



**Supreme Court of New Zealand
Te Kōti Mana Nui**

15 August 2018

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**ERIC MESERVE HOUGHTON v TIMOTHY ERNEST CORBETT
SAUNDERS AND ORS**

(SC 135/2016) [2018] NZSC 74

PRESS SUMMARY

This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at Judicial Decisions of Public Interest www.courtsofnz.govt.nz

In mid-2004 shares in Feltex Carpets Ltd (Feltex) were sold in an initial public offering (IPO). The IPO involved an offer for sale of approximately 113 million shares in Feltex held by its then owner, Credit Suisse Asian Merchant Partners LP (CSAMP), and an offer of approximately 29.5 million new shares by Feltex itself. The price per share was \$1.70.

By December 2006 Feltex had been placed into liquidation and the shares were essentially worthless.

The appellant, Mr Houghton, brought a representative claim on behalf of himself and others who had invested in Feltex shares in the IPO, alleging that the prospectus issued by Feltex in relation to the offer was misleading in a number of respects and that this had caused loss to the investors.

The High Court ordered a split trial. The first hearing (the stage 1 hearing) was to deal with Mr Houghton’s claims in their entirety. It was also to resolve issues that were common to Mr Houghton and the other investors. Issues that were potentially not common, like reliance and loss, were to be dealt with at a stage 2 hearing. This appeal concerns the issues raised in the stage 1 hearing.

First cause of action: Securities Act 1978

The first cause of action dealt with at the stage 1 hearing was under s 56 of the Securities Act 1978 (now repealed). In this case that meant Mr Houghton had to prove that:

- (a) there was an untrue statement in the prospectus;
- (b) he invested on the faith of the prospectus; and
- (c) he suffered loss by reason of the untrue statement.

Section 55(a)(i) deemed a statement to be untrue if it was misleading in the form or context in which it was included.

The s 56 claim was brought in respect of:

- (a) The directors of Feltex during the offer period, in their personal capacities.
- (b) Credit Suisse Private Equity Inc (CSPE), the manager of CSAMP, as promoter of the offer. (A claim that CSAMP was also a promoter was not pursued in the Supreme Court.)
- (c) First NZ Capital and Forsyth Barr Ltd, who were the joint lead managers, on the basis that they were also promoters and liable in that capacity.

The High Court held that Mr Houghton had failed to prove the prospectus contained any untrue statements.

Mr Houghton's appeal to the Court of Appeal was successful on one point only. The Court of Appeal held that the forecast operating revenue for the financial year ended 30 June 2004 (FY04) was an untrue statement. This was because, at the time of allotment of shares, the Feltex directors knew that the forecast would not be achieved. They had been advised of a likely shortfall of between \$7.5 and \$9 million, amounting, based on the higher shortfall figure, to approximately 10 per cent of the forecast for the final quarter of FY04 or 2.8 per cent for the year. However, the Court of Appeal found that the untrue statement was not capable of causing loss because it could not have influenced any decision to invest.

The Supreme Court has unanimously upheld the Court of Appeal's finding that the FY04 revenue forecast was an untrue statement. The Supreme Court held that even an anticipated shortfall of 2.8 per cent for the year could be considered sufficiently significant to render the forecast untrue when considered in the context of Feltex's history and the cyclical nature of the carpet market. The anticipated shortfall was even more significant when considered against the background that the forecast spanned a period of only three months (the first nine months being actual figures), that the anticipated operating revenue for those three months was approximately 10 per cent below forecast and that the fourth quarter was traditionally one of the two best quarters for Feltex.

The Supreme Court has dismissed Mr Houghton's appeal in relation to other parts of the prospectus which he argued amounted to untrue statements.

The findings of the Supreme Court related to the alleged untrue statements are findings on common issues which bind the other investors.

On the second requirement of s 56, the Supreme Court held that the term “on the faith of the prospectus” does not require investors to have seen or read the prospectus. There is an inference that investors invested in reliance on the truth of the registered prospectus that informs the market and thus on the faith of the prospectus.

There was nothing to suggest that Mr Houghton did not meet this test. Whether other investors invested on the faith of the prospectus will be for determination at the stage 2 hearing.

As to the third requirement under s 56, Mr Houghton did not lead any evidence on the loss he suffered in the High Court. He instead relied on an argument that his loss equalled the whole of his investment. This was on the basis that, once an untrue statement was proved, loss equal to the value of the investment followed automatically. The Supreme Court rejected that argument. The Court also rejected his application for an inquiry into damages.

Mr Houghton thus failed to prove loss at the stage 1 hearing. This means the end of his personal claim under the Securities Act, unless the High Court allows him to participate in the stage 2 hearing.

Contrary to the view of the Court of Appeal, the Supreme Court held that the untrue statement in the FY04 revenue forecast was capable of causing loss. Whether in fact it did cause loss for the investors other than Mr Houghton will be a matter for determination at the stage 2 hearing.

The Supreme Court has also held that the joint lead managers were not promoters under s 56 on the basis that their role fell within the professional capacity exception in para (c) of the definition of promoter in s 2(1) of the Securities Act. The claim against the joint lead managers under s 56 of the Securities Act was therefore dismissed.

Second cause of action: Fair Trading Act 1986

The second cause of action was for breach of s 9 of the Fair Trading Act 1986, which prohibits persons in trade from engaging in misleading and deceptive conduct. This cause of action was brought against the directors, CSAMP, CSPE and the joint lead managers.

The High Court held that the Fair Trading Act did not apply because of the primacy provisions in the Fair Trading Act and Securities Act which provided that a party cannot be liable under the Fair Trading Act for conduct which is regulated by the Securities Act. These primacy provisions came into force after the events in issue in Mr Houghton’s claim.

A majority of the Court of Appeal reversed that finding, holding that the Fair Trading Act applied as the primacy provisions did not have

retrospective effect. They found, however, that the untrue statement in the FY04 revenue forecast did not breach the Fair Trading Act.

The Supreme Court has upheld the majority's reasoning on the primacy provisions. However, the Supreme Court has held that the inclusion of the untrue statement in the FY04 revenue forecast amounted to misleading and deceptive conduct under s 9 of the Fair Trading Act.

The issue of whether there is a remedy available under the Fair Trading Act is left for consideration at the stage 2 hearing for all investors including Mr Houghton.

The Court has, however, dismissed the Fair Trading Act claim against the joint lead managers, because Mr Houghton failed to prove that the untrue statement in the FY04 revenue forecast could be attributed to them as primary parties.

Summary

In summary, the Supreme Court has held that the FY04 revenue forecast was an untrue statement for the purposes of s 56(1) of the Securities Act but has rejected all of the other claims relating to the prospectus. It has also held that the untrue statement constituted a breach of s 9 of the Fair Trading Act.

Whether investors invested on the faith of the prospectus and whether the untrue statement has caused any loss to the investors other than Mr Houghton will be determined by the High Court at the stage 2 hearing. Whether the breach of s 9 of the Fair Trading Act leads to a remedy to the investors (including Mr Houghton) under that Act will also be for determination at the stage 2 hearing.

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