the contravention did not take place with his or her knowledge and consent. Similarly, a promoter is exposed to liability for breach of regulations implementing a recognition regime under s 76 but it is a defence to show that the contravention did not take place with that person's knowledge and consent.

[262] Under these provisions, therefore, a promoter will not be liable unless they sign the prospectus (s 58) or know of and consent to the breach (ss 59 and 76). Adopting the definition of promoter we have would not therefore result in open-ended liability. We do not see these provisions as contra-indicators to giving the words of s 2 their ordinary meaning.

Do the JLMs fall within the definition of promoter?

[263] It is first necessary to determine whether the JLMs fall within the broad definition of promoter before determining if the professional services exception applies to them.

[264] The majority on this point, Randerson and Winkelmann JJ, consider that the nature of the role played by the JLMs brought them within the definition of promoter in para (a) because they were actively involved in the formulation of the plan to offer securities. The JLMs worked as part of the group that developed the plan and were a

means by which it was implemented. The critical commercial role they played in the offer meant they were able to shape aspects of the offer, even if they did not have decision-making power. This is evidenced in the role they played in agreeing the lockup of shares. Although the objections made by Mr McLellan as to poor process in advancing this aspect of the appellant's case are noted, the role the JLMs played in agreeing the lockup of the shares with directors is recorded in the prospectus. The JLMs were party also to the preparation of the prospectus because they played a significant part in shaping its contents.

[265] The minority, Ellen France P, considers that the JLMs do not fall within the definition because their role was to assist with the offer. The terms of the JLMs' engagement were set out in the letter of engagement which was described by Martin Stearne, a director of First NZ, as reflecting "standard terms" and describing the "usual type of professional services … provided by a lead manager or JLM in an IPO". Robert Hamilton, a managing director of First NZ, gave similar evidence as did Neil Paviour-Smith, his equivalent at Forsyth Barr.

[266] Against those terms of engagement Ellen France P considers it is relevant that, as the Judge said, none of those witnesses was "challenged on their perception that sharebroking firms acting as lead managers for IPOs in New Zealand fell outside the definition of a promoter".[111] Although the JLMs gave advice as to the required shape of the offer to meet the market, including the lockup, that was the role they were engaged to perform and for which they were paid. A decision-making role is not necessary before a person such as the JLMs will be a promoter. But it is also relevant, as Mr McLellan submits, that the uncontested evidence at trial was that key decisions such as the initiative for the offer and firm allocation of shares and scaling, and the final responsibility for the offer document and for the decision to proceed with the offer were made by Credit Suisse and Feltex.

Professional capacity exception

[267] We also heard argument as to whether the JLMs were excluded from the definition by reason of acting "solely in [their] professional capacity". This issue

[111] HC judgment, above n 2, at [578].

arises on the majority's view that the JLMs fall within the definition of promoter in para (a).

[268] Ms Mills for the appellant argues that the use of the words "person" and "his or her" in para (c) excludes corporate persons so that the JLMs cannot fall within the professional services exclusion. We can deal with this point shortly. As Mr McLellan submits for the JLMs, if Mr Houghton is correct, the meaning of the word "person" in para (c) would conflict with the SA's own definition of a "person": "person includes a corporation sole, a company or other body corporate (whether incorporated in New Zealand or elsewhere) …".[112] There is nothing to suggest Parliament would want to limit the application of the exception to natural persons.

[269] The appellant's alternative argument is that the JLMs do not fall within the professional capacity exception because of the extent of their financial interest in the outcome. They earned fees scaled to the extent of funds raised and were exposed on the BSA.

[270] The Judge rejected that argument:[113]

> [595] Mr McLellan submitted that [First NZ] did not have any economic interest in the outcome of the IPO other than its fees. [First NZ] was entitled to a termination fee if the offer did not proceed or if it was no longer willing to act as a JLM, and I accept that such an arrangement is typical of an adviser to the offer, rather than a stakeholder in it. Following the opening of the offer, the JLMs were also exposed to the market on the shares allocated to them under their firm allocation, plus the bond shortfall commitment. However, these liabilities put them in no different position to that of all other brokers who took a firm allocation. Taking firm allocations in an IPO is a relatively standard component of the business of larger broking firms. Certainly, it involves exposure to risk, but it is undertaken to maintain the firm's client base, as well as to earn the brokerage on the sale of the shares to clients of the firm.

[271] The policy reason behind the professional services exception is described in *Re Great Wheal Polgooth Co Ltd*, a case in which it was alleged that a solicitor was a promoter for a company for which fraudulent prospectuses had been issued:[114]

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112 Securities Act, s 2.
113 HC judgment, above n 2.
114 *Re Great Wheal Polgooth Co Ltd* (1883) 53 LJ Ch 42 (Ch) at 47–48.

> Considering the gravity of these accusations, it becomes of the utmost importance in this case and all others to know whether a man who acts as solicitor, and only as solicitor, thereby comes within the 165th section, and is to be called a promoter. That a banker is not an officer of the company, though his name is in the list of persons engaged in carrying on the company, has been very plainly decided. Why should I hold that because a solicitor's name is printed in the body of the prospectus he becomes a promoter? It seems to me to be a conclusion that I cannot for a moment draw.
>
> …
>
> What is a solicitor to do? He is not master over the directors. He is not to prescribe to the directors what they are to do. He is to carry into effect their directions, provided they are lawful; and not one of the things in which he was employed was in any sense unlawful. He had no interest in the matter; he never had any interest in the company, except the right a solicitor has to be paid for his labour; and, in my opinion, there is no ground from which I can conclude, reading from the clause in the Act of Parliament, that [the solicitor] acted in any sense as a promoter of the company.

[272] The role fulfilled by the JLMs was of an entirely different nature to the professional advisors spoken of in *Re Great Wheal*. They were entitled to fees calculated by reference to the success of the venture, although we accept that other professionals on occasion charge fees calibrated by reference to the success of their client's venture. The JLMs also took firm allocations but, as the Judge said, brokers commonly take firm allocations. There is also the issue of what seems in substance to be an underwrite of the bondholder allocation and its impact upon the proper clarification of the JLMs' role.

[273] It is by no means a straightforward issue whether the services and commitments entered into by the JLMs can properly be characterised as undertaken by them acting "solely in [their] professional capacity". We did not hear argument on the essential nature of professional services. Although evidence was led that the JLMs were engaged on standard industry terms, it may be that the industry regularly strays beyond acting in a professional capacity into the realm of becoming risk participants. Because the issue is not dispositive of this appeal, and in the absence of full argument, we prefer not to express a concluded view on this last point. In taking this cautious approach we have weighed, as the Judge noted, that the now governing statute, the Financial Markets Conduct Act 2013, does not include the concept of promoter among those liable for misleading statements.

Credit Suisse

[274] CSAMP was the vendor of shares offered in the IPO and as such fell within the definition of issuer for the purposes of the SA. However, s 56 extends liability for misleading statements in a prospectus to an issuer only where the issuer is an individual.[115] It was on this basis that the Judge found that CSAMP could not be liable as an issuer for the purposes of s 56(1) even if Mr Houghton were able to prove he had suffered loss by reason of an untrue statement in the prospectus.[116] Mr Houghton has not appealed that finding. He does, however, appeal the Judge's finding that CSAMP was not a promoter for the purposes of s 56. It is not disputed that a corporate entity can be liable as a promoter under s 56.

Judgment

[275] CSAMP and CSPE agreed that CSPE would be the promoter and CSPE was described in, and signed, the prospectus as the promoter. The Judge accepted Mr Houghton's argument that the designations chosen by CSPE and CSAMP could not be decisive.[117] But he said that, in considering whether CSAMP was a promoter, it was "inappropriate to attribute to it the independent conduct undertaken by CSPE in a context where CSPE assumed liability as promoter and carried out the tasks that qualified it as such".[118] The Judge continued:

> [606] I am mindful that respecting the division of roles that CSAMP (as passive owner) and CSPE (as active manager and administrator) agreed between them could, in other circumstances, lead to the prospect of a special purpose, judgment-proof company being deployed as promoter to shield those with the substantive interest in the transaction from the risk of subsequent liability under the SA regime. The plaintiff made no such suggestion here, and other factors are likely to limit that risk in other circumstances. For instance, interposing a $100 company as the promoter would be likely to substantially dent the credibility of any IPO. Further, the vendor or issuer of the shares would generally also be liable for any breaches of the obligations under the SA.
>
> [607] I am not persuaded that the limited role CSAMP played in the IPO in its own name was sufficient to attribute to it the status of a promoter. Nor can it be attributed with that status by virtue of the work undertaken in its

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115 Securities Act, s 56(1)(a) and (b).
116 HC judgment, above n 2, at [612].
117 At [605].
118 At [605].

interests by CSPE, when that entity had the status in its own right as a promoter.

Argument on appeal

[276] The appellant argues that CSAMP had "total control" over the IPO process through its ownership of the shares the subject of the secondary offering. And if that submission is not accepted, it is a promoter through its relationship with CSPE. The Judge's approach to treating CSPE as the promoter, allowing CSAMP to escape all liability, he says is inconsistent with agency law. CSAMP effectively appointed CSPE its agent to act as promoter in respect of CSAMP's shares. However, interposing an agent to perform the tasks of promoter does not allow the promoter to escape liability for its agent's actions in accordance with the normal rules of agency law.

Discussion

[277] The evidence is that CSAMP was a holding entity for Credit Suisse's private-equity investments in the Asia-Pacific region, which included the investment in Feltex. It was administered and directed by CSPE. Both CSAMP and CSPE confirmed that CSPE was the promoter. Credit Suisse's legal advisors confirmed that this was the correct analysis.

[278] We agree with the Judge's analysis that in these circumstances it was CSPE which fell within the s 2 definition of promoter, as it was CSPE and not CSAMP which was a means by which the plan or programme pursuant to which the securities were issued to the public was formulated. It was CSPE which played the active role for Credit Suisse in the formulation and preparation of the IPO.

[279] There is nothing in the agency point. The SA is definitive of which entity or entities are to be classed as promoter, not the common law. As discussed above, the definition focuses upon the role played, not ownership, in determining who is and who is not a promoter for the purposes of the SA. This interpretation does not create a potential loophole as the vendor of shares is liable as an issuer and, where the issuer is a corporate entity, the issuer's directors are liable pursuant to s 56.

Ground of appeal: Do s 63A of the SA and s 5A of the FTA apply to preclude a claim under the FTA?

[280] The first two causes of action pleaded in the fourth amended statement of claim were claims under the FTA. The defence to those claims was that the FTA could not apply because of the provisions of s 63A of the SA and s 5A of the FTA. The Judge held that those provisions precluded a successful claim under the FTA where, as here, the conduct is regulated by the SA and the defendant is not liable for that conduct under that Act.

Legislative provisions

[281] Section 63A of the SA was added by the Securities Amendment Act 2006 (SAA), which came into force 25 October 2006. It provides:

> **63A No liability under Fair Trading Act 1986 if not liable under this Act**
>
> A court hearing a proceeding brought against a person under the Fair Trading Act 1986 must not find that person liable for conduct that is regulated by this Act if that person would not be liable for that conduct under this Act.

[282] Section 24 of the SAA contained transitional provisions which provided, in material part, as follows:

> **24 Transitional provision for existing offences and contraventions**
>
> (1) The principal Act continues to have effect as if it were not amended by this subpart for the purpose of—
>
> …
>
> (b) commencing or completing proceedings for an existing offence or contravention:
>
> (c) imposing a penalty or other remedy, or making an order, in relation to an existing offence or contravention.
>
> (2) In this section, **existing offence or contravention** means—
>
> (a) an offence under, or contravention of, the principal Act that was committed or done in respect of a prospectus that was registered, or an advertisement that was distributed, before the commencement of this subpart; …

[283] The SAA contained numerous amendments of substance to securities law in relation to offences and contraventions and s 24 must be understood in that context. As the Judge said "[t]he transitional provision in s 24 of the [SAA] was required to regularise the position with a number of the substantive amendments that had been made".[119]

[284] Section 5A was added to the FTA and came into effect on 29 February 2008. It was inserted by the Fair Trading Amendment Act 2006. Section 5A duplicated the effect of s 63A. It provides:

> **5A No liability under Act if not liable under Securities Act 1978 or Securities Markets Act 1988**
>
> A court hearing a proceeding brought against a person under this Act must not find that person liable for conduct—
>
> (i) that is regulated by the Securities Act 1978 if that person would not be liable for that conduct under that Act:
>
> …

[285] The Feltex prospectus the subject of these proceedings was issued well before either s 63A or s 5A came into force. The conduct the subject of the proceeding also occurred before either provision came into force. Specifically, this proceeding was issued after s 63A came into force but before s 5A came into force.

[286] Ms Mills for the appellant argues that neither s 5A nor s 63A applies to oust the application of the FTA to these proceedings. She argues that the effect of the transitional provision, s 24, is that s 63A does not apply to proceedings concerning prospectuses registered before 25 October 2006. And, in any case, to apply either provision so as to deprive shareholders of rights that had accrued under the FTA before either provision came into force is to apply those provisions retrospectively. Such an interpretation is inconsistent with standard principles of statutory interpretation and, in particular, with s 7 of the Interpretation Act 1999 which provides that an enactment does not have retrospective effect. The Judge rejected these arguments. The appellant says he erred in doing so.

[119] HC judgment, above n 2, at [625].

Judgment

[287] The Judge held that in the circumstances of this case s 63A meant the Court could not find the respondents liable under the FTA.[120] He accepted an argument that s 63A of the SA does not have retrospective effect.[121] He said:

> [622] In considering the terms in which these mutual exclusivity provisions were expressed by the legislature, it is relevant that s 63A does not constrain commencement of proceedings in which causes of action invoke both the SA and the FTA. What is prohibited by both provisions is a finding of liability against a person under the FTA, if the claim relates to conduct that is regulated by the SA where the defendant would not be liable for the conduct complained of under the SA.
>
> [623] Although there can be no doubt in the present circumstances, claims are likely to arise in contexts where the claimant is not able to be certain at the outset whether the conduct complained of is indeed regulated by the SA. An obvious example is whether the offer in question constituted an offer of securities to the public. In such cases, an application to strike out a cause of action under the FTA might well fail because a determination is needed as to whether the conduct complained of is indeed regulated by the SA before the Court could exclude the prospect of a finding of liability against the defendant under the FTA.
>
> [624] On that interpretation of the provisions, no issue of retrospectivity arises. In this case, the third cause of action under the SA is pleaded as an alternative to the first cause of action under the FTA. However, it is only when there is an admission or a finding that the conduct the plaintiff complains of is regulated by the SA that the Court is deprived of the jurisdiction to make a finding of liability under the FTA.
>
> (Footnote omitted.)

[288] The Judge saw the absence of any transitional provision in the FTA as supporting his interpretation because, on his interpretation, such a transitional provision was unnecessary as neither s 63A nor s 5A would operate retrospectively.[122] But the transitional provision in s 24 of the SAA was required to address whether a number of the substantive amendments to the SA applied to proceedings founded upon an infringement committed when these substantive amendments were not in force.[123] There were no corresponding provisions inserted into the FTA which were required to be addressed in a similar fashion.

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[120] At [629].
[121] At [624].
[122] At [625].
[123] At [625].

[289] On appeal the respondents endorse the Judge's reasoning. They say that since s 63A only directs what courts may do in the future this is not to give the provisions retrospective effect. As to s 24 of the SAA, it applies to proceedings under the SA but not to proceedings alleging a breach of the FTA.

Analysis

[290] A statute is usually regarded as retrospective if it effects some change to the legal nature or consequences of a past act or omission. As this Court said in *Waitakere City Council v Bennett*:[124]

> Whether or not a statute has retrospective effect in a way which engages s 7 is not necessarily easy to discern and, as noted in *Bennion on Statutory Interpretation* (5th ed, 2007), p 317:
>
> > … the mere fact that a change is operative with regard to past events does not mean that it is objectionably retrospective. Changes relating to the past are objectionable only if they alter the legal nature of a past act or omission in itself. A change in the law is not objectionable merely because it takes note that a past event has happened, and bases new legal consequences upon it.

[291] The rationale behind the application of the presumption against retrospectivity (found now in s 7 of the Interpretation Act) is that Parliament does not intend statutes to cause unfairness. Staughton LJ explained the rule in *Secretary of State for Social Security v Tunnicliffe*:[125]

> In my judgment the true principle is that Parliament is presumed not to have intended to alter the law applicable to past events and transactions in a manner which is unfair to those concerned in them, unless a contrary intention appears. It is not simply a question of classifying an enactment as retrospective or not retrospective. Rather it may well be a matter of degree—the greater the unfairness, the more it is to be expected that Parliament will make it clear if that is intended.

[292] The majority on this point, Randerson and Winkelmann JJ, agree with the respondents that s 24(1)(b) does not address claims under the FTA but rather claims under the SA when it provides, in substance, that claims for existing offences or contraventions are to be determined as if the SA had not been amended. However, the majority disagree with the Judge's view that applying s 63A in the present case

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124 *Waitakere City Council v Bennett* [2008] NZCA 428, [2009] NZRMA 76 at [52].

125 *Secretary of State for Social Security v Tunnicliffe* [1991] 2 All ER 712 (CA) at 724.

does not give the provision retrospective effect because to apply the s 63A bar on relief would have the effect of taking away from claimants' substantive rights which had already accrued. If we had found that statements in the prospectus were misleading or deceptive then, as at the date of the allotment of securities, Mr Houghton had a cause of action available to him under the FTA. On the respondents' argument, accepted by the Judge, he could still bring a claim for breach of the FTA. Nevertheless, without access to a remedy for breach, a right of action is worthless. Removing the right to a remedy removes substantive rights.

[293] It is open to Parliament to provide that a statute should have retrospective effect.[126] It may do so expressly or a court may infer that this was the intention of Parliament from the language, purpose, subject-matter and other relevant context to the legislation. However, the greater the unfairness created by a retrospective application, the more clearly it would be expected that Parliament would express that intention. We do not consider that there is any indication in the language of s 24 of the SAA or 63A of the SA to indicate that s 63A was intended to have retrospective effect. The Judge identified as a policy objective of the amendments that "the application and enforcement of a specific civil liability regime governing the issuance of securities should not be subverted by an overarching consumer protection statute".[127] We agree that was the policy objective but that policy objective does not require retrospective application.

[294] Nor do we see the absence of a transitional provision in the FTA as evidence that the amendment was intended to have retrospective effect. On our interpretation, if conduct occurred prior to the 2006 amendments, no matter when proceedings were initiated, neither s 63A nor s 5A would operate to deprive plaintiffs of their rights which accrued when that conduct occurred. If a provision is intended to operate retrospectively, it would be more usual to include a transitional provision to that effect. There is simply a lack of parliamentary material supporting the Judge's interpretation which is, in the majority's opinion, to give the provisions retrospective effect.

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[126] Interpretation Act 1999, s 4.
[127] HC judgment, above n 2, at [627].

[295] In the majority's view, to apply s 63A as argued for by the respondents creates unfairness. The SAA amended the civil liability regime, providing for different remedies and creating a penalty regime. These are provisions Mr Houghton cannot invoke by virtue of s 24(1)(c) of the SAA. As such, in the majority's view, it would be unfair in this case to deprive him of any cause of action he had under the FTA when he cannot access the enhanced rights under the SAA.

[296] The minority on this point, Ellen France P, agrees with Dobson J that s 63A of the SA does preclude a successful claim under the FTA by the appellant for the reasons given by Dobson J. In her view, the SA is clear that it is intended to apply to any proceeding. Because, as Dobson J explained, the provision would only apply where it was clear the SA regulated the conduct, no issue of unfairness arises.

[297] Notwithstanding the view of the majority, we do not go on to consider Mr Houghton's claims regarding the conduct complained of constituting misleading or deceptive conduct under s 9 of the FTA. That is because, in determining whether to grant any of the remedies pleaded for in s 43 of the FTA, Mr Houghton must show that any breach of s 9 was an effective cause of some loss or damage.[128] As the Supreme Court said in *Red Eagle Corp Ltd v Ellis*:[129]

> Then, with breach proved and moving to s 43, the court must look to see whether it is proved that the claimant has suffered loss or damage "by" the conduct of the defendant. The language of s 43 has been said to require a "common law practical or common-sense concept of causation" … The impugned conduct, in breach of s 9, does not have to be the sole cause, but it must be an effective cause, not merely something which was, in the end, immaterial to the suffering of the loss or damage.

[298] In view of the Court's findings above, the only conduct the majority sees Mr Houghton as capable of making out as misleading or deceptive is the forecast in respect of FY04. However, given the Court's finding that the forecast for FY04 was immaterial, the majority considers the contention that the forecast caused loss is untenable.

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128 Fair Trading Act 1986, s 43(1).
129 *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [29] (footnote omitted).

Ground of appeal: Loss

[299] In the absence of a finding that the prospectus contained an untrue statement (the Judge appeared to treat the FY04 forecast as to sales revenue as true on the basis that it was immaterial), the Judge did not rule definitively on any aspect affecting loss.[130] However, to the extent he made any observations, the appellant says he erred.

[300] The Judge noted that Mr Houghton did not call any evidence on loss because his case was that he would not have invested if there had been full disclosure and so was entitled to all of his money back.[131] Alternatively, Mr Houghton argued that had full disclosure taken place, the IPO would not have proceeded as it would have reduced the retail price for the shares to a level which would have been unacceptable to CSAMP and to Feltex.[132]

[301] The Judge said that Mr Houghton needed to have produced evidence of his loss. He rejected the notion that the measure of his loss was the full purchase price because the shares clearly had substantial value at the time he purchased them.[133] The Judge said that Mr Houghton's approach also overlooked his obligation to mitigate loss:[134]

> Given a daily market for the shares from 2 June 2004, when Mr Houghton discovered the discrepancies (or arguably when he ought reasonably to have discovered them if he monitored his investment prudently), then opportunities would have arisen to minimise the loss by selling the shares on market.

[302] As to the second of Mr Houghton's' arguments, that full disclosure would have in substance sunk the IPO, he observed there was also no evidentiary foundation laid for that proposition.[135]

[303] He noted Mr Houghton's ultimate fall-back position — that the quantum of loss ought to be reserved for subsequent inquiry — but said the division of issues in

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130 HC judgment, above n 2, at [712].
131 At [703].
132 At [706].
133 At [704].
134 At [705].
135 At [707].

the staged hearing contemplated a full resolution of Mr Houghton's claim.[136] Accordingly, had there been a finding of liability he would not have been prepared to receive further evidence from Mr Houghton on the issue of loss.[137]

[304] He noted the defendants' position was that the correct measure of loss was the difference between the sum paid for the shares and the fair value of the shares if their price had been adjusted to reflect the untrue statement.[138] He summarised the defendants' case as follows:

> [711] The defendants' analysis on loss was to the effect that because Feltex's shares traded within an otherwise explicable range of the issue price of $1.70 for some nine months, the issue price could not be shown as over-valuing the shares. This analysis proceeded on two alternate premises. First, that the market became aware of the impact of any material matters that were either misstated or omitted from the prospectus, so as to factor those changes into the price. Secondly, given that Feltex's shares were the subject of publicised comment by four broker analysts, and that the share price largely reflected the then current assessment of the value of its future cash flows, any misstatement or omission in the prospectus would have lost its impact over nine months, and was therefore no longer relevant to the market price for Feltex shares.

[305] The Judge concluded:

> [710] Had I found misleading content or omissions, I would have required the plaintiff to establish that the market remained unaware of the true position in relation to that aspect of Feltex's business, for the period of nine months or so until there was a significant drop below the initial issue price for the shares. Unless that proposition was made out, the plaintiff had an adequate opportunity to avoid or minimise loss by selling when the market was informed, and (for that period of nine months or so) did not treat the further information about Feltex as materially affecting its share price.
>
> (Footnote omitted.)

[306] On the appellant's case, the Judge was wrong to apply the tortious measure of damages when there was a statutory framework for this inquiry. In particular, he should have concluded that, since s 33 of the SA prohibits the offering of securities to the public unless the offer is made in an investment statement and registered prospectus that complies with the SA, this prospectus should not have been registered. It contained untrue statements. But for the making of a prohibited offer

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136 At [708].
137 At [709].
138 See [711].

the investors could not have invested in Feltex. They would not have lost their investment.

[307] Mr Houghton also argues that the Judge erred in imposing any duty to mitigate upon him.

[308] Finally, he says the Judge was wrong to address issues of loss at a general level when issues of loss were to be addressed for other shareholders at the second stage of trial, as determined by French J.[139]

Analysis

[309] We have already recorded above our findings on the appellant's argument as to the required proof of reliance. As we have set out, the "but for" arguments that Mr Houghton invokes to support his arguments that he need not prove loss are unsustainable in view of the language of s 56.

[310] The Judge was also correct that in terms of the pre-trial directions, although a staged resolution of issues was contemplated, the directions given by French J required a full resolution of Mr Houghton's claim. Mr Houghton needed to produce evidence to substantiate the loss he claimed.

[311] We also agree with the Judge's approach to quantification of the loss. As we have noted above, the reason for the enactment of the statutory ancestors of s 56 was to remove the need for a plaintiff to prove fraud in relation to misstatements in a prospectus. Section 56, however, like its predecessors, uses language which suggests an intention to carry forward the approach to reliance and quantification of loss in the 19th-century deceit cases. In claims brought under the predecessors to s 56, compensable loss is quantified as the difference between the price paid for the securities and the estimated value of the securities if there had been full and accurate disclosure.[140] This is the approach to quantification of loss applied by the Judge and

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[139] See Minute of French J, above n 11.

[140] *Broome v Speak (CA)*, above n 46, at 623; *Cackett v Keswick* [1902] 2 Ch 456 (Ch) at 468; *McConnel v Wright* [1903] 1 Ch 546 (CA) at 553; and *Bundle v Davies*, above n 45, at 383.

is an approach with which we agree. On this analysis, however, the duty to mitigate does not arise.

Ground of appeal: The Judge was wrong to require the appellant to disclose work product

[312] The appellant also seeks to pursue on appeal what he characterises as a finding by the Judge that the appellant was obliged to disclose to the respondents work product in the form of data converted to a usable format. However, we do not read the passages in the judgment relied upon as recording findings but rather observations by the Judge.[141] He goes on to make clear that his concern at the delay in the provision of that data was not determinative of the issues he was addressing at that point in his judgment,[142] which was the significance of the practice of forward dating of invoices and the extent of that practice. Given that all counsel are in agreement that this issue is not determinative of any aspect of the appeal, we will not consider it further.

Result

[313] The appeal is dismissed.

[314] All parties sought the opportunity to file written submissions on the issue of costs with, at least, counsel for the second and third respondents indicating they would seek increased costs if successful. Our preliminary view is that there is no justification for increased costs but we will receive submissions on the point should the respondents wish to advance that argument.

[315] We would be assisted if the respondents could file joint submissions. The appellant's submissions and the respondents' joint submissions should each be no longer than five pages.

[316] Any submissions by the respondents are to be filed and served no later than 20 working days after delivery of this judgment.

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141 HC judgment, above n 2, at [421]–[422].

142 At [423].

[317] Any submissions by the appellant are to be filed and served 10 working days thereafter.

Solicitors:
Wilson McKay, Auckland for Appellant
Bell Gully, Auckland for First to Third and Fifth to Seventh named First Respondents
Clendons, Auckland for Fourth named First Respondent
Russell McVeagh, Wellington for Second and Third Respondents
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McElroys, Auckland for Fifth Respondent