IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI

SC 135/2016
[2018] NZSC 74

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 INCORPORATED Second Respondent
	CREDIT SUISSE FIRST BOSTON ASIAN MERCHANT PARTNERS LP Third Respondent
	FIRST NZ CAPITAL Fourth Respondent
	FORSYTH BARR LIMITED Fifth Respondent

Hearing:	5, 6 and 7 September 2017 (further submissions received 9 October 2017)
Court:	Elias CJ, Glazebrook, O'Regan, Arnold and Kós 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 Respondents (other than Mr Magill) T C Weston QC and S V A East for Mr Magill 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 QC for Fourth and Fifth Respondents
Judgment:	15 August 2018

JUDGMENT OF THE COURT

A The appeal in relation to the fourth and fifth respondents is dismissed.

B The appeal in relation to the first, second and third respondents is allowed to the limited extent described below.

C The Court of Appeal's finding that the forecast of revenue for the financial year ended 30 June 2004 (the untrue statement) was, at the time of allotment of the shares offered for subscription in the Feltex prospectus, an untrue statement for the purposes of s 56 of the Securities Act 1978, is upheld.

D The Court of Appeal's findings that the untrue statement did not give rise to liability under s 56 of the Securities Act 1978 and was not in breach of s 9 of the Fair Trading Act 1986 are set aside.

E We find that the untrue statement was in breach of s 9 of the Fair Trading Act 1986.

F The questions of whether plaintiffs represented by the appellant:

(i) invested on the faith of the prospectus in terms of s 56 of the Securities Act 1978 and, if so;

(ii) suffered any loss by reason of the untrue statement in terms of s 56 of the Securities Act 1978 and, if so, the quantum of such loss; and

(iii) are entitled to any remedy under the Fair Trading Act 1986

are left for resolution by the High Court at the stage 2 hearing.

G In all other respects, the appeal in relation to the first to third respondents is dismissed.

H Costs in this Court and the Courts below are reserved. Submissions on costs should be filed and served according to the following timetable:

(i) Appellant: 20 working days after the date of this judgment.

(ii) First to third respondents: 10 working days after the appellant's submissions are filed.

(iii) Fourth and fifth respondents: 10 working days after the first to third respondents' submissions are filed.

(iv) Appellant in reply: 10 working days after the fourth and fifth respondents' submissions are filed.

REASONS

(Given by Glazebrook, O'Regan and Kós JJ)

Table of Contents

	Para No.
The parties and the proceedings so far	[2]
Issues on appeal	[11]
Background facts	[19]
The statutory framework	[41]
Section 55(a): "untrue statement"	[72]
Definition or extension?	[75]
Entire prospectus as untrue statement?	[79]
Materiality requirement?	[81]
Clause 9, schedule 1	[88]
Section 56(1): "on the faith of" and "by reason of"	[93]
High Court	[95]
Court of Appeal	[97]
Legislative history	[102]
The "but for" argument	[111]
"On the faith of"	[119]
"By reason of the untrue statement"	[130]
Mr Houghton's contentions	[138]
The issues we will discuss	[143]
The prospectus	[146]
General information	[147]
Historical financial information	[148]
Prospective financial information	[149]
Events up to allotment	[155]
FY04 full year results	[178]
Was the FY04 revenue forecast a misleading statement?	[181]
High Court	[182]
Court of Appeal	[184]
Issues arising	[190]
When does a forecast become untrue or misleading?	[192]
Feltex's financial performance leading up to the forecast period	[196]
Failure to achieve FY04 revenue forecast	[203]

Significance of meeting EBITDA and net surplus forecasts [222]
Lack of market reaction to FY04 results [228]
Conclusion [230]
Was the reversal of the MIP provision the main reason Feltex achieved the FY04 EBITDA forecast? [232]
High Court [233]
Court of Appeal [234]
Our assessment [235]
Were sales in FY04 artificially bolstered by the offering of extended credit? [238]
High Court [239]
Court of Appeal [241]
Our assessment [242]
Should problems with tufters have been disclosed? [245]
High Court [247]
Court of Appeal [248]
Our assessment [251]
Was the FY05 projection a misleading statement? [252]
High Court [255]
Court of Appeal [260]
When is a projection an untrue statement? [261]
Our analysis [262]
Conclusion on whether the prospectus contained an untrue statement [267]
Stage 2 hearing and loss [269]
High Court [272]
Court of Appeal [273]
Our assessment [275]
Is a due diligence defence available to the respondents? [280]
High Court [283]
Court of Appeal [286]
The respondents' case [289]
Our assessment [291]
Can the Feltex directors and Credit Suisse be liable under the Fair Trading Act? [293]
High Court [304]
Court of Appeal [305]
The respondents' case [306]
Interpretation [308]
Retrospectivity [311]
Breach of the Fair Trading Act? [318]
Remedies under the Fair Trading Act [321]
Were the joint lead managers "promoters" for the purposes of the Securities Act? [326]
High Court [331]
Court of Appeal [334]
Meaning of "promoter" in the Securities Act [339]
The joint lead managers' role [352]
Were the joint lead managers "instrumental"? [361]
Does the "professional capacity" exception apply? [362]

Conclusion [367]
Summary [368]
Result [378]
Costs [385]

[1] This appeal raises for consideration a number of issues relating to the liability of those associated with an initial public offering (IPO) of shares in a company, in circumstances where it is alleged the offer document was misleading.

The parties and the proceedings so far

[2] The offer document at issue was a combined investment statement and prospectus issued by Feltex Carpets Ltd (Feltex), a carpet manufacturing company, on 5 May 2004. We will refer to this document as the prospectus.

[3] The appellant, Mr Houghton, applied for shares in Feltex and these were allotted to him on 2 June 2004. By September 2006, Feltex had gone into receivership, and in December 2006 it was placed in liquidation, which meant that the shares subscribed for by Mr Houghton had essentially no value.

[4] The claim initiated by Mr Houghton was a representative claim, in which he had acted in a representative capacity for himself and for others who had been allotted shares in Feltex in the IPO, and who had opted into the representative action. He claimed the respondents were liable to him for the loss he suffered under the Securities Act 1978, the Fair Trading Act 1986 and for negligent misstatement.[1]

[5] Under the prospectus, the shares in Feltex held by Credit Suisse First Boston Asian Merchant Partners LP (CSAMP) were offered for sale and, in addition, new shares to be issued by Feltex were offered for subscription. CSAMP is managed by

[1] The Securities Act 1978 has now been repealed by the Financial Markets (Repeals and Amendments) Act 2013 and replaced by the Financial Markets Conduct Act 2013. The detailed requirements for offers of securities to the public for subscription were contained in the Securities Regulations 1983 (which were revoked and replaced by the Securities Regulations 2009, themselves revoked by the Financial Markets (Repeals and Amendments) Act when the Securities Act was repealed. These have been replaced by the Financial Markets Conduct Regulations 2014). Unless stated otherwise, our discussion of the provisions of the Securities Act, Securities Regulations and Fair Trading Act 1986 refers to those provisions as they were at the time of the IPO.

Credit Suisse Private Equity Inc (CSPE). CSAMP and CSPE are referred to in the rest of this judgment, as they were in the lower Courts, under the generic name Credit Suisse, unless it is necessary to differentiate between them.

[6] The case for Mr Houghton is that the respondents are liable to him under the Securities Act for the loss he suffered in relation to his investment in Feltex in response to the prospectus. He says that the respondents are liable in the following capacities:

(a) The first respondents (the Feltex directors) as directors of Feltex at the time of the IPO. All signed the prospectus in that capacity.

(b) The second respondent, CSPE, as a promoter.[2] CSPE was named in the prospectus as a promoter and signed the prospectus in that capacity.

(c) The fourth respondent, First NZ Capital (First NZ) and the fifth respondent, Forsyth Barr Ltd (Forsyth Barr) as promoters. First NZ and Forsyth Barr were the organising participants and joint lead managers for the IPO. We refer to them collectively as the joint lead managers. Neither was named in the prospectus as a promoter but Mr Houghton alleges they were promoters of the offer and are liable in that capacity.

[7] Mr Houghton also argues that the Feltex directors, CSPE and the third respondent, CSAMP, were in breach of the Fair Trading Act because of misleading statements in the prospectus and that he is entitled to remedies under that Act.[3] He also claimed against the joint lead managers under the Fair Trading Act both as secondary parties to the alleged breaches of the other respondents and as primary parties in their own right. He has abandoned the secondary liability claim but it is not clear whether he has also abandoned the primary liability claim.[4]

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2 Mr Houghton also argued in the High Court and Court of Appeal that CSAMP was a promoter. Both Courts rejected that argument and it was not pursued in this Court: *Houghton v Saunders* [2014] NZHC 2229, [2015] 2 NZLR 74 (Dobson J) [*Houghton* (HC)] at [607]; and *Houghton v Saunders* [2016] NZCA 493, [2017] 2 NZLR 189 (Ellen France P, Randerson and Winkelmann JJ) [*Houghton* (CA)] at [277]–[279].

3 CSAMP was the vendor of its shares in Feltex and an "issuer" in terms of the Securities Act, but would not be liable for any breach of that Act for the reasons explained below at n 56.

4 See below at [319]–[320].

[8] In the High Court, Mr Houghton's claims under the Fair Trading Act and the Securities Act failed.[5] The Fair Trading Act claim failed when Dobson J concluded that causes of action under the Fair Trading Act in relation to the conduct in issue were excluded because that conduct was regulated by the Securities Act.[6] He found that Mr Houghton had failed to prove that the prospectus contained any materially misleading statements or omissions that would give rise to liability under the Securities Act.[7] He also considered that the respondents might have been able to make out a "due diligence" defence if they had breached the Securities Act.[8] He found that the joint lead managers were not promoters.[9] The Judge did not need to make a finding on loss, but indicated he did not accept the contention on behalf of Mr Houghton that he would be entitled to a full refund on his investment plus interest if he established the respondents (or any of them) were liable.[10]

[9] The Court of Appeal upheld the judgment of Dobson J, but differed from him in one respect. The Court of Appeal found that the forecast of revenue for the year ending 30 June 2004 (the FY04 revenue forecast) was an untrue statement contrary to the finding of Dobson J.[11] However, the Court found that it was not material and therefore did not lead to liability under the Securities Act on the part of the respondents.[12] Although it found no liability, it considered whether the due diligence defence would have applied if there was liability. It found that the due diligence defence would not apply where the directors and promoter knew there was an untrue statement in the prospectus but believed (reasonably) that it was immaterial.[13] It generally agreed with Dobson J's finding on loss.[14]

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5 A claim in negligence also failed. This claim is no longer pursued and we say no more about it.
6 *Houghton* (HC), above n 2, at [629], referring to s 63A of the Securities Act and s 5A of the Fair Trading Act.
7 At [50]. See also at [164]–[533].
8 At [554].
9 At [583] and [596].
10 At [709].
11 *Houghton* (CA), above n 2, at [99]–[102]. The FY04 revenue forecast is one component of the prospective financial performance forecast for FY04. The other significant components were the forecast EBITDA (Earnings Before Interest, Tax, Depreciation, Amortisation and Write-offs) and net surplus attributable to shareholders.
12 At [104]–[116].
13 At [209]–[210].
14 At [309]–[311].

[10] The Court of Appeal found that liability under the Fair Trading Act was not precluded,[15] but found no liability on the part of the respondents under that Act.[16]

Issues on appeal

[11] The principal focus of the appeal is on the FY04 revenue forecast and, in particular, the finding of the Court of Appeal that, although this was untrue and misleading, it did not lead to liability under s 56 of the Securities Act.[17] Mr Houghton challenged both the factual finding and the legal basis for the findings made by the Court of Appeal and High Court in relation to that statement. He also argued, for the first time in this Court, that the prospectus did not comply with cl 9 of sch 1 to the Securities Regulations 1983 because it omitted information about the forecast financial information for the year ending 30 June 2004 (the FY04 forecast) that cl 9 required to be included in the prospectus.[18]

[12] Mr Houghton also argued that there were other misleading statements in the prospectus. In his written submissions, it was argued that the prospectus, as a whole, was a misleading statement for the purposes of s 56 of the Securities Act, but his counsel did not develop the argument at the hearing.

[13] In Mr Houghton's written submissions it was also argued that the respondents are liable for misleading statements or omissions in the prospectus under the Fair Trading Act. The Feltex directors and Credit Suisse argued that liability under the Fair Trading Act is precluded by s 63A of the Securities Act. At issue is whether liability under the Fair Trading Act is excluded, as Dobson J found, and as Ellen France P, dissenting on this aspect in the Court of Appeal, agreed. If liability under the Fair Trading Act is not precluded, it will be necessary to determine whether there is any basis for liability under that Act.

[14] If Mr Houghton establishes that all or any of the respondents could be liable under the Securities Act, it will be necessary to determine whether they are able to rely

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15 At [292]–[295] but see the dissenting view of Ellen France P at [296].
16 At [297]–[298].
17 See below at [97]–[101].
18 See below at [88]–[92].

on the due diligence defence provided by s 56(3)(c) of the Securities Act. There is no equivalent provision in the Fair Trading Act.

[15] If any of the respondents are found to be liable under the Securities Act (and not able to rely on the due diligence defence), it will be necessary to determine whether the joint lead managers were "promoters" for the purposes of the IPO, in which case they could be liable under the Securities Act too. Dobson J found they were not promoters.[19] The Court of Appeal did not finally decide the point.

[16] Mr Houghton's principal argument was that the respondents were liable to pay him compensation equal to the amount he invested in the IPO. He did not adduce evidence of loss in the High Court. If his claim succeeds but his argument for full reimbursement fails, it will be necessary to determine whether he is entitled to compensation and, if so, on what basis. Mr Houghton argued there should be an inquiry as to damages and that his case should be remitted to the High Court for that purpose if this issue requires resolution. We will need to address that argument too.

[17] The High Court ordered that there should be a split trial for the representative claim.[20] The first hearing (the stage 1 hearing) dealt with Mr Houghton's claim in its entirety on the basis that the resolution of issues that were common to all members of the class represented by Mr Houghton would be binding on all. It was envisaged that there would be a further hearing dealing with individual aspects of the claims of each member of the class (the stage 2 hearing). The Court of Appeal observed that, if Mr Houghton was unsuccessful in that Court, there would be no need for a stage 2 hearing.[21] That observation was challenged in the present appeal.

[18] Before addressing the parties' arguments about the issues raised in the appeal, we set out a brief factual background. A more detailed factual background is provided below at [146]–[180].

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19 *Houghton* (HC), above n 2, at [583] and [596].

20 *Houghton v Saunders* [2012] NZHC 1828, [2012] NZCCLR 31 [judgment of French J]; and *Houghton v Saunders* HC Christchurch CIV 2008-409-348, 9 December 2011 [Minute of French J] at [1]. The common issues were recorded in a memorandum dated 20 January 2012 which was adopted in the 2012 judgment of French J at [40].

21 *Houghton* (CA), above n 2, at [33].

Background facts

[19] In 1996 Credit Suisse acquired 85 per cent of the shares in Feltex, with the remainder being held by executives of Feltex. Mr Thomas, then head of Credit Suisse First Boston's Asia Pacific private equity division, became a director of Feltex. Mr Thomas retired from Credit Suisse in 2001 but continued to work with it in a consulting capacity until 2005 and remained as a director of Feltex during that time. Soon after Credit Suisse's acquisition, Feltex experienced a period of difficult trading conditions but had made a reasonable recovery by 1999, assisted by improvement in the building and construction sector in Australia and New Zealand in the late 1990s.

[20] In 2000 Feltex purchased Shaw Industries Australia Pty Ltd (Shaw), a subsidiary of an American carpet firm, which carried out its Australian operations. As part of the transaction Credit Suisse became the sole shareholder in Feltex. Both of the main competitors to Feltex, Cavalier Corporation Ltd and Godfrey Hirst Australia Pty Ltd (Godfrey Hirst), had been interested in acquiring Shaw and the building market was strong. Credit Suisse therefore knew that it would "pay a reasonably full price" but was concerned that Feltex would be in a weak market position if either of its competitors acquired Shaw.

[21] A major benefit of the acquisition of Shaw was the opportunity to secure ongoing access to expertise, technology, products and supplies from the American parent company which was achieved through several support agreements. The acquisition also gave greater focus on the Australian, as against the New Zealand, market.[22] Another benefit was the expansion from wool into the synthetic market. Woollen carpets are generally high quality and command a high price. Synthetic carpets are usually in a lower price bracket. In the middle market sector synthetic and wool are substitutes for each other. Feltex's sales in the residential market were classified in internal reports as premium, middle and mass. In general, margins were higher in the premium and middle market segments than in the mass segment.

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22 After the acquisition of Shaw approximately 80 per cent of Feltex's sales were made in Australia with most of the remaining 20 per cent being made in New Zealand.

[22] Shaw's managing director, Mr Magill, became the Chief Executive Officer of Feltex and was responsible for bringing the businesses of Feltex and Shaw together, including integrating the Shaw business under the Feltex brand. The integration of Shaw and Feltex was a significant task. One of the issues was that Shaw was a low-end volume driven business while Feltex was a higher end, high margin business and this created tension in the company.

[23] In the first full financial year after the Shaw acquisition, there was a good first six months' trading result to 31 December 2000[23] and then a bad second half, due partly to restructuring but mostly to the contraction of both the commercial and residential markets. This contraction continued into the first half of the 2002 financial year, and Feltex's financial position was not assisted by a period of industrial action in October/November 2001. There was improvement in the second half of the 2002 financial year, with merger costs down, increased manufacturing efficiency and lower inventory. There was also an improved product mix, meaning a higher margin was achieved.

[24] In 2003, Feltex issued a prospectus for convertible notes (we will refer to this as the 2003 bond prospectus) and raised $60 million, reducing the high debt levels that had resulted from the Shaw acquisition. The improvement in the financial results continued in the 2003 financial year largely because of cost saving and margin improvement strategies. In the second six months EBITDA[24] was ahead of the projections used in the 2003 bond prospectus, a result partly assisted by the implementation of price increases in March 2003.

[25] In the course of 2003, Credit Suisse began to investigate the possibility of a sale of Feltex, considering an IPO or a possible trade sale to its major competitor, Godfrey Hirst. This was part of its strategy to dispose of certain classes of international investments. By December 2003 Mr Thomas was recommending an IPO

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23 Feltex's balance date was 30 June. Unless otherwise stated, all references to financial years in this judgment refer to the period beginning on 1 July of the previous calendar year and ending 30 June the next year. For example, the 2004 financial year ran from 1 July 2003 to 30 June 2004.

24 The normal definition of EBITDA is Earnings Before Interest, Taxation, Depreciation and Amortisation. The definition that was used in the prospectus is noted at n 11 and n 30.

because of the alignment between the state of the business, the state of the market and the state of the exchange rates for the Australian and New Zealand dollars.

[26] On 16 March 2004, Credit Suisse requested Feltex to proceed with an IPO. The Board resolved to do so and appointed a due diligence committee, which included Mr Saunders, the Chairman of the Feltex Board; Mr Thomas; Mr Kokic, the Chief Operating Officer; Mr Tolan, the Chief Financial Officer; and legal advisors for both Credit Suisse and Feltex. Representatives of each of the joint lead managers attended meetings as observers, as did other Feltex executives and accountants from Feltex's auditors, Ernst & Young.[25]

[27] At the date of the prospectus, the key executives of Feltex were the Chief Executive Officer (Mr Magill), Mr Tolan and Mr Kokic.

[28] Under the prospectus registered on 5 May 2004, Credit Suisse offered for sale all of the 113,523,100 shares it held in Feltex and Feltex offered for subscription a further $50,000,000[26] worth of shares, with the precise number to be issued depending on the final offer price. The closing date for the public offer, other than through firm allocations, was 21 May 2004. For applications through firm allocations the closing date was 2 June 2004.

[29] The prospectus provided for a share price between $1.70 and $1.95, with the final price to be determined by a book build process.[27] The final price determined by that process was $1.70 per share. Holders of convertible notes issued by Feltex under the 2003 bond prospectus, referred to above, received a five per cent discount on the $1.70 offer price if they converted their convertible notes to shares in Feltex in the IPO. That meant that the price per share for them was $1.615.

[30] The prospectus contained a forecast for the 2004 financial year (FY04) ending 30 June 2004 and a projection for the financial year ending 30 June 2005 (FY05). The commentary to the relevant Financial Reporting Standard, FRS-29, provides a useful

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25 Ernst & Young had been contracted to do a review of the due diligence process.
26 Unless otherwise mentioned, all dollar figures in this judgment are NZD.
27 The book build process is described in further detail below at [126].

summary of the difference between a forecast and a projection: "Forecasts reflect the most probable outcome while projections reflect a range of possible outcomes".[28]

[31] Dobson J, in his judgment,[29] set out the difference between a forecast and a projection in more detail as follows:

> [281] The prospective financial information included in the prospectus constituted a forecast for FY2004, and a projection for FY2005. The relevant Financial Reporting Standards (FRS) defined a forecast as prospective financial information prepared on the basis of assumptions that the directors reasonably expect to occur associated with the actions the directors reasonably expect to take as at the date that the information is prepared. A forecast is accordingly a best estimate assumption. The prospectus specified that the forecast for FY2004 was prepared in accordance with that definition.
>
> [282] In contrast, a projection is prepared on the basis of hypothetical but realistic assumptions (or "what if" scenarios) reflecting possible courses of action. It reflects an opinion that the projection falls within a range of possible outcomes. The terms of the prospectus similarly related the FY2005 projection to this definition … .
>
> (footnotes omitted)

[32] For the year to June 2004 the forecast was for total operating revenue of $335,498,000; EBITDA of $41,641,000;[30] and a net surplus of $10,113,000. This forecast was prepared using actual figures until the end of March 2004 and then forecast sales figures for the last three months of the financial year: April, May and June 2004. The FY05 projection was for total operating revenue of $348,147,000; for EBITDA of $51,683,000; and a net surplus of $23,889,000. Although the forecast and the projection figures were yearly totals, they came from a financial model prepared on a "bottom-up" basis using detailed month by month figures.[31]

[33] When the actual sales in the month of April 2004 were less than the forecast sales used for the FY04 forecast, no change was made to the prospectus and it was registered and distributed with the FY04 revenue forecast based on the assumed (but not achieved) sales in April 2004.

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28 Financial Reporting Standards Board *Financial Reporting Standard No 29: Prospective Financial Information* (Institute of Chartered Accountants of New Zealand, 1996) [FRS-29] at [4.3].

29 See further at *Houghton* (HC), above n 2, at [281]–[286].

30 For the purposes of the prospectus EBITDA was defined as Earnings Before Interest, Tax, Depreciation, Amortisation and Write-offs, which included a write-off for a bank facility fee and bond issue costs.

31 See below at [157].

[34] The last meeting of the due diligence committee was on 2 June 2004 after the offer period had closed but prior to the allotment of shares. The committee was told by Mr Magill that Feltex "might not meet its sales forecast for [the year ended 30 June 2004]". The minutes of the meeting indicated that the "might" in Mr Magill's statement was interpreted as meaning "will". The anticipated shortfall was around 2.8 per cent of the forecast annual sales.[32] The committee was told that the market was lifting and that some of the April and May shortfall should be recovered in June. It was also told that there was a high level of confidence that Feltex would achieve the forecast EBITDA and forecast net surplus.

[35] In light of the information and explanations from the executives, the committee decided that no material adverse circumstances had arisen since 5 May 2004 when the prospectus was issued that would cause the prospectus to be false or misleading. This view was reported to and accepted by the Board at its meeting on 2 June and the allotment of shares went ahead.

[36] The results for FY04 were announced on 24 August 2004. In the event, the shortfall in revenue as against forecast for the FY04 year was 2.3 per cent. Both EBITDA and net surplus exceeded the forecast figures.

[37] On 23 February 2005, the interim result for the first six months of FY05 to 31 December 2004 was announced. The interim surplus was up 7.1 per cent on the result for the corresponding period the year before. EBITDA was also up (by 6.9 per cent on the comparable period) but revenue was down by 7.4 per cent.

[38] There were difficult trading conditions in the first calendar months of 2005 and, on 1 April 2005, Feltex issued a profit downgrade warning indicating that the directors did not consider the company would achieve the level of profitability set out in the FY05 projection in the prospectus. A second revised earnings announcement was made on 20 June 2005.

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32 Approximately $7.5 to $9 million dollars.

[39] On 22 September 2006 Feltex's bank appointed receivers and, in October 2006, the company's assets were sold to Godfrey Hirst. Feltex was placed in liquidation on 13 December 2006.[33]

[40] This summary provides the context for the legal discussion that follows. As mentioned earlier, we will provide a more detailed analysis of the relevant facts when addressing the issues later in this judgment.

The statutory framework

[41] The Securities Act was, at the relevant time, the legislation governing the offering of securities to the public in New Zealand.[34] The offer was made in a combined investment statement and prospectus.

[42] Mr Houghton's claim is made under s 56(1), which provides:

> **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.

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33 This was pursuant to a court order: see *Feltex Carpets Ltd v N & I Investments Ltd* (2006) 3 NZCCLR 714 (HC).

34 The legislative history is briefly summarised in the decision of this Court in *Hickman v Turn and Wave Ltd* [2012] NZSC 72, [2013] 1 NZLR 741 [*Hickman* (SC)] at [41]–[45].

[43] Section 56(3)(c) provides a defence to a person who would otherwise be liable to pay compensation under s 56(1). Section 56(3)(c) provides:

> (3) No person shall be liable under [section 56(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; …

[44] Section 56(1) does not refer to an investment statement explicitly, but that is not an omission. Section 2A(2)(b) provides that an investment statement is an advertisement, so s 56(1) covers untrue statements in an advertisement, an investment statement or a prospectus.

[45] Those entitled to compensation under s 56(1) are persons who subscribe for securities "on the faith of" a registered prospectus (or advertisement). The compensation is for loss or damage sustained "by reason of such untrue statement". Much of the legal argument before us dealt with the meaning of those phrases. We address those arguments below.[35]

[46] Section 56 must be read in conjunction with s 55(a), which gives guidance in relation to the key term, "untrue statement". That provision 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:

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35 See below at [93]–[136].

[47] Mr Houghton alleges that the Feltex prospectus contained untrue statements, that he subscribed for shares in Feltex on the faith of the prospectus and that he has sustained loss by reason of the untrue statements. Section 56(1) provides for payment of compensation for loss or damage. In the present case, however, Mr Houghton alleges that his loss is the full subscription amount (that is, $1.70 for every share acquired in the IPO). We will return to that aspect of the case later.[36]

[48] An important issue that arises in relation to s 55(a) is whether a statement that is deemed to be untrue in terms of that provision must be misleading *in a material respect*. Another issue is whether s 55(a) defines "untrue statement" for the purposes of the Act or whether as argued by Mr Houghton, the term retains its natural meaning, with s 55(a) operating only to extend that meaning. A third issue is whether an entire prospectus can be an untrue statement under s 55(a). We will address these arguments later.[37]

[49] Section 56 appears in Part 2 of the Securities Act, entitled "Restrictions on offer and allotment of securities to the public". In order to determine the scope of s 56(1) and the extent of the liability it creates, it is important to consider it in its statutory context.

[50] Part 2 begins with s 33, which deals with offers of securities to the public for subscription. Section 33(1) is the relevant provision in this case. It provides:

> **33 Restrictions on offer of securities to the public**
>
> (1) No security shall be offered to the public for subscription, by or on behalf of an issuer, unless—
>
> (a) the offer is made in, or accompanied by, an authorised advertisement that is an investment statement that complies with this Act and regulations; or
>
> (b) the offer is made in an authorised advertisement that is not an investment statement; or
>
> (c) the offer is made in, or accompanied by, a registered prospectus that complies with this Act and regulations.

[36] See below at [269]–[278].
[37] See below at [73]–[92].

[51] There is no doubt that the Feltex offer was an offer "to the public for subscription", even though the offer combined both an offer of new shares to be issued by Feltex itself, and an offer for the sale of previously allotted shares owned by CSAMP. That is because "subscription" includes "purchase"[38] and s 6(3) of the Securities Act makes it clear that an offer to the public for sale of equity securities (shares) that have previously been allotted can be subject to the provisions of the Act. This occurs where the owner of the shares (in this case, CSAMP) offers them for sale to the public and the original allotter (in this case, Feltex) "advises, encourages or knowingly assists the holder or offeror in connection with the offer or sale of the security".

[52] So s 33(1) applied to the IPO (both to the sale of CSAMP's shares in Feltex and the offer for subscription by Feltex of new shares in Feltex).

[53] Where previously allotted shares are offered to the public for sale, both the original allotter of the security (Feltex) and the offeror of the security (CSAMP) are "issuers" except in relation to some provisions which are not relevant for present purposes.[39] In this case, therefore, Feltex was an issuer in relation to the shares offered for sale by CSAMP as well as in relation to the new shares it offered for subscription. CSAMP was an issuer only in respect of the Feltex shares it sold through the IPO.

[54] Section 33 does not require that an offer be made in a registered prospectus – that is only one of the permitted methods of making an offer. The others are in an investment statement or in an authorised advertisement.[40]

[55] However, a registered prospectus was required in relation to the IPO. This is not because s 33(1) required it, but because of the application of s 37(1) of the Securities Act. The relevant provisions of s 37 are ss 37(1) and (4), which provide:

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38 This is provided for in the definition of "subscribe" in s 2 of the Securities Act.
39 Section 6(7) of the Securities Act.
40 As noted earlier, the offer in this case was made in a document that was both an investment statement and a registered prospectus. So it was lawfully made under s 33(1)(a).

37 Void irregular allotments

(1) No allotment of a security offered to the public for subscription shall be made unless at the time of the subscription for the security there was a registered prospectus relating to the security.

…

(4) Any allotment made in contravention of the provisions of this section shall be invalid and of no effect.

[56] Under s 37(1), an allotment cannot be made without a registered prospectus. That means there can be no meaningful offer of securities to the public without a registered prospectus. But, as s 33(1) makes clear, it is not a requirement that the document communicating the offer is, itself, a registered prospectus.

[57] There is no specific civil sanction in the Securities Act for a breach of s 33(1). However, if the offer is not withdrawn and securities are subscribed for by investors, the allotment of those securities will be invalid and of no effect under s 37(4). If no subscriptions are made in response to the offer, no investor will have suffered loss as a result of receiving the offer. Nor is there a specific criminal sanction for breach of s 33(1), but the generic offence of making an offer of a security to the public in contravention of the Securities Act in s 59 would criminalise the making of an offer that did not meet one of the methods of compliance set out in s 33.

[58] A registered prospectus is a prospectus that has been presented to the Registrar of Companies for registration and has been registered under s 42 of the Securities Act.[41] Where there is no registered prospectus so that any allotment of securities is invalid and of no effect, any money received in relation to subscriptions for the securities must be repaid (with any interest earned). If this does not occur, the issuer and the directors of the issuer (but not the promoter) are jointly and severally liable to repay the subscriptions.[42]

[59] In this case, there was a registered prospectus when the allotments were made so it is not suggested that the allotments were invalid and of no effect under s 37(4).

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41 The Securities Commission has power under s 44 to suspend or cancel the registration of a prospectus.

42 Section 37(5) and (6). Provision is made for relief from liability under s 37 in ss 37AA to 37AL.

[60] Section 39(1) of the Securities Act specifies the requirements for a registered prospectus. It is required to be in writing and be dated, to specify the documents required to be endorsed or attached to it under s 41 and the Securities Regulations and contain "all information, statements, certificates, and other matters that it is required to contain" by sch 1 to the Securities Regulations. The information required by sch 1 includes details about the offeror, issuer (and its subsidiaries), directors and advisers, promoters and substantial security holders of the issuer. It also requires details of the terms of the offer and has detailed requirements relating to the financial information to be included in the prospectus, including a statement as to the trading prospects of the issuing group. In addition to the specific requirements, sch 1 requires disclosure of any material matters relating to the offer.

[61] Mr Houghton argued that the Feltex prospectus did not comply with the Securities Regulations because it did not comply with cls 9 and 10 of sch 1 to those Regulations.[43]

[62] Section 34(1)(b) of the Securities Act prohibits the distribution of a registered prospectus "if it is false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances". This applies whether it was misleading from the outset or becomes so during the offer period because of a change in circumstances. In the latter event, a prospectus may be amended, although the section does not impose any obligation to amend.[44] The Registrar is required to refuse to register a memorandum of amendments of a registered prospectus if he or she is of the opinion that the registered prospectus as amended contains a statement that is false or misleading on a material particular or omits any material particular.[45]

[63] The requirement for an investment statement in relation to the IPO arose because under s 37A(1)(a), an allotment of a security offered to the public for subscription may not be made if the subscriber has not received an investment statement before subscribing for the security. An offer made without an investment statement is voidable by the subscriber.[46]

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43 We discuss this aspect of the claim below at [88]–[92] and n 68.
44 Section 43. See the discussion below at [66](b) and n 49.
45 Section 43(5)(a).
46 Section 37A(3), discussed below at [67]–[68].

[64] The Registrar is also required to refuse to register a prospectus from the outset if he or she is of the opinion that the prospectus contains a statement that is false or misleading on a material particular or omits any material particular.[47]

[65] Section 37A(1)(b) deals with the situation that arises where an investment statement or registered prospectus is known by the issuer or any director of the issuer to be misleading.[48] It prohibits any securities that were offered to the public for subscription being allotted to subscribers if:

> … at the time of allotment, the investment statement or registered prospectus relating to the security is known by the issuer of the security, or any director of the issuer, to be false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances (whether or not the investment statement or registered prospectus became so false or misleading as a result of a change of circumstances occurring after the date of the investment statement or registered prospectus); …

[66] We make two points about s 37A(1)(b):

(a) First, it recognises that an investment statement or prospectus may be false or misleading in a material particular not only because it fails to refer to adverse circumstances but also because it fails to give them "proper emphasis" (this includes post-prospectus, pre-allotment changes in circumstances).

(b) Second, this provision provides a strong incentive to issuers to amend a prospectus if a change of circumstances leads to a statement in a registered prospectus that was true at the time of registration to become false or misleading in a material particular.[49]

[67] An allotment made in contravention of s 37A(1) is voidable at the instance of the subscriber by notice in writing to the issuer at any time within the "prescribed

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47 Section 42(3)(b).

48 As noted above at [53], both CSAMP and Feltex were issuers in this case.

49 Perhaps surprisingly, there is no explicit provision in Part 2 of the Securities Act that requires an issuer to amend its prospectus in these circumstances. Nor is there any provision setting out what needs to be done in relation to those who applied for securities before the date of the amendment. This can be contrasted with the clear provisions in the Financial Markets Conduct Act: see ss 79 and 80.

period".[50] The prescribed period is either the period of one year after the security or a certificate of the security has been sent to the subscriber or a period of six months after the subscriber knows or ought reasonably to know that the allotment was made in contravention of the prohibition, whichever is the lesser.[51]

[68] If an allotment of securities is avoided under s 37A, the issuer must immediately return the subscriptions to the subscriber.[52] If that does not occur then the issuer and all its directors are jointly and severally liable to repay the subscriptions with interest.[53] Unless a notice avoiding the allotment is given by the investor within the prescribed period, the allotment is valid.[54]

[69] Provision is made in ss 37B–37G for relief from liability under s 37A in some circumstances. If relief is granted the court can order that compensation be paid to subscribers for "any loss or damage suffered by the subscriber that is caused by the contravention of section 37A".[55] This is a more direct expression of the need for a causative link between breach and loss than the "by reason of" wording in s 56(1).

[70] Two points can be made about Mr Houghton's claim, based on this statutory context:

(a) Mr Houghton's claim is made under s 56(1), that is, he says he invested on the faith of the prospectus, the prospectus contained an untrue statement and he sustained a loss (of his entire investment) by reason of the untrue statement; and

(b) Mr Houghton is not claiming the remedies available in relation to an invalid allotment under s 37(4) or a voidable allotment under s 37A(3). So the availability of those remedies (the repayment of subscriptions)

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50 Section 37A(3).
51 Section 37A(4).
52 Section 37A(6).
53 Section 37A(7). The liability of directors is subject to a proviso that a director is not liable if he or she proves that the default in the repayment of the subscription was not due to any misconduct or negligence on his or her part.
54 Section 37A(5).
55 Section 37E(b). Sections 37AG(1) and 37AJ(b) are similar provisions applying where relief is granted in relation to a breach of s 37.

is not in issue in this case. The securities for which Mr Houghton subscribed and which were allotted to him were validly allotted and his claim is therefore a claim for loss or damage for which compensation may be payable under s 56(1).[56]

[71] We now turn to the two key sections of the Securities Act and set out our approach to their application in this case.

Section 55(a): "untrue statement"

[72] For convenience, we set out the text of s 55(a) again:

> **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:

[73] Three issues arise in relation to s 55(a). These are:

(a) whether s 55(a) exhaustively defines "untrue statement" or extends the normal meaning of the term untrue statement;

(b) whether a prospectus as a whole can be an untrue statement; and

(c) whether there is any materiality requirement.

[74] We will deal with each of these in turn and then address Mr Houghton's argument about the application of cl 9 of sch 1 to the Securities Regulations.

56 This has particular significance in relation to CSAMP. As an issuer, CSAMP would have been liable to return the money it received on the sale of its shares in Feltex to investors under s 37A, but it has no liability under s 56 because s 56(1)(a) provides that an issuer is liable under s 56 only if the issuer is an individual, that is a natural person.

Definition or extension?

[75] Section 55(a) does not use the wording commonly found in a definition section such as "untrue statement means …". Rather it says that a statement is "deemed to be untrue" if either of para (i) or (ii) applies. Mr Houghton argues that this indicates that s 55(a) is not an exhaustive definition of the word untrue, and that word should be given its common meaning. The purpose of s 55(a) is, he argues, to deem otherwise true statements to be untrue for the purposes of s 56(1) if they are misleading in the form and context in which they are included or by reason of a material omission. The Court of Appeal rejected this submission.[57]

[76] The Court of Appeal saw s 55(a) as signifying that a statement that is literally true when read in isolation may nevertheless be deemed to be untrue if it is misleading in context and, conversely, that a statement that is literally untrue if read in isolation may not be untrue for the purposes of the provision if it is not misleading when read in context. We agree with the first of those propositions, but have some reservations about the second. However, we do not see this as giving rise to any point of significance in the context of the present appeal, because there is nothing to indicate that the analysis of the allegations of untruthful statements in the Feltex prospectus involves any controversy about a statement that is literally untrue but alleged not to be so because of the context in which it appears.

[77] The definition of "untrue" in s 55(a) is very broad. It is clear that at least s 55(a)(ii) extends the meaning of the term "untrue statement". The term "misleading" is used in both (i) and (ii) of s 55(a). The breadth of the term "misleading" is illustrated by reference to s 37A(1)(b), which refers to a prospectus being false or misleading "by reason of failing to refer, or give proper emphasis, to adverse circumstances". Although those words do not appear in s 55(a), we consider a broad interpretation of the term "misleading" is appropriate. Because of the breadth of the definition in s 55(a), we do not consider that it makes any difference (at least for the purposes of the present appeal) whether it is seen as an exhaustive definition or not. We will therefore treat the definition as exhaustive for the purposes of this judgment.

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57 *Houghton* (CA), above n 2, at [51].

[78] We do note, however, that the term "untrue statement" and the definition in s 55(a) must be interpreted in the context of the Act and its investor protection purpose. This means that, to be an untrue statement in terms of s 56(1), any statement must be on a topic that may be relevant (either on its own or in combination with other considerations) to a decision to invest. Statements (even if incorrect) that are incapable of being relevant to an investment decision will not be untrue statements for the purpose of s 56(1).[58] For example, trivial errors, such as an error in the middle name or address of a director or a clear typographical error, are unlikely to be capable of being relevant to an investment decision.[59]

Entire prospectus as untrue statement?

[79] Although not developed in oral argument, in his written submissions, Mr Houghton also argued that the prospectus in its entirety could be an untrue statement for the purposes of s 56(1). This was rejected by both Dobson J[60] and the Court of Appeal.[61]

[80] We are not convinced that this argument has any bearing on the outcome of the appeal, given the focus on a particular aspect of the prospectus, namely the FY04 revenue forecast. A claim that a prospectus is, in its entirety, an untrue statement will be able to be substantiated only if it can be shown that statements in (or omissions from) the prospectus have a cumulative effect, making the overall document misleading. While such an argument may be broadly described as an argument that the prospectus itself is an untrue statement, the reality is that it is unlikely to be successful unless it is supported by identified misleading statements or omissions.

Materiality requirement?

[81] The High Court found that the failure to achieve the FY04 revenue forecast was not material and, at least implicitly, that it was not therefore an untrue statement.[62]

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58 In any event, it is difficult to see a statement that could not be relevant to an investment decision as misleading in terms of s 55(a).

59 In this case, the alleged untrue statements are all on topics that are relevant to an investment statement, particularly since they relate to financial performance.

60 *Houghton* (HC), above n 2, at [58]–[77].

61 *Houghton* (CA), above n 2, at [52]–[56].

62 *Houghton* (HC), above n 2, at [187]–[192].

The Court of Appeal accepted that a statement could be an untrue statement under s 55(a)(i) whether or not it was material.[63] The respondents submit that the High Court was correct and that a statement is not an untrue statement if it is not materially untrue.

[82] There is nothing in the wording of s 55(a) that requires that a statement be misleading to a material extent. Section 55(a)(i) uses the term "misleading" without any reference to materiality. It is true that s 55(a)(ii) refers to a statement that is misleading by reason of the omission of a particular which is material to the statement. That does introduce the word "material", but not as a qualifier of the word "misleading". Rather, it is a qualifier of "a particular". The effect of para (ii) is that a statement that is otherwise true can become an untrue statement for the purposes of s 56(1) if a particular is omitted and the particular that is omitted is such that its omission makes the otherwise true statement misleading. There is nothing in s 55(a)(ii) that supports the proposition that a misleading statement will not breach s 55(a)(i) unless it is misleading to a material extent.

[83] In the present case, Mr Houghton argues that the FY04 revenue forecast was an untrue statement. To the extent that Mr Houghton relies on s 55(a)(i), we, like the Court of Appeal, do not think there is any requirement that an untrue statement be misleading to a material extent. All that is required is that the statement is misleading in the form and context in which it is included in the prospectus.[64]

[84] A comparison of s 56(1) with s 58(3) reinforces the view that neither s 55(a)(i) nor s 56 require that an untrue statement be misleading to a material extent. Section 58(3) imposes criminal liability where a prospectus includes an untrue statement. Section 55(a) applies to s 58, as well as to s 56. Section 58(4) provides a defence for any person who would otherwise be liable under s 58(3) if:

> … the person proves either that the statement was immaterial or that he or she had reasonable grounds to believe, and did, up to the time of distribution of the prospectus, believe the statement was true.

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63 *Houghton* (CA), above n 2, at [102]. The Court of Appeal did, however, consider that there was a materiality requirement in s 56: see the discussion below at [97]–[100].

64 As we will explain later, whether the fact that a prospectus contains a misleading statement leads to liability for the issuer, directors and promoters will be determined (under s 56(1)) by whether an investor sustains loss by reason of the untrue statement: see below at [131].

[85] The defence in s 58(4) for an untrue statement that is immaterial reinforces the conclusion that there is no materiality element in s 55. To be an untrue statement for the purposes of s 55(a), the statement or omission must be misleading. It does not need to be materially misleading.[65]

[86] Section 58(4) can be contrasted with s 56(3)(c), which provides for a defence against civil liability under s 56(1) if the person who would otherwise be liable had reasonable grounds to believe and did believe an untrue statement in a prospectus was true.[66] Section 56(3)(c) makes no reference to materiality, unlike s 58(4). No defence of immateriality is required against civil liability under s 56(1). Civil liability will arise only if a person suffers loss by reason of the untrue statement, which could happen only if the untrue statement was of sufficient significance to cause loss. This could arise either because the untrue statement presents the securities that are offered to the public for subscription as having a greater value than they have in fact or because it induces an investor to subscribe for shares when he or she would not have done so had he or she known the true position.

[87] We will discuss what the lack of materiality requirement means for forecasts and projections below.[67]

Clause 9, schedule 1

[88] In the course of argument in this Court, Mr Houghton claimed to expand the argument apparently made in the Courts below to focus on what he says was the failure to set out in the prospectus important matters relating to the FY04 forecast. These included details about the way in which the FY04 forecast was calculated and risk factors that were known to Feltex and its directors that could impact on Feltex's ability to achieve the FY04 forecast. He argued that the FY04 forecast was an untrue statement for the purposes of s 56(1) because there was a failure to comply with cl 9 of sch 1 to the Securities Regulations.[68]

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65 *Houghton* (CA), above n 2, at [209]–[210].
66 See above at [43].
67 At [193]–[194] and [261].
68 In his written submissions, Mr Houghton also argued that the FY04 forecast was an opinion which was not allowed to be included in the prospectus. This argument was based on the proposition that the only permitted opinions for prospectuses for IPOs was the prospective statement of cashflows required by cl 10(1)(c) of sch 1. This argument was not developed in oral submissions

[89] Clause 9(1) of sch 1 to the Securities Regulations requires that a registered prospectus contain:

> **9 Prospects and forecasts**
>
> (1) A statement as to the trading prospects of the issuing group, together with any material information that may be relevant thereto.
>
> (2) The statement required by subclause (1) of this clause shall include a description of all special trade factors and risks that—
>
> (a) Are not mentioned elsewhere in the registered prospectus; and
>
> (b) Are not likely to be known or anticipated by the general public; and
>
> (c) Could materially affect the prospects of the issuing group.

[90] Mr Houghton argued that the prospectus did not comply with cl 9 because adverse material information that was known by the directors (and the promoters) was not disclosed, and this rendered the FY04 revenue forecast misleading.

[91] The respondents take issue with this submission on a number of grounds. The first is that it was neither pleaded nor argued in the High Court or Court of Appeal, and so is raised for the first time in this Court. The second is that it is factually incorrect, given the substantial statement of assumptions underlying the forecast that appeared in the prospectus at page 88 and the lengthy statement of risks that appeared in the "What are my risks?" section on pages 125 to 130 of the prospectus.[69]

[92] We do not see Mr Houghton's argument as advancing his case. If material information that was relevant to the FY04 revenue forecast was omitted, this would support the argument that the FY04 revenue forecast was an untrue statement in terms of s 55(a)(ii), because it would amount to the omission of a particular which was

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and is at odds with the express requirement of cl 9 of sch 1 for a "statement as to the trading prospects of the issuing group", the relevant accounting standards which require the information set out in the FY04 forecast and the express recognition of prospective financial information in the definition provision in reg 2 of the Securities Regulations and in cl 42(2) of sch 1 which required audit certification in a particular form if the registered prospectus contains prospective financial information.

69 At the beginning of the section setting out the assumptions underlying the forecast, the following statement appeared: "The principal assumptions upon which the forecast financial information is based are summarised below and should be read in conjunction with 'What are my risks?' on pages 125 to 130 of this Offer Document".

material to the FY04 revenue forecast. Thus the omission of material information would provide a basis for a claim under s 56(1) if that makes the FY04 revenue forecast an untrue statement.[70] Even if it were established that the omitted particulars make the FY04 forecast non-compliant with cl 9 of sch 1 to the Securities Regulations, that would add nothing to the claim under s 56(1).

Section 56(1): "on the faith of" and "by reason of"

[93] The liability imposed on issuers, directors and promoters under s 56(1) is a liability to compensate investors who invested "on the faith of [the prospectus]" for any loss or damage they may have sustained "by reason of such untrue statement". The positions of the parties as to the interpretation of s 56(1) were starkly contrasting. Mr Houghton's position was that all he needed to prove was that there had been an untrue statement in the prospectus, upon which he would be entitled to compensation equal to the total amount of his investment. On this view, no element of materiality is required. The respondents argued in the High Court that an investor had to prove they had read the untrue statement in the prospectus and had relied on it explicitly, in the same way as for a claim for negligent misstatement. They argued that, if the investor could prove such reliance, their loss would be the difference between the price they paid for their Feltex shares and the fair value of the shares had accurate disclosure been made.

[94] We begin our analysis of these issues by first setting out in more detail the way they were dealt with in the Courts below. Because we see the legislative context as assisting with the understanding of the meaning of ss 55 and 56, we then discuss the legislative history, before addressing Mr Houghton's "but for" argument. We will then analyse the meaning of the phrases "on the faith of [a registered prospectus which contains an untrue statement]" and "by reason of [the] untrue statement" in s 56.

High Court

[95] In the High Court, Dobson J found that, in order to trigger liability under s 56, a statement must be misleading in a material respect.[71] He did not consider that the

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70 As explained above at [82].
71 *Houghton* (HC), above n 2, at [118].

requirement that an investment had been made "on the faith of" a registered prospectus required the same reliance on particular passages as would arise, for example, in a tortious claim for reliance on a negligent misstatement.[72] He considered that the purpose of the legislation was to "create liability in respect of misleading content or omissions where that content materially contributed to a claimant's decision to invest".[73]

[96] This meant that any untrue statement or statements must be sufficiently material that, if corrected, it would have been more likely than not that the investment would not have been made. This would assume 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".[74] Dobson J rejected Mr Houghton's "broader claim that indirect reliance, merely on the existence of a prospectus, would be sufficient".[75]

Court of Appeal

[97] The Court of Appeal considered that there is a materiality requirement in s 56. It said that to succeed plaintiffs must prove:[76]

> (a) an untrue statement;
>
> (b) that they read and considered the prospectus; and
>
> (c) that a notional investor's decision to invest was more likely than not to have been influenced by the particular untrue statement (unless the evidence establishes the particular plaintiff did not rely on the untrue statement).[77]

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72 At [117].
73 At [118].
74 At [118].
75 At [118].
76 *Houghton* (CA), above n 2, at [82](c).
77 It will be apparent from what we say below that we do not adopt this approach. At this point we just note that s 56 says "on the faith of [the] prospectus" and not "on the faith of the untrue statement". Any loss, however, would have to be by reason of the untrue statement as we explain below.

[98] The Court of Appeal recognised that information in a prospectus may not be understood by a notional investor (the prudent but non-expert person). It said a notional investor could be expected to seek advice if information in the prospectus is not readily understandable to him or her.[78] The Court rejected (correctly, in our view) a submission made on behalf of Mr Houghton that only information that is comprehensible by the notional investor without professional assistance may be included in a prospectus.[79]

[99] The Court saw the materiality requirement flowing from the requirement in s 56(1) that the investor show that his or her loss was suffered "by reason of such untrue statement". The Court said that if an untrue statement was immaterial, it was difficult to see how a plaintiff could have suffered loss by reason of it.[80]

[100] The Court of Appeal considered that s 56 required plaintiffs to show reliance on the untrue statement to establish loss by reason of it. The first element required was the "on the faith of" requirement:

> [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.[81] 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.

[101] The Court then went on to consider the second requirement: that the investor must prove that the loss occurred by reason of the untrue statement. The Court referred to the High Court's conclusion that the investor must establish 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 then set out its approach as follows:

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78 At [78].
79 At [77]. See our rejection of the notional investor standard below at [105]–[107].
80 At [60].
81 See *Saunders v Houghton* [2009] NZCA 610, [2010] 3 NZLR 331 at [85]–[86] where [the Court of Appeal] 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.

[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 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:

> 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). Section 3(1) of that Act provided:

> **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 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. Nevertheless, the *Arnison* approach to causation continued to be applied under the Act.
>
> [73] Section 56 of the [Securities Act], 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 [Securities Act]: that of the notional investor as we now discuss.
>
> (footnotes omitted)

Legislative history

[102] In our view, the legislative context is an important consideration in the interpretation of s 56(1). As noted earlier, s 33 does not require that an offer of securities to the public be made in a registered prospectus.[82] What is required is that there be a registered prospectus in relation to the offer.[83]

[103] The provisions allowing an offer to be made in an investment statement without a copy of the prospectus being provided to each offeree were introduced into the Securities Act by the Securities Amendment Act 1996 (the 1996 Amendment). The 1996 Amendment gave effect to the Accord on Retirement Policies[84] entered into by the National, Labour and Alliance parties after the publication of the last of three reports by the Task Force on Private Provision for Retirement, known as the Todd Task Force.[85] A working group was set up by the Government to advise on implementation

82 Above at [54].
83 Securities Act, s 37(1). See above at [55]–[56].
84 An Accord on Retirement Income Policies (entered into August 1993 by the Alliance, Labour and National Parties) [1993 Accord].
85 The third report was *Private Provision for Retirement: The Way Forward* (Final Report of the Task Force on Private Provision for Retirement, December 1992) [Todd Task Force – *The Way Forward*]. The earlier reports were *Private Provision for Retirement: The Issues* (Interim Report of the Task Force on Private Provision for Retirement, December 1991) and *Private Provision for Retirement: The Options* (Report of the Task Force on Private Provision for Retirement, August 1992).

of the 1993 Accord and, after public consultation, released its final report in December 1995.[86]

[104] The Working Group Report recommended the introduction of provision for investment statements aimed at the "prudent but non-expert investor".[87] The Working Group saw this as broadly consistent with the two-tiered disclosure system that had been considered by the Securities Commission in 1980.[88] Ultimately, the Securities Commission had rejected the two-tier regime on the basis that such a regime did not fit comfortably within the Securities Act as enacted.[89] The Securities Commission had described the proposed two tiers of disclosure as follows:[90]

> (a) One part, addressed to the general public, could deal with the matters regarded as of particular interest to the general public rather broadly and uncomplicated by the detail that is required by an expert analyst.
>
> (b) The other part would include the full measure of disclosure which an expert analyst would reasonably require.

[105] The 1996 Amendment gave effect to the Working Group Report and the new s 38D of the Securities Act provided that the purpose of the investment statement was the provision of key information to assist a "prudent but non-expert person" to determine whether or not to invest. No substantive changes were made to the required contents of a prospectus when the provisions relating to investment statements in the 1996 Amendment were enacted.[91] There was nothing in the 1996 Amendment to indicate any variation from the Working Group Report's recommendation.

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86 Working Group on Improved Product and Investment Advisor Disclosure *Implementation of Part 4 of the 1993 Accord on Retirement Income Policies: Recommendations for Improved Investment Product and Investment Adviser Disclosure* (Final Report, 21 December 1995) [Working Group Report].

87 At [155]. The term "prudent non-expert investor" echoed the reference in Todd Task Force – *The Way Forward*, above n 85, at 72 of the need for investors to obtain information "designed to enable prudent but non-expert savers to make meaningful comparisons between essentially similar savings products".

88 At [73].

89 Securities Commission *Proposals for the Enactment of Regulations Under the Securities Act 1978* (March 1980) [Securities Commission 1980 Report] at [6.1.6].

90 At [6.1.5].

91 The 1996 Amendment made the following changes to disclosure by prospectus: (a) it extended the coverage of the provisions to include life insurance, superannuation and unit trust products; (b) it no longer required every investor to receive a prospectus, instead, prospectuses would be available on demand; (c) it enabled a prospectus to be combined with an annual report; and (d) it allowed the term of a registered prospectus to be extended. The provisions regulating what was required to be contained in a prospectus were not changed.

[106] This background demonstrates that s 38D, which provides that the purpose 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 invest, should not be interpreted in any broader way so as to provide guidance as to the purpose of a prospectus. There is nothing in s 38D to indicate that it was intended to apply to a prospectus.[92]

[107] In light of this background, we do not consider that the "prudent but non-expert person" is the statutory standard against which the information provided in a prospectus is to be assessed. That standard applies to investment statements only. We disagree with the Court of Appeal's conclusion to the contrary and with the High Court decisions cited in support of that conclusion.[93]

[108] The 1996 Amendment did not make any amendment to s 56 to reflect the new regime that allowed an offer of securities to be made to members of the public without providing a copy of the prospectus to each offeree. This is perhaps surprising, but it was not a matter of oversight. Both the Working Group and the Select Committee to which the Investment Product and Adviser (Disclosure) Bill was referred, the Justice and Law Reform Committee, considered such an amendment but decided none was necessary.[94] The Select Committee Report acknowledged that, prior to the 1996 Amendment, investors would, in order to recover loss, be required to show they relied on the prospectus and any untrue statement in it when subscribing for securities.[95] The Select Committee noted that the Bill did not change the law and said it did not consider any change was necessary.

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92 The Court of Appeal's notional investor was defined as the prudent but non-expert person (see above at [98]). This was based, in part, on the fact that s 38D of the Securities Act requires that an investment statement must provide information likely to assist a prudent but non-expert person to decide whether or not to invest. As is apparent, we do not accept that the reference in s 38D to the prudent but non-expert person in relation to an investment statement should be seen as indicating the same standard applies to a prospectus.

93 *Houghton* (CA), above n 2, at [74], citing *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [63], *R v Petricevic* [2012] NZHC 665, [2012] NZCCLR 7 at [224]–[225]; and *R v Graham* [2012] NZHC 265, [2012] NZCCLR 6 at [25].

94 Working Group Report, above n 86, at [168]; and Investment Product and Adviser (Disclosure) Bill 1995 (138-2) (select committee report) [Select Committee Report] at iv.

95 Select Committee Report, above n 94, at iv. That is not self-evidently correct but it is not necessary for us to engage with the point.

[109] Despite the fact that Parliament did not amend s 56 when the 1996 Amendment was passed, the new regime introduced by the 1996 Amendment is important context that needs to be considered when interpreting s 56(1). The reality that, in many offers, the investor will not have received the prospectus, let alone have read it, is an important element of that context.

[110] The significance of this point was foreshadowed in the decision of the Court of Appeal in *Saunders v Houghton*.[96]

The "but for" argument

[111] Mr Houghton argued that the hypothetical test applied by the Court of Appeal did not fit within the structure of the Securities Act and s 56. He said that asking what would have happened if the investors had known the true position was artificial because the true position is not known. It would not have been sufficient for the FY04 revenue forecast to be corrected: what was required was a disclosure of budgetary issues, sales information, manufacturing problems and other trade risks to the investors. He argued that none of this was included in the prospectus.[97]

[112] Mr Houghton argued that as the investor invested on the faith of the prospectus, all that was required once the untrue statement had been established was an inquiry as to loss. The essence of the argument is that:

(a) the prospectus for the IPO contained one or more untrue statements and therefore did not comply with the Securities Act and the Securities Regulations;

(b) that meant the prospectus was issued in breach of s 33(1)(c), which refers to an offer being made in or accompanied by "a registered prospectus that complies with this Act and regulations";

96 *Saunders v Houghton*, above n 81, at [88].
97 He also said the prospectus did not comply with cl 9 of sch 1 to the Securities Regulations: see above at [88]–[92].

(c) therefore the IPO was an unlawful offer of securities to the public for subscription from the time the offer commenced until 2 June 2004, when allotment occurred;

(d) Mr Houghton invested in Feltex "on the faith of [the] registered prospectus" in terms of s 56, because he invested in reliance on the registered prospectus being compliant with the Securities Act and the Securities Regulations, including the requirement that no untrue statement be included in the prospectus; and

(e) Mr Houghton suffered loss equivalent to the whole of the amount he invested by reason of the untrue statements in the prospectus. His loss was "by reason of [the] untrue statement" because the untrue statement made the prospectus non-compliant with the Securities Act and the Securities Regulations. This non-compliance was the reason that the offer was unlawful under s 33(1)(c). So the offer should not have been made at all and if it had not been made he would not have invested and would not have sustained the loss of his entire investment.

[113] The Court of Appeal rejected a similar argument in that Court. It said:

> [61] [Counsel for Mr Houghton] attempts to meet this point with a "but for" argument constructed as follows. The [Securities Act] 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.
>
> [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.
>
> (footnote omitted)

[114] We agree with the Court of Appeal that Mr Houghton's argument is flawed, for three reasons.

[115] The first reason is that the underlying basis of the argument is wrong. The key point of the argument advanced by Mr Houghton is the proposition that the inclusion of an untrue statement in the prospectus for the IPO meant that the offer was made in breach of s 33(1). We do not accept that is the case. As noted above, s 33 sets out three possible ways that an offer of a security to the public for subscription may be made.[98] Section 33(1)(c) is one of those, but a failure to comply with that provision does not make the offer unlawful in terms of s 33 unless there is also a failure to comply with the other two. In this case, the offer complied with s 33(1)(a), in that it was made in an authorised advertisement that is an investment statement complying with the Securities Act and the Securities Regulations.[99] Accordingly, the fundamental proposition that the offer was made in breach of s 33 is incorrect.[100]

[116] The inclusion of an untrue statement in the prospectus can, if the untrue statement is material and is known by the issuer or directors of the issuer to be materially misleading, render the offer voidable under s 37A, as explained above.[101] However, that is not because there is an unlawful offer under s 33, but because s 37A(1)(b) specifically provides for this situation.

[117] The second reason is the fact that liability under s 56 is a liability to compensate for loss or damage sustained by the investor "by reason of such untrue statement". Mr Houghton argues that he suffered loss "by reason of [the] untrue statement" because the untrue statement caused the offer to be unlawful under s 33(1)(c): but for

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98 See above at [54]–[56].

99 The offer document in the present case consisted of both an investment statement and a prospectus. Mr Houghton did not suggest any non-compliance with the Securities Act or Securities Regulations in relation to the investment statement.

100 Mr Houghton argued that the lower Courts were wrong to rely on cases predating the Securities Act in determining quantification of loss under s 56 because by doing so, they failed to take into account the prohibition under s 33. This highlights the significance of his (flawed) view as to the significance of s 33.

101 See above at [63]–[69].

that, the IPO would not have been made and he would not have lost the amount he invested in the IPO. As that argument also stands or falls on the proposition that a prospectus containing an untrue statement makes the offer unlawful under s 33, which we consider to be wrong, we also reject Mr Houghton's interpretation of the "by reason of" requirement in s 56(1).

[118] The third reason is that the acceptance of Mr Houghton's argument would effectively entitle him to the same remedy as is available under s 37A(6) and (7). That remedy is available only if notice is given within the prescribed period under s 37A(3). No such notice was given in this case. And s 37A(1)(b) applies only if the issuer or a director *knows* the prospectus is false or misleading in a material particular. There is no similar knowledge requirement in s 56(1). We do not consider that s 56(1) should be interpreted so as to provide essentially the same remedy as is available under s 37A in circumstances where the requirements of s 37A are not met.

"On the faith of"

[119] The High Court considered that s 56 reflected a legislative intention to create liability in respect of misleading content or omissions where that content materially contributed to an investor's decision to invest.[102] This assumed the investor could prove he or she actually relied on the prospectus.

[120] As noted earlier, the Court of Appeal said the expression "on the faith of" could be seen as a necessary first point of establishing that the untrue statement was material to his or her decision to invest.[103] It said the connotation is that an investor has invested in reliance on the statements in the prospectus and trusted in the truth of those statements. It added that the requirement that a plaintiff establish that an investment was made "on the faith of" the prospectus "excludes those who invest other than in response to the prospectus". But ultimately its approach did not require the investor to prove actual reliance. Rather, it said a rebuttable presumption of reliance arises upon proof that a notional investor's investment decision was more likely than not to have been influenced by the untrue statement.[104]

102 *Houghton* (HC), above n 2, at [118], summarised above at [95]–[96].
103 *Houghton* (CA), above n 2, at [65], quoted above at [100].
104 At [69], quoted above at [101].

[121] The phrase “on the faith of” has a long statutory pedigree, beginning with the Directors Liability Act 1890 (UK).[105] In New Zealand, it has appeared in provisions relating to prospectuses since 1891.[106] In all instances, it has been used in the context of a provision referring to a prospectus that constitutes the offer document for the securities being offered for subscription and the subscription is made on the terms of the prospectus. In that context, the phrase can be seen as broadly synonymous with “in reliance on”, as the Court of Appeal noted.

[122] There are also other statutory references to “on the faith of” in different contexts that indicate it is intended to be broadly synonymous with “in reliance on”.[107]

[123] That interpretation of the phrase is problematic, however, in the present legislative context because actual reliance on a prospectus can be anticipated only if the prospectus is the document containing the offer and it is provided to each offeree as a basis for the offeree’s assessment of the terms of the offer.

[124] We do not think it is sustainable to interpret s 56(1) in a way that excludes from the protection of the legislative regime investors who do not receive a copy of the prospectus when the scheme of the legislation contemplates that that may well be a standard feature of offers of securities to the public for subscription.[108] The fact that some IPOs are made in documents which are both investment statements and prospectuses does not alter the fact that a combined investment statement/prospectus is not a requirement of the legislation and, indeed, receipt by an offeree of a copy of the prospectus is not contemplated by the legislation as being necessary.

[125] There are a number of references in the Securities Act to a prospectus being “distributed”, which jars somewhat with the fact that the legislation specifically

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105 The text of this section appears in *Houghton* (CA), above n 2, at [71], which is reproduced above at [101].

106 Promoters’ and Directors’ Liability Act 1891, s 3; Companies Act 1903, s 76; Companies Act 1908, s 76; Companies Act 1933, s 48; and Companies Act 1955, s 53.

107 See for example the Partnership Act 1908, s 17 (on the faith of a representation); and Insurance Law Reform Act 1977, ss 4 and 5 (a statement made by a proposed insured on the faith of which the policy was issued).

108 Section 56 also covers those who invest on the faith of an investment statement (see above at [44]). But the information in an investment statement is limited, in contrast to the detailed information in a prospectus. So it is likely that any claim relating to misleading statements in relation to an offer will be directed at the prospectus not the investment statement.

permits an offer to be made in an investment statement without the prospectus being provided to offerees. However, the definition of "distribute" in s 2(1) includes "make available". All investment statements are required to state that more information about the offer can be obtained in the prospectus and to describe where a copy of the prospectus can be obtained free of charge.[109] Thus, a registered prospectus will have been "distributed" even if an investor does not ask for, or receive, a copy of the prospectus, because it has been "made available".

[126] The statutory scheme must contemplate that the registration of a prospectus and the ready availability of the document to those who ask for it will inform the market in a way that does not require that the prospectus itself be provided to potential investors. In the case of an offer of shares in an IPO, it can be expected that brokers advising investors or other market commentators will have studied the prospectus and formed a view about the value of the securities as a result. In the present case, that is reinforced by the fact that the price was set during the offer period. The final price was substantially influenced by an institutional "book build" process, which involved brokers and institutional investors bidding for shares at particular prices, leading to the setting of the price in the present case of $1.70 per share. That process was described in the prospectus as follows:

> Between Wednesday, 19 May 2004 and Friday, 21 May 2004 the Joint Lead Managers will undertake a book build process inviting NZX Firms and institutional investors in New Zealand, Australia and potentially elsewhere, to submit bids indicating the number of Shares they wish to apply for at a range of prices. This book build process, in conjunction with demand from other investor classes at the close of the book build process, will be used to assist the Vendor and Feltex, in consultation with the Joint Lead Managers, to determine the Final Price.
>
> The Final Price will be set prior to 10.00am on Monday, 24 May 2004 taking into account various factors, including the following:
>
> - the overall demand profile for Shares at various prices;
> - pricing indications from institutional investors and NZX Firms under the book build process;
> - the level of demand for Shares from applicants under the Enhanced Priority Offer, the Priority Offer and the Public Offer;

[109] Securities Regulations, sch 3D, cl 18.

- the desire of the Vendor and Feltex to have an orderly and successful aftermarket for the Shares; and
- any other factors the Vendor, Feltex, and the Joint Lead Managers consider relevant.

> The Vendor and Feltex reserve the right to set the Final Price outside the Indicative Price Range. However, the Retail Price will not be greater than $1.95 per Share.

[127] We consider that "on the faith of" means in reliance on the truth of the publicly registered document, which informs the market, but does not require that investors have seen or read the prospectus. Investors rely on the accuracy of the prospectus in the sense that they assume it contains no untrue statements and that the advice they receive or the market commentary they observe is founded on accurate and complete disclosure of the information included in the prospectus. So, to adapt the approach taken by Lord Halsbury in *Arnison v Smith* to which the Court of Appeal referred to when discussing the present statutory context,[110] it can be inferred that if a prospectus contained a misleading statement, the investor who subscribed for shares invested on the faith of the prospectus assuming the statement was true.[111] This inference would be displaced if the investor knew the truth and invested anyway. We leave open whether there may be other circumstances where the inference may be displaced.

[128] We recognise that this means that the "on the faith of" aspect of s 56(1) will not be difficult for an investor to satisfy in the event that a prospectus contains an untrue statement. We see that as consistent with the investor protection objective of the Securities Act. There was no reason on the evidence before us to suggest that Mr Houghton would not satisfy this requirement. As reliance is an issue reserved for the stage 2 hearing, however, we make no finding in relation to the other investors.

[129] If investors establish that they have invested on the faith of the prospectus, it will still be necessary for them to establish that they have sustained loss by reason of the untrue statement. We turn to that aspect of s 56(1) now.

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110 *Arnison v Smith* (1889) 41 Ch D 365 (CA) at 369, cited by the Court of Appeal in *Houghton* (CA), above n 2, at [70], as set out above at [101].

111 It follows that we do not accept, contrary to the view of the High Court (see above at [119]) and the Court of Appeal's approach (see above at [97](b)), that there is any requirement that plaintiffs must prove they read the prospectus.

By reason of the untrue statement

[130] The words "loss or damage [investors] may have sustained by reason of such untrue statement" indicate that there must be a nexus between the untrue statement and the loss sustained by the investor. The issue is what type of nexus is required. We consider that the words must be interpreted consistently with the meaning given to the concept of "untrue statement" in terms of s 55(a) (in particular the fact that it refers to an untrue statement, not a materially untrue statement) and the words "on the faith of [the] prospectus" in s 56(1) (particularly that those words do not require proof of actually having read and relied on the untrue statement and, indeed, do not require that an investor has read the prospectus).[112]

[131] Given our conclusion that s 55(a) deals with untrue statements, not just materially untrue statements, we see the "by reason of" requirement in s 56 as a mechanism for controlling the imposition of liability under s 56 (which is consistent with the courts' approach to "legal" causation in other areas).

[132] As noted earlier, the High Court found that the legislative intention was to create liability in respect of misleading content in, or omissions from, a prospectus where the content materially contributed to the investor's decision to invest.[113]

[133] The Court of Appeal's approach involved both subjective and objective elements, focussing on whether the notional investor would have invested if he or she had known the true position.[114] The respondents argued that we should adopt the same approach as the Court of Appeal.

[134] We consider that the issue is rather whether loss or damage was sustained "by reason of" an untrue statement in a prospectus. This means that a court must determine whether the effect of the untrue statement was such that the market value of the

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112 The use of the phrase "may have sustained" rather than "have sustained" is puzzling, given that compensation would normally not be required where the suffering of loss or damage is only a possibility. It could be argued that the "may have" wording recognises that establishing a causative link in at least some s 56 cases is likely to be a rather imprecise process. We think it is more likely that it is simply a mode of expression and should be interpreted as meaning the same as "have sustained".

113 See above at [95].

114 See above at [101].

securities for which the investor subscribed would have been lower than the price paid if the misleading statement had not been made or, put another way, if the prospectus had complied in all respects with the Securities Act and the Securities Regulations. If the price paid by the investor was greater than the price that would have been payable if adequate disclosure had been made in the prospectus, the investor will have suffered loss "by reason of" the untrue statement, assuming the investor has proved he or she invested on the faith of the prospectus in the sense described above.

[135] In some cases, the untruth will be egregious and its impact obvious. In that type of case, subscribers may be able to obtain compensation equalling the full amount of their investment under s 56. Their argument would be that revelation of the truth would have revealed that the securities were, in truth, valueless or of such little value that investors would not have invested had the true position been known. In less serious cases, the inquiry will be on whether the revelation of the true position in the prospectus would have indicated the securities had a lower value than the offer price.

[136] There may be circumstances in which factors other than market value affect an investor's decision to invest in securities offered in a prospectus. For example, an investor who is concerned about a particular risk or has a particular risk profile may argue that he or she would not have invested if the existence of that risk had been disclosed in the prospectus, even if the risk was not of such significance as to affect the market value of the securities offered for subscription. Similarly, an investor who has concerns about particular types of investments may argue that he or she had that concern at the time of investing and was misled into believing that the investment was not of a type the investor would consider objectionable. These arguments were not advanced in the stage 1 hearing and we make no comment on them.

[137] We apply this analysis to Mr Houghton's case later.[115]

Mr Houghton's contentions

[138] In light of the legal principles discussed, we now turn to a detailed examination of the factual contentions. As indicated above, the principal focus of Mr Houghton's

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115 See below at [269]–[279].

argument on this appeal is that the FY04 revenue forecast contained in the prospectus was untrue and misleading. This is because, by the time the prospectus was registered and certainly before the shares were allotted, it was clear that the predicted forecast would not be achieved.

[139] In Mr Houghton's submission, the projections for the 2005 financial year were also untrue and misleading, especially in light of Feltex's actual performance at the beginning of the 2004 calendar year. Further, there was no proper basis for the directors to have concluded that the projected increase in Feltex's share of the market, as assumed for the purposes of the FY05 projection, could be achieved.

[140] Mr Houghton also raised a number of other points.[116] He alleged that the following matters were not fully disclosed in the prospectus:

(a) the bad trading history of Feltex before 2003;

(b) issues with the new tufter machines;

(c) the increasing competition from Godfrey Hirst;[117]

(d) issues with Feltex's bankers;[118]

(e) the deterioration of relations with one of Feltex's major customers;[119] and

(f) the likely effect on Feltex's business of the removal of tariffs in Australia and the related issue of the Strategic Investment Program.[120]

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116 Some of these points were only mentioned briefly in the written submissions and not developed at the hearing. Mr Houghton's argument relating to cl 9 of sch 1 to the Securities Regulations and his "but for" argument have been addressed above at [88]–[92] and [111]–[118] respectively.

117 This was not mentioned in the Court of Appeal judgment and there was nothing in Mr Houghton's submissions to this Court beyond an assertion that this ought to have been disclosed.

118 This point was abandoned in the High Court and not pursued in the Court of Appeal.

119 The comment above at n 118 also applies to this point.

120 This was an Australian Government programme "to foster the development of sustainable, competitive textile related industries in Australia". Counsel for Mr Houghton, Ms Mills, said at the hearing in this Court that she was not making anything of this point in this Court.

[141] In addition, Mr Houghton argued that:

(a) the main reason EBITDA for FY04 was achieved was the reversal of a provision for the payment of management incentive payments (MIP);

(b) sales in FY04 were artificially inflated through extended credit terms offered;

(c) the concentration on EBITDA in the prospectus was misleading for retail investors and the use of the term "EBITDA" in a non-standard sense may have confused investors.[121]

[142] The respondents say that most of these issues were not raised in the application for leave to appeal and many had not been part of the appeal in the Court of Appeal. They thus cannot be properly raised before this Court. As to the issues properly raised, they say that the appeal should be dismissed.

The issues we will discuss

[143] We largely accept the respondents' submission that most of the issues raised by Mr Houghton should not be dealt with by this Court because they were not pleaded, were abandoned in the High Court, were not pursued in the Court of Appeal, were not within the scope of the leave granted by this Court or were not developed in argument before us.[122]

[144] We do, however, propose to discuss the reversal of the provision for MIP payments, the offering of extended credit and the issues relating to tufters as these were fully argued in this Court and are related to the issues in respect of the failure to meet the FY04 forecast. Tufters are relevant to the FY05 projection, which we also consider.

[121] As noted above at n 30 EBITDA was defined in the prospectus as Earnings Before Interest, Tax, Depreciation, Amortisation and Write-offs. Neither point was pursued by Mr Houghton in the Court of Appeal.

[122] We will not therefore address the issues referred to above at [140] (other than [140](b) and [141](a) and (b)).

[145] Before considering these issues, we set out the facts in more detail. We have undertaken a full review of the evidence given in the High Court, the information available to the due diligence committee and other contemporaneous documentation in order to evaluate the arguments we consider in this judgment. We have not recited this material in detail, but set out aspects of it that have particular significance in the context of the arguments raised.

The prospectus

[146] First, we summarise the contents of the prospectus, in particular the information relating to prospective financial performance, which was the main focus of the argument in this Court.

General information

[147] The general information about Feltex that appeared in the prospectus included the following:

(a) Feltex had an excellent earnings base and competitive position having gained synergies from the integration of Shaw's business;

(b) Feltex was repositioning its product mix towards higher value, higher margin products;

(c) Feltex had installed new tufting technology and expected carpet produced by the tufters to contribute to earnings growth in FY05;

(d) the carpet markets in both Australia and New Zealand were mature with long-term trends showing only modest growth; and

(e) Feltex's sales revenue generally displays a seasonal pattern: the first half of the financial year benefits from strong sales in the lead up to the December holiday period while second half sales are affected by slower sales in January and the Easter holidays.

Historical financial information

[148] Historical sales revenues and EBITDA were disclosed (along with brief commentary explaining the factors affecting them). We summarise this material in tabular form as follows:

	Sales Revenue (NZD)	EBITDA (NZD)
FY01, 1st half year[123]	182.3m	13.1m
FY01, 2nd half year[124]	146.5m	4m
FY02, 1st half year	[154m][125]	(1m)
FY02, 2nd half year	147.8m	13.8m
FY03, 1st half year	165.9m	14.7m
FY03, 2nd half year	147.3m	17.9m
FY04, 1st half year	171.7m	23.0m

Prospective financial information

[149] As noted above,[126] for FY04 the prospectus set out a forecast of total operating revenue of $335,498,000; EBITDA of $41,641,000; and a net surplus attributable to shareholders of $10,113,000. It was explained that this was prepared using the actual results for the first nine months and a forecast for the final three months. This is significant because, although the FY04 forecast was presented as a forecast for the full financial year, the only predictive aspect related to the final quarter. As will become apparent, we see this as important because, although actual revenue for FY04 was estimated to be less than forecast revenue by 2.8 per cent, the actual revenue for the final quarter of FY04 (that is, the forecast period) was estimated to be less than forecast

123 This period was the first financial period after the Shaw acquisition. The result was positively affected by sales associated with the Sydney Olympic Games and unfulfilled orders from the buoyant period prior to the introduction of Goods and Services Tax in Australia in July 2000.

124 Affected by restructuring following the Shaw acquisition: see above at [23].

125 This figure was not stated in the prospectus. It is an extrapolation from the statement in the prospectus that sales revenues in this period decreased by 15.5 per cent from the prior corresponding period.

126 Above at [32].

revenue by approximately 10 per cent.[127] The prospectus said that the forecast was prepared as at 4 May 2004 for use in the prospectus and that there was no present intention to update it.

[150] The assumptions on which the forecast rested were set out, including that there would "be no material change to the general economic environment, the building or refurbishment markets in New Zealand or Australia"; that there would be no material changes in the competitive environment, industry structure or legislative environment; and that there would be no major disruptions to Feltex's business operations. Assumed average exchange rates for the three months ending June 2004 had been used. It was said further that the:

> … forecast assumes that demand for Feltex products continues the trend experienced over the nine months ended March 2004 (adjusted for increased fourth quarter seasonality), that a small volume of new product is introduced into the market and that existing customers will continue to trade with Feltex at their current levels.

[151] For FY05, Feltex projected total operating revenue of $348,147,000. EBITDA was projected to reach $52 million, an increase of 13 per cent on forecast EBITDA for FY04 (on a pro-forma basis adjusted for one-off items). The forecast pro-forma EBITDA for FY04 had in turn been an increase of 48 per cent on EBITDA of $31 million in the 2003 financial year. The net surplus projection for FY05 was $23,889,000.

[152] There were similar assumptions underlying the FY05 projection to those set out for the FY04 forecast. The projection also assumed that the size of the carpet market in New Zealand and Australia, measured by volume of linear metres sold, would grow over the projected period by approximately one per cent, which was below the average growth rate of the past 10 years. In addition, the projection assumed that:

> Feltex's market share [would increase] by approximately 1% over the projected period. No change in the selling prices for carpets [was] assumed during the projected period.[128]

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[127] These estimates were at the date of the last due diligence committee meeting. See above at [34] and below at [166]–[174].

[128] Mr Thomas accepted in cross-examination that when Feltex was considering its market share, it was primarily considering volumes.

[153] In relation to both the forecast and the projection potential investors were directed to the risks section of the prospectus, which included risks relating both to the carpet industry and to Feltex's business in particular. It was noted that the floor coverings industry in Australia and New Zealand is highly competitive. There were also risks relating to market change, the carpet market being strongly driven by the level of activity in the building industry. Exchange rate risks were outlined. The issue of competition from imports, including after the scheduled reduction in Australian tariffs, was outlined. Commodity prices and availability, disruption of operations and possible equipment failure, technology changes and labour relations were discussed. The possibility of loss of key personnel in Feltex was outlined, as were general economic, commercial and regulatory business risks.

[154] In general it was said relating to forward-looking statements in the prospectus:

> Certain statements in this Offer Document constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Feltex, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include but are not limited to, among other things, exchange rates, reliance on equipment, general economic and business conditions, consumer preferences or sentiment, adverse product publicity, distribution arrangements, termination of key strategic relationships, failure of new initiatives, competition, the continued input of key personnel and other factors referred to in this Offer Document.
>
> Given these uncertainties, investors are cautioned not to place undue reliance on such forward-looking statements in this Offer Document. In addition, under no circumstances should the inclusion of such forward-looking statements in this Offer Document be regarded as a representation or warranty by the Vendor, Feltex or any other person with respect to the achievement of the results set out in such statements or that the assumptions underlying such forward-looking statements will in fact be true.

Events up to allotment

[155] As already noted, the Board of Feltex appointed a due diligence committee on 16 March 2004.[129] The due diligence committee met regularly during the process up to the allotment of the shares. Its first meeting was on 19 March 2004. At that meeting the process for and purpose of the due diligence was discussed. The key elements of the offer and the role of the committee were described. The due diligence committee

129 Above at [26]. The due diligence defence is discussed below at [280]–[292].

approved a materiality threshold of AUD 500,000 impact on the profit and loss or balance sheet. Below we discuss only the subsequent meetings of the committee that have some relevance to the appeal.

[156] On 1 April there was a Board strategy meeting. This was not a due diligence committee meeting but matters relevant to due diligence were discussed. In particular, there were presentations by expert advisors on the Australian and New Zealand economies and the outlook for the building sectors. Mr Thomas' evidence was that he had requested these as he had been "slightly nervous" about the trend of the United States economy during the fourth quarter of calendar year 2003 and the possible impact on New Zealand and Australia. The presentations gave a positive report on the building sector in Australia for 2005 and 2006, where 70 per cent of Feltex's sales were made. There was also a positive report for New Zealand in 2004 and 2005 but with some decline anticipated in 2006. There were largely positive presentations on consumer confidence, an important factor in the carpet market, although it was noted that the Westpac Melbourne Institute Consumer Sentiment Index had fallen by 3.8 per cent in March from its January and February level.

[157] At this meeting Mr Tolan gave a presentation on the proposed FY04 forecast and FY05 projection, which were scheduled to be presented to the due diligence committee and joint lead managers the following week on 8 April 2004 when the results for March were available. In his evidence in the High Court, Mr Tolan explained the "bottom-up" process Feltex used for preparing budgets: by forecasting sales and costs for each month, starting with historical figures and then adjusting for anticipated changes based on assumptions about future sales, costs, exchange rates, and so forth. This was done by product range and reviewed by all relevant managers. A similar process was involved for forecasting costs, including raw materials, labour, utilities, overheads and freight. The process for preparing the FY04 forecast and the FY05 projection was similar to the budgeting process, except for the 2004 forecast there were actual figures for the nine months to 31 March 2004.

[158] In the course of his presentation on 8 April 2004 Mr Tolan referred to a table setting out Feltex's Australasian market share from FY99 to FY05.[130] Market share was shown as declining from 30.67 per cent in FY99 to 26.10 per cent in FY04, with a projected rise to 27.12 per cent in FY05. These figures were based on carpet volume.

[159] The projected rise in market share and sales revenue in FY05 related to projected increases in volume arising, among other things, from projected increases in volume of tufted wool rich/blend, solution dyed nylon and polypropylene and a decline in printed and fluid dyed nylons. Mr Tolan said that Feltex would protect the profitable core business developed over the last three years, target commercial opportunities, increase rebates to generate growth in sales and reinforce the growth strategy and encourage movement of customers from competitors by offering extended credit terms.

[160] Management interviews of key Feltex personnel were conducted by the due diligence committee from 31 March to 6 April 2004, including Mr Magill and Mr Tolan.

[161] Mr Magill's answers to the committee included:

(a) Feltex's improvement in profitability should continue, assuming ownership stability and investment;

(b) Feltex's sales should exceed $300 million in the next 12 months; and

(c) Feltex could achieve greater growth in the next 12 months providing new strategies (addressing each market segment separately rather than mass marketing) achieved their objectives of increasing market share and increasing the purchasing share of Feltex's dealers.[131]

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130 It is not clear whether this table was also shown at the Board strategy meeting of 1 April 2004.

131 In cross-examination in the High Court, Mr Magill said Feltex had reduced volume in the mass market and increased volume in the premium and middle parts of the market.

[162] Mr Tolan's answers to the committee included:

(a) in the first nine months of FY04 (July 03–March 04) Feltex's revenues were AUD 17.9 million below budget and AUD 4.1 million ahead of the previous year;[132]

(b) in percentage terms, Feltex's sales were split between wool and synthetics 37.2 : 62.8 by volume and 52.5 : 47.5 by revenue; sales were split between Australia and New Zealand 85.2 : 14.8 by volume and 80.2 : 19.8 by revenue;

(c) volume was the biggest driver of profit;[133]

(d) Feltex's revenue had a seasonal profile. The second and fourth quarters are traditionally the best quarters. Budgeting reflects this seasonality of revenue; and

(e) the risks faced by Feltex were (as recorded in the minutes of the due diligence committee meeting):

> Need to maintain volume and increase market share.
>
> Key driver is sales volume and sales at good margins.
>
> A significant drop in sales would adversely impact on the Group's results.
>
> Overheads in check and well controlled.
>
> Potential risk is meeting bank covenants – these have been set at conservative levels considering the worse case scenario.
>
> Well prepared for life as a public company. Believe will meet and exceed expectations.
>
> No general issues.

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132 The FY04 sales budget was some $20 million higher than the FY04 sales forecast. The budget had been sent to Feltex's bank, from which it could be inferred that Feltex thought it was achievable.

133 In evidence in the High Court, Mr Tolan said volume per se did not drive margins, rather it was the composition of sales per market segment.

[163] The Board met again on 27 April 2004. The minutes record that a final version of the offer document was to be circulated to the Board on the following day. At that meeting, contrary to the advice of the joint lead managers, the Board resolved that FY05 should be a projection and not a forecast.[134] The minutes of the Board meeting for 27 April 2004 recorded that March had been a good sales month with a good sales mix and that commercial had had a good result for March.[135] It was said that "April is forecast to be a difficult sales month but the shortfall will be picked up in May and June".

[164] The draft prospectus had been sent to the Companies Office and to NZX for approval by the time of the sixth due diligence committee meeting on 21 April 2004. The seventh meeting of the due diligence committee was held on 30 April 2004, at which time the final version of the FY04 forecast and FY05 projection had been completed. Any final comments on the prospectus were to be provided by 8.00 pm that night.

[165] The final due diligence committee report was signed by all the members on 3–4 May 2004. The eighth meeting of that committee was held on 4 May 2004 and members confirmed that no material matters had arisen. The Board met later in the day and briefly on 5 May 2004 to approve the prospectus, which was registered on 5 May.

[166] The ninth meeting of the due diligence committee was held on 2 June 2004. It was attended by Feltex's three principal executives, Mr Magill, Mr Kokic and Mr Tolan. Each gave an update and was questioned by the committee.

[167] We note that at this stage the Group Operating Report (the standard report presented by management to the Feltex Board at each Board meeting reflecting Feltex's performance in the most recent month) for April 2004 would presumably have been available, but not the one for May.[136] Mr Magill and Mr Tolan (and other key

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134 The issue of whether FY05 would be a projection or a forecast had been discussed earlier but this was the formal decision on this issue. The joint lead managers had prepared a memorandum dated 23 March 2004, outlining their view that the prospective financial information for FY05 should be a forecast because that would give investors greater confidence in the figures.

135 Issues with aviation and export were also noted.

136 The Group Operating Reports provided detailed financial and operational information to the Board

executives) did, however, receive daily sales reports.[137] This meant it can be presumed that they would have had reasonably accurate sales figures for May by the time of the due diligence committee meeting. The daily sales reports would have contained indicative margin figures based on the standard costing system (called by some the gross margin and by others the net margin before freight). However, Mr Tolan's evidence was that these figures would not have taken into account realised efficiencies in the manufacturing process or operating variances, the latter having to be factored in after the manufacturing accounts for all the factories were completed. Other financial figures, such as rebates, would also not have been available. Thus it would not have been possible to produce an accurate monthly trading report for May by the time of the due diligence committee meeting of 2 June.

[168] The April Group Operating Report recorded the very poor result achieved in April 2004. Sales volume and sales revenue were not only below budget but also below the level reflected in the FY04 forecast and below the actual result in the previous financial year.[138] The report recorded that carpet volume was below budget by 19.5 per cent,[139] and carpet margin dollars were down by 6.1 per cent. Total carpet revenue was 22.8 per cent below budget. This was largely as a result of lower volumes, but lower average selling prices also contributed to the lower sales revenue. Total volume, revenue and margin dollars were all down on the levels that were reflected in the FY04 forecast[140] and volume and revenue was down on the year before.[141] Revenue fell short of the forecast by around 18 per cent. Different market segments were affected differently. For example, residential mass and premium were below

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and issues relating to future performance, including management views on likely trends. Commercial and residential sectors were addressed separately and, as noted above at [21], residential sales were split into premium, middle and mass. These reports provided tables in many cases in both NZD and AUD. It was not explained in evidence what exchange rates were used but the rates seem to have led to discrepancies, as will be seen later, in result to budget between NZD and AUD: see for example at n 141 below.

137 We do not know if the directors still received weekly sales reports as they had been doing in 2003.

138 This was particularly significant because April 2003 had itself been a "soft" month and had been a cause for concern in relation to the 2003 bond prospectus. See below at [205]–[209].

139 This was said to reflect "a quieter than expected month by retailers and a fall in orders following a peak in March". It was said that the March peak was "partly influenced by efforts of retailers to achieve rebate incentives for the March quarter".

140 As against forecast, volume was down by 298,000 m^2, total sales were down by NZD 6,294,000 (AUD 5,046,000), and total margin dollars were down by NZD 1,325,000 (AUD 1,226,000).

141 We note that, while margin dollars were up by NZD 167,000 on the previous year, they were down by AUD 40,000. This divergence would seem to result from the exchange rate conversion described above at n 136.

budget in volume but middle was above budget. Premium was 15.6 per cent below budget on volume and 31.9 per cent below budget on revenue on the basis of lower than average selling prices and greater than budgeted sales of seconds and aged stock. Middle was below budget on revenue due to similar factors.

[169] When questioned by the committee at the 2 June meeting, Mr Magill and Mr Tolan both said that total sales for the FY04 year were likely to be between $7.5 million and $9 million below the forecast annual total. If that were the case, this would be a shortfall of approximately 10 per cent on forecast[142] for the final three months of FY04.[143] This was an anticipated shortfall of approximately 2.8 per cent of the forecast annual sales. Mr Tolan's evidence was that he had considered that, as the prospectus only gave annual figures, the sales shortfall should be assessed against the annual shortfall, rather than the last three months of FY04 (even though the annual forecast used the actual figures for the first nine months of FY04).

[170] In explanation for the shortfall in sales, Mr Magill told the committee that the newly introduced growth rebate scheme for retailers had resulted in good sales for March. However, the market had slowed in April and May and retailers had taken longer than expected to move the stock they purchased in March. In addition, the scheduled April plant closures for maintenance had meant that Feltex had not been able to deliver certain sales orders by the required delivery dates. Mr Magill also pointed to unforeseen production issues which in turn impacted on delivery time. In particular, Mr Magill noted issues with the manufacture of solution dyed nylon, which had led to approximately $3 million of the shortfall for April and May.[144] Mr Magill explained that the solution dyed nylon issue had now been resolved. Solution dyed nylon was produced in Australia on the synthetic side of the business and was predominantly a middle to upper margin product.

[171] The due diligence committee was told that discussions by Feltex personnel with key retailers had indicated that the market was lifting and that it was believed that Feltex would recover some of the April and May shortfall in June. The due diligence

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142 On the assumption of a shortfall of $9 million at the highest range of the estimate.

143 Mr Tolan did indicate that the "feedback from the market indicates that June will be a strong month as retailers push for their quarterly rebates".

144 It was not clear from the evidence when these issues had surfaced.

committee was also told that Mr Magill was confident that the sales and other projections for the year ending 30 June 2005 would be met. Mr Tolan confirmed that he did not consider Feltex's failure to meet the sales forecast to be a material adverse circumstance as Feltex would still achieve its EBITDA and net surplus forecast numbers.[145]

[172] We interpolate that the minutes of the due diligence committee do not record why it was thought that the forecast EBITDA and net surplus would be met, but in the event, these projections were not only met but exceeded. It appears that this was partly due to the strategy of moving to product lines with higher margins. There were also favourable operating variances and the removal of the provision for MIP discussed below,[146] as well as the expected upturn in sales that occurred in June. It also appears from the evidence of Mr Tolan that some provision had been made for possible production difficulties, which would have lessened or removed the possible impact on EBITDA of the solution dyed nylon issue.[147]

[173] Having considered the information provided to it by Mr Magill, Mr Tolan and Mr Kokic, the members of the due diligence committee and the observers present at the meeting all confirmed that, to the best of their knowledge, no material adverse circumstances had arisen since the registration on 5 May 2004 of the combined investment statement and prospectus for the offer that would cause the prospectus to be false or misleading. This was subsequently reported to the Board at its meeting on 2 June 2004, which followed the due diligence committee meeting.

[174] At its meeting of 1 June 2004, the Board had approved the allotment or transfer (as the case may be) of new and existing shares to investors. On 2 June it confirmed that no material adverse change had occurred since the issuing of the prospectus.

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145 We interpolate that, according to the April Group Operating Report discussed below, for the year to date to April EBITDA and net surplus forecast figures had not been met. In his evidence in the High Court, Mr Tolan said the fact Feltex was around 10 per cent below forecasted sales revenue at the date of the due diligence committee's meeting of 2 June 2004 was not significant because it was not 10 per cent down in profit and it was profitability that drove business valuation.

146 Below at [232]–[237].

147 Mr Tolan said in cross-examination in the High Court that the risk of machinery failure had been taken into account in the EBITDA forecast.

[175] The May and June 2004 Group Operating Reports provide details of the gap between what Feltex's forecast had anticipated would occur in those months and what actually occurred.

[176] Carpet volume in May was below budget by 17.8 per cent, carpet revenue was down by 23.2 per cent and carpet margin dollars were down by 11.2 per cent on budget. Volume, revenue and total margin dollars were all below the level reflected in the FY04 forecast[148] and below the year before. Revenue was down on the level reflected in the FY04 forecast by around 19 per cent.[149]

[177] Sales picked up in June. Carpet volume exceeded budget by 17 per cent, carpet revenue was up by 13.7 per cent and carpet margin dollars were up by 20 per cent on budget. Volume, carpet revenue and margins were all above forecast[150] and above the previous year.

FY04 full year results

[178] Feltex's performance in FY04 exceeded the FY04 forecast in the prospectus for EBITDA and net surplus. EBITDA was above forecast by $0.5 million or 1.2 per cent and net surplus was also higher by $1.1 million or 10.6 per cent. Total operating revenue was, however, lower than forecast by $7.7 million or 2.3 per cent.[151]

[179] In the 2004 annual report the following explanations for the variance between actual results and forecast were given. As to the revenue shortfall, this was said to be due to two factors:

(a) Lower than forecast sales in April and May 2004, "particularly in the lower price value segments of the business". It was said that the

148 As against forecast, volume was down by 293,000 m^2, total carpet revenue was down by NZD 6,302,000 (AUD 5,470,000), and total margin dollars were down by NZD 1,909,000 (AUD 1,636,000).

149 The comment made at n 138 relating to the April 2004 figures applies equally to those for May 2004.

150 As against forecast, volume was up by 255,000 m^2, total sales revenue was up by NZD 4,199,000 (AUD 4,534,000), and total carpet margin dollars were up by NZD 1,046,000 (AUD 1,181,000).

151 According to the June Operating Report, sales revenue for FY04 was $27,428,000 below budget and $7,685,000 below forecast but $8,290,000 above the year before. Total margin dollars were $48,000 above budget but $2,211,000 below forecast and $9,229,000 above the year before.

shortfall was, to some extent, made up by the stronger than forecast sales in the month of June 2004.

(b) The translation impact of the stronger New Zealand dollar in the month of June 2004 on the group's Australian sales when translated from Australian dollars into New Zealand dollars for reporting purposes.

[180] It was said that EBITDA was higher than forecast by $510,000, "mainly due to the superior product mix of sales, yielding higher than forecast margins and actual overheads lower than forecast". It was also said that the depreciation charge was lower than forecast mainly due to the timing of capital expenditure. These two factors meant that net surplus also exceeded forecast.

Was the FY04 revenue forecast a misleading statement?

[181] As noted above, by the time of the last due diligence committee meeting on 2 June 2004, it was known that there would be a sales shortfall as against forecast for FY04 of somewhere between $7.5 and $9 million.[152] This would have amounted to a shortfall of approximately 10 per cent on the forecast for the last three months of FY04 and would have meant an anticipated sales shortfall of around 2.8 per cent for the year.[153] Before analysing whether the likely FY04 shortfall meant the prospectus was misleading, we first set out the analysis in the Courts below on this and related issues. We will deal later with the arguments relating to the reversal of the provision for the payment of MIP and to the offering of extended credit terms. As will become apparent, we consider that these issues are of limited relevance to the analysis of the arguments relating to the FY04 revenue forecast.

High Court

[182] The High Court said that the views that had been put forward in evidence by the respondents (that meeting gross revenue and volume of sales targets was unimportant) were exaggerated.[154] The Court was not, however, persuaded that, on

152 Above at [34] and [169].
153 As noted above, this is on the assumption of a shortfall of $9 million.
154 *Houghton* (HC), above n 2, at [186]–[187].

the material available when the prospectus was issued on 5 May 2004, the directors "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". The Court said that the directors could not be criticised for accepting management's advice that the variance was not material "when the [FY04] result subsequently confirmed that their analysis was accurate".[155] Even though the extent by which revenue was going to fall short had been more clearly identified by the time of the due diligence committee meeting on 2 June 2004, the same argument as above would apply to that.[156]

[183] The Court discussed what would have occurred if the true position had been disclosed. The Court said that the directors could legitimately have cited the analysis provided to the directors that, although gross sales revenues were unlikely to achieve the forecast, improved margins meant that the directors adhered to the forecast for EBITDA and net surplus. That was the message given in August 2004 when the FY04 result was announced. Dobson J accepted the evidence of an expert witness called by the respondents, Professor Cornell,[157] that the lack of reaction in terms of the share price to the announcement in August 2004 of the FY04 result confirmed the difference was not material.[158] At that stage, as noted above, it had been established that the revenue shortfall was 2.3 per cent (not 2.8 per cent, as had been anticipated at the due diligence committee meeting on 2 June 2004) because of a good June result.[159]

Court of Appeal

[184] The Court of Appeal left open the possibility that, at the time of issuing the prospectus on 5 May 2004, the directors may have continued to believe the forecast would be achieved but said that, by the time of the allotment, the directors knew there could be a shortfall in operating revenue. As the directors did not claim that they had a reasonable basis to believe, as at June 2004, that the operating revenue for FY04

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155 At [187].

156 At [191]–[192].

157 Professor Cornell was at the time a Visiting Professor of Financial Economics at the California Institute of Technology. He had previously been a professor of finance at the University of California.

158 At [188].

159 See above at [36] and [178].

would be achieved,[160] the Court proceeded on the basis that the statement was untrue.[161]

[185] The Court considered that the fact that it was stated in the prospectus that the forecast would not be updated did not take the directors far. There was still an obligation to inform of material adverse circumstances.[162] The Court concluded that the notional investor would not regard the shortfall as material.[163] It was a two-month shortfall in a market where figures fluctuate from month to month. There were explanations suggesting that the issue was temporary.

[186] March had been a strong month but retailers were taking time to sell product. Scheduled plant closures meant Feltex had not been able to deliver some product and there had been unexpected production difficulties (accounting for $3 million of the shortfall).[164] June was projected to be a good month.[165] No shortfall in EBITDA or net surplus would result. This was partly due to the strategy of changing to higher priced and higher margin products.[166]

[187] The Court said that the shortfall had also to be seen within the context of a generally improving financial performance. There had been positive variances in the half year to December 2003 and for the third quarter.[167] The Court pointed out that there was in fact a good performance in June and this meant a good result for the year.[168]

[188] In considering materiality, the Court took into account the explanations for the shortfall that had satisfied the due diligence committee and the directors.[169] It considered that, if the shortfall had been signalled to potential investors, these explanations would also have been ventilated.[170]

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160 *Houghton* (CA), above n 2, at [100].
161 At [102].
162 At [103].
163 At [104].
164 At [105].
165 At [106].
166 At [107].
167 At [111].
168 At [112].
169 At [105]–[107].
170 At [113].

[189] The Court concluded that, in light of the above factors, a notional investor would have proceeded with the investment.[171] The lack of reaction by the market to the release of FY04 results was a useful cross-check on this conclusion.[172]

Issues arising

[190] Mr Houghton argues that the prospectus should not have been issued in light of the April results or that the shares should not have been allotted on 2 June because the prospectus had become false and misleading by that point in light of the known information on the sales shortfall in April and May. We propose to concentrate on the latter argument. If the prospectus had become false and misleading by 2 June 2004, then liability will have been shown, even if it were not false and misleading in May 2004, when it was issued.

[191] We will first examine when a forecast becomes false and misleading and then consider if the FY04 revenue forecast had become false and misleading in this case. Next, we will consider the relevance of the expectation that Feltex would meet the forecast EBITDA and net surplus. We then discuss the significance of the fact that the market did not react to the FY04 financial results when they were released in August 2004.

When does a forecast become untrue or misleading?

[192] The focus under s 55(a) is on the truth or otherwise of the statement or omission and whether it is misleading, not on materiality.[173] As explained above, a forecast is an estimate of the most probable outcome, based on reasonable (and clearly stated) assumptions.[174] A forecast will therefore be misleading if the assumptions were not reasonable in a manner that affects the forecast or the forecast outcome was not reasonably assessed as the most probable outcome in light of the stated assumptions.

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171 At [113].
172 At [114]–[115].
173 See above at [83]–[86].
174 See above at [30]–[31].

[193] Where assumptions become untrue or new risks arise this may mean that, in some cases, there are untrue statements (including omissions) in the prospectus, independent of their effect on the forecast.

[194] The issue of whether a statement in a prospectus is untrue must be assessed up to allotment. We thus agree with the Court of Appeal that the fact that the prospectus said that the FY04 forecast would not be updated would not be sufficient to absolve the promoters and directors of responsibility if the forecast had become false and misleading before the allotment of the shares. This could be the case either because the assumptions were no longer reasonable or the forecast outcome was no longer the most probable outcome in light of the stated assumptions.[175]

[195] It is, however, necessary to acknowledge that the fact that a forecast is not achieved in one or more respects does not necessarily mean on its own that the forecast was an untrue statement. We accept that a forecast is not a representation that all of the exact figures set out in that forecast will be achieved. This means that, in assessing whether a forecast has become an untrue statement in the sense set out above, the probability and extent of any possible shortfall must be assessed in light of all the circumstances.

Feltex's financial performance leading up to the forecast period

[196] Before considering the FY04 revenue forecast itself, we first deal with Feltex's financial history in the period leading up to the forecast period. This history was summarised in the prospectus.[176] In particular, the financial performance of Feltex in

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175 *Houghton* (CA), above n 2, at [103]. See also above at [149]. Compare *Macquarie Generation v Peabody Resources Ltd* [2000] NSWCA 361. That case concerned a forecast of staffing levels for a contract for the supply of coal, which was expressed to be an estimate as at a certain date. Beazley JA said at [123] that the representation was not a continuing representation because it was clear it was no more than an estimate as at a particular date. We do not see a similar approach as being open in the present case, where the statutory regime requires that the prospectus not include any untrue statement up to the time of subscription and allotment and the due diligence defence is available only if the person relying on it believed on reasonable grounds that the untrue statement was true "up to the time of the subscription for the securities": Securities Act, s 56(3)(c). We also note that in *Kerr v Danier Leather Inc* 2007 SCC 44, [2007] 3 SCR 331 the Supreme Court of Canada found an issuer was not liable for a misrepresentation in a prospectus that arose because of a change of circumstances between the filing of the prospectus and the closing of the offer that meant the forecasted financial result in the prospectus was unlikely to be achieved. This case was, however, the product of a different statutory scheme with distinct legislative definitions.

176 See above at [148].

the first nine months of FY04 (the period immediately before the three month period of the FY04 forecast) is important context to the analysis of the FY04 forecast. We now turn to the evidence on that.

[197] We have already set out levels of sales revenue and EBITDA for the FY03 and for the first six months of FY04, ending on 31 December 2003.[177] Sales revenue was below budget for the first half of FY04. However, the revenue and EBITDA figures for the first half of FY04 were significantly greater than for the corresponding period in FY03. Feltex's interim report for the first half of FY04 attributed this improvement to buoyant markets in Australia and New Zealand and a successful shift towards higher value products, yielding improved margins.

[198] The Group Operating Reports for 2003, including for December 2003, and for January and February 2004 would have been available to the due diligence committee. The March 2004 Group Operating Report was included in the Board papers for the 27 April 2004 Board meeting, but presumably would have been available to those working on the draft prospectus and would have become available to the due diligence committee as the prospectus was being finalised.

[199] The Group Operating Reports for both January and February 2004 recorded poor sales. In January, carpet sales by volume were 27.2 per cent below budget and revenue was also below budget by 29.0 per cent.[178] The January report described that month as "very disappointing" and said "for some unknown reason" it was an extremely quiet trading month. In February, results were also recorded to be "disappointing although not as bad as January". Carpet sales by volume were 9.6 per cent below budget and by revenue 19.2 per cent below budget. The report recorded concerns about future building activity in Australia and New Zealand that could affect demand for carpet. The March report reflected an improvement with carpet sales by volume 2 per cent above budget and by revenue 1.4 per cent above budget.

177 See above at [148].
178 Actual revenue was AUD 14,858,000. Budget was AUD 20,521,000. Actual revenue in the previous year had been AUD 16,160,000.

[200] It is notable that, of the AUD 17,381,000 deficit in budgeted sales revenue for the first nine months of FY04 (to 31 March 2004), AUD 5,663,000 occurred in January and AUD 4,629,000 in February, those two months contributing over half of the deficit to budget. For both of these months sales revenue was also below the year before. Margins were slightly below the year before in January and also below the year before in February. In January the carpet margin dollars achieved were largely due to increased margins in the mass (as against middle and premium) sectors.

[201] It is relevant to the forecast for the last three months of FY04 that the trends analysis in both the March and February reports was that the market, in Australia in particular, could soften in the short term.[179] The March Group Operating Report said that residential new building activity in Australia had reached its peak and that "the fundamentals for new housing demand point to a soft landing". A further decline, "albeit moderate", was expected over the next couple of months and, after that, conditions would begin to stabilise, absent further interest rate rises. It was noted that BIS Shrapnel[180] was forecasting strong underlying demand over the long term. The renovations market was generally more resilient.

[202] In summary, the background to the FY04 forecast was that revenue and EBITDA in the first half of FY04 had exceeded the figures in the corresponding period of FY03. The first three months of 2004 had featured poor performance in both January and February, but a much improved performance in March. Overall sales revenue in the first nine months of FY04 was significantly below budget, with the major contributors to this being the poor sales in January and February 2004. There was some concern about a potential softening of the market. It is against this background that the failure to achieve the forecast sales revenue for the last three months of FY04 must be considered.

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179 Mr Thomas had expressed concern in an email to Credit Suisse in November 2003 about the outlook for the Australian and New Zealand building cycles.

180 Mr Thomas' evidence was that this company is a leading adviser and forecaster on the building industry.

Failure to achieve FY04 revenue forecast

[203] The forecast was based, among other things, on the assumption that there would be no major disruption to Feltex's business operations and on the assumption there would be no material change in market conditions. It was assumed that "demand for Feltex products [would continue] the trend experienced over the nine months ended March 2004 (adjusted for increased fourth quarter seasonality)".[181] We assume that the reference to an adjustment for increased fourth quarter seasonality refers to the fact that traditionally the fourth quarter, along with the second quarter, were the best trading quarters.[182]

[204] The assumptions outlined must be seen as relating to the forecast period and not to any longer term view. At least by the time of the 2 June due diligence committee meeting, they were no longer true. There had been disruption to Feltex's business operations because of the solution dyed nylon issue, leading to some $3 million of the shortfall.[183] Further, far from seeing the traditional fourth quarter increased seasonality, sales volume and revenue for April and May were well behind the monthly figures used in coming to the annual revenue forecast contained in the prospectus. The market had been unexpectedly slow in those months and indeed, volume and sales revenue were below the year before and those months had been soft themselves in FY03.

[205] The significance of the fact that volume, sales revenue and margin were below the year before is illustrated by the concerns expressed by Mr Thomas about the situation that arose in June 2003, just before the bond issue. Mr Thomas had written to Mr Magill in the following terms:

> While the EBITDA result is impressive, and heartening, it would have been more reassuring if the Revenue side had met forecast, rather than the cost side holding in line, allowing EBITDA to be achieved (nearly) through cost savings (vs forecast) in cost/expense items between Margin and EBITDA, rather than revenue attainment, and gross margin contribution???

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181 See above at [150].

182 See above at [162](d).

183 See above at [170]. We acknowledge that the significance of the $3 million shortfall is diminished by the fact that the possibility of unexpected production difficulties it appears had been factored into the forecast: see above at n 147. As far as we are aware, the issue had been resolved by 2 June and there does not appear to be any suggestion in contemporary material that it heralded similar issues arising in the future.

> Why are we missing Sales Forecasts (dollars and volume) by such margins. Are we losing market share in total market, or in any sector?? Given the "forecast' was prepared/confirmed in March, to miss May by such a margin (15.7% in dollars, and 18% in volume) is baffling??

[206] On 26 June 2003 Mr Magill replied formally to the directors,[184] indicating that there had been a slowing of the order intake in April and May 2003. He noted that this should not have been a surprise "as we provide the bank and the directors a weekly update on the key [key performance indicators] of sales, orders, [and] product versus budget/forecast". He said that, at the time the forecast had been confirmed in March, the order queues had grown (between February and March). However, "April and May proved to be soft in order intake with an improvement only starting in June". He said that the "market has become patchy".[185]

[207] Mr Magill explained that the sales result in his view had been reasonable. He noted that, at the March Board meeting, he had indicated to the Board that he had put in place a "growth incentive plan" with major customers for the April to June quarter to try to protect the prospectus forecast. The surge in forward orders in March reflected this strategy. He said, without this, the company would not have reached the sales it did. He said that there had been a small growth in "our market share of local production in the [January to March] quarter in Australia from 29.0% in 2002 to 29.2% in 2003". It was not possible to quantify the share of the New Zealand market as statistics of carpet production were no longer kept by the New Zealand Government, but it was thought that Feltex market share in New Zealand had dropped in the last 12 months but Mr Magill believed "we will correct this situation in the next 12 months". As to April, it was said:[186]

> The shortfall in orders in April was mainly in the residential area, due to the Easter holidays in the same week as Anzac Day, resulting in a week of April where most retailers closed for the week, plus the prior Easter Friday (8 days).

[184] Mr Thomas' query had been copied to all directors and Mr Magill had been requested by the Board at its meeting on 24 June 2003 to provide a full response to Mr Thomas. Mr Magill was recorded as explaining at that meeting "that incentives were in place to achieve the results projected". He also indicated that April had been a very poor order month.

[185] This is uncannily similar to events in April–June 2004.

[186] It is notable that similar events recurred in April 2004 with holiday dates occurring close together, but did not appear to have been factored into the FY04 revenue forecast.

[208] There were various other explanations given for the shortfall, most said to be due to a restructure in the business which had taken longer than anticipated but was now complete. We assume these explanations were accepted by the Board as there is no mention of any further discussion in the minutes of the next Board meeting.

[209] Mr Thomas said in cross-examination that the extent of the shortfall in volume and sales in May 2003 (18 per cent and 15.7 per cent) concerned him, even though EBITDA remained achievable. This can be contrasted with the respondents' contention in relation to the similar situation in FY04 that an anticipated shortfall in budgeted revenue was not of significance because it was anticipated that forecast EBITDA would be achieved.

Assessment of shortfall

[210] The factors described above at [204] had led to a likely revenue shortfall for FY04, judged at the time of the due diligence committee meeting on 2 June 2004, of between $7.5 and $9 million.[187] This meant that, by the time of allotment of the shares, the revenue forecast in the prospectus was no longer a probable outcome. As noted above,[188] and contrary to the approach in the Courts below, this stage in the inquiry is limited to deciding if a statement is untrue in terms of s 55(a), not determining its materiality.

[211] Given it is a forecast, however, and not a representation that the forecasted figure would be met, it is necessary to consider whether the extent of the shortfall that was anticipated on 2 June was such that it rendered the FY04 revenue forecast misleading in the sense described above at [192]. This requires an assessment of the extent of the shortfall, looking at matters in the round and in light of all the relevant circumstances, including in this case that it was anticipated that forecast EBITDA and net profit after tax would be achieved.[189]

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187 The extent of the anticipated shortfall was estimated to be 2.8 per cent of annual operating revenue.
188 Above at [83]–[86] and [192].
189 See above, at [194]–[195]. In *Macquarie Generation v Peabody Resources Ltd*, above n 175, Beazley JA referred at [123] to the "internal flexibility" of an estimate or forecast. Although made in a different context, this illustrates the need to consider the extent to which an anticipated shortfall is below the original forecast when determining whether the forecast has become an untrue statement.

[212] Taken over the whole year, the shortfall anticipated at the last due diligence committee meeting was a likely shortfall of some 2.8 per cent but it was a shortfall of approximately 10 per cent over the last three months. The last three months were in fact the only forecasted numbers because actual figures for the previous nine months had been used.

[213] Even an anticipated shortfall of 2.8 per cent cannot be considered insufficiently significant to render the FY04 revenue forecast untrue when considered in the context of Feltex's history, the nature of the carpet market and the period covered by the forecast. As Mr Thomas had accepted in evidence, Feltex had suffered two severe downturns in the previous eight years (1997 to 1998 and 2001 to 2002). It was only just recovering in 2003, but sales revenue had still not reached the levels achieved in the first full six months after the Shaw acquisition.[190]

[214] Mr Thomas accepted in his evidence that the carpet market, particularly in Australia, was cyclical and that Feltex was sensitive to the ups and downs in the market. He also accepted that, in November 2003, he had had some concerns about the state of that cycle.[191] The shortfall in April and May could have been a sign that the recent improvement in Feltex's financial performance may have been faltering. It could also have signalled a possible downturn in the cycle.

[215] The shortfall in April and May also has to be considered in light of Feltex's performance in the first nine months of FY04 and particularly in the third quarter. Feltex had not made budgeted sales figures for six of those nine months.[192] In itself, this would not be an issue because the evidence was that the budget had been set at an ambitious level. We note, however, that although ambitious, Feltex seems to have considered the budget was achievable.[193]

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190 See above at [23] and [148].
191 See above at n 179.
192 The exceptions were July, where sales exceeded budget by AUD 26,000 (it is noted that only AUD figures were available for this month), October, where sales exceeded budget by NZD 698,000, although were below budget in AUD by 6,000, and March, where sales exceeded budget by NZD 789,000 and AUD 475,000.
193 See above at n 132.

[216] As noted above, January and February had been particularly poor months and the comments in the Group Operating Reports show that the market downturn in those months was unexpected and that there was no obvious explanation for this.[194] The sales revenue shortfall in those two months also accounted for over half of the shortfall against budget up to March 2004.[195] Again, this might indicate issues with the market cycle or with the state of Feltex. The poor performance in January and February and its contribution to a budget deficit could well be a matter that should have been separately disclosed in any event. We do not need to be definitive on this, however, given our findings on the FY04 forecast.

[217] The likely revenue shortfall in FY04 also has to be assessed against the fact that the forecast was only in fact for three months and that it was in two of the three forecasted months that the shortfall arose. That this was the case must raise doubts as to the basis for the forecast. It had been stressed by the joint lead managers that great care needed to be taken with the forecasts to ensure that they would be achieved.[196]

[218] We accept that, at its 2 June meeting, the due diligence committee was told by Mr Magill that the market would pick up in June and partly compensate for the lower sales in April and May. But it must be remembered that the Board had been told at the end of April that the April shortfall would be picked in May and June. May had instead also shown a shortfall. In the event, sales did pick up in June but the matter cannot be judged by hindsight.

[219] In addition, some of the explanations given for the shortfall, such as scheduled plant closures and Easter, were known events that should have been taken into account in the forecast. In fact, both of those issues had been signalled by Mr Magill at the beginning of April as causing possible issues in sales in the coming month.[197] Further, the process for building up the forecast had taken the previous year's figures and

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194 See above at [199]–[200].

195 See above at [200].

196 The evidence of Ross Mear, at the time of the IPO head of investment banking at Forsyth Barr, said: "We re-iterated on a number of occasions that Feltex management and the Board had to be highly confident that these FY2004 financials would be achieved (ie they were in the bag)."

197 The Board minutes of 1 April 2004 had noted that April would be a difficult month because of the Easter holiday. Mr Magill had told the due diligence committee on 6 April that April sales would be difficult because production facilities would be closed for a week.

adjusted them to take account of sales trends. Easter had been in April the year before albeit a bit later in the month and had also coincided with Anzac Day.[198] The prospectus had noted the seasonality of the sales cycle with the second half of the year being "affected by slower sales in January and the Easter holidays".[199]

[220] That known events were not taken into account in the forecast, and particularly where the forecast was effectively for three months only, raises questions about the basis for the forecast. Further, the trends analysis at the end of March had suggested a softening of the market in the short term, which again should have been factored into the forecast.[200]

[221] Finally, and most importantly, the shortfall becomes even more significant when viewed in the context of the seasonal profile of sales. The fourth quarter is traditionally one of the two best quarters for Feltex. Even discounting the portion of the likely shortfall in that quarter related to one-off operational issues that had been resolved by the time of the 2 June due diligence committee meeting, the sales shortfall for that quarter was significant and in a quarter that should have achieved similar results to the second quarter.[201]

Significance of meeting EBITDA and net surplus forecasts

[222] The next issue is whether the fact that it was thought that the forecasts for EBITDA and net surplus would remain the same affects the above analysis.

[223] We do not consider it does. There were three key figures given in the forecast – net operating revenue (largely comprised of sales revenue), EBITDA and net surplus. That it was known that one of these figures would not be met by such a large margin, when considered in light of the fact it was only a three month forecast, in itself shows the significance. As indicated above, this becomes even clearer when considered

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198 This had been noted by Mr Magill in a report to the board in June 2003 about sales in April 2003 being below the level that had been reflected in the FY03 revenue forecast for the 2003 bond prospectus.

199 See above at [147](e).

200 See above at [201]. We note that the softening of the market in the short term had also been foreshadowed in the trends analysis in the February Group Operating Report.

201 As noted above at [150], one of the assumptions on which the forecast was based referred explicitly to "fourth quarter seasonality".

against the nature of the carpet market and the history of Feltex, particularly because this stage of the inquiry is to determine whether the forecast was an untrue statement.

[224] Like the Courts below, we do not accept that gross sales figures are not an indicator of the health of a company like Feltex. Sales must be seen as one of the vital inputs in a retail company. Both the FY05 projections and the FY04 forecast were done by a meticulous, "bottom up", process using detailed month by month figures.[202] Sales were obviously a key component of this. As was conceded in cross-examination, manufacturing companies like Feltex have high fixed costs. Sales were needed to ensure these fixed costs were covered. This is presumably why the Group Operating Reports report on the volume of carpet sold and sales revenue as well as margin.

[225] As the High Court noted,[203] Mr Magill acknowledged that he had explained to brokers and in institutional presentations prior to the IPO that if Feltex did not achieve sufficient sales revenue, then because of high break-even costs, it would obviously go into loss. The point can therefore be seen as having some importance, at least to analysts. We also note Mr Thomas' exchange with Mr Magill in 2003 on the topic of sales revenue and the fact that April 2004 had, like April 2003, seen a very significant shortfall in sales.[204] Indeed, the April 2004 results were below those in April 2003.[205] Further, it was not only sales that were below forecast in May 2004 but margin dollars too.[206]

[226] We accept that Feltex's strategy was to favour sales at a higher margin over volume per se and that, as noted in the High Court, there had been a positive improvement in margin, EBITDA and net surplus from December 2003 to April 2004.[207] This strategy was designed to cover fixed costs and provide higher profitability. Even this strategy relies on sales, however, as was clear from Mr Tolan's

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202 See above at [157].
203 *Houghton* (HC), above n 2, at [176]–[177].
204 See above at [205]–[209].
205 See above at [168]. For divergence in the margin dollars for the month of April see above n 141.
206 See above at [176].
207 *Houghton* (HC), above n 2, at [179]. Mr Thomas provided a table in evidence showing the improvements in margins achieved by Feltex in the middle and premium sectors in FY04 and the first half of FY05. This showed improved margins achieved as a result of increased proportion of total sales in those sectors and reduced proportion in the mass sector.

due diligence committee interview.[208] This was also evident from a sensitivity analysis on the FY03 EBITDA forecast prepared by Mr Tolan in relation to the 2003 bond issue.[209] This analysis illustrated the interrelationship between volume, price, margin and EBTIDA.[210] The Group Operating Reports covering FY04 also show the symbiotic relationship between volume, sales prices and product mix in achieving margin.

[227] We do understand that, as Mr Tolan put it,[211] it is necessary to have the right kind of volume to be profitable but the trend towards lower sales volume at higher margins should already have been factored into the FY04 forecast, particularly as it was based on nine months of known figures. Feltex's higher margin strategy thus does not provide an explanation for the shortfall in April and May. It merely provides a partial explanation for why EBITDA and net surplus were not affected. It was not suggested that there had been any particular and unexpected move towards higher margin products in April and May and indeed carpet margin dollars in May had been below budget and below forecast.[212]

Lack of market reaction to FY04 results

[228] The fact that the market did not react to the end of year results when released was said by the Courts below to show the failure to achieve the FY04 revenue forecast was not material. As we note above, materiality does not arise at this stage of the inquiry.[213] In any event, we do not consider that whether the forecast was misleading should be judged by hindsight. It should be judged as at 2 June when the shares were allotted and in light of the historical trading difficulties.

[229] To the extent that the lack of market reaction may be of some assistance in assessing the situation as at 2 June, the assessment of its significance would require consideration of the accuracy of the explanation that accompanied the end of year

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208 See above at [162].
209 The 2003 bond prospectus is discussed above at [24].
210 We do not know whether similar sensitivity analyses were done before the prospectus was issued.
211 See above at n 133.
212 See above at [168] and [176].
213 See above at [83]–[86].

result. As the accuracy of the explanation may be an issue in the stage 2 hearing in relation to loss, we will make no further comment.

Conclusion

[230] The due diligence committee asked itself whether material adverse circumstances had arisen since 5 May 2004 when the prospectus was registered that would cause the investment statement and prospectus to be false or misleading.[214] That may have deflected it from the crucial issue, namely whether the FY04 revenue forecast was, given the information now available to the due diligence committee (and through it, to the Board of Feltex), an untrue statement in terms of s 56. It did not matter whether the FY04 revenue forecast had become false, misleading or untrue because of a material adverse circumstance or otherwise. The only question was whether it was untrue, false or misleading.

[231] In the context of all the circumstances set out above, whether judged over the whole year or over the last quarter, the extent of the likely shortfall, judged at the time of the due diligence committee meeting on 2 June, meant that the FY04 revenue forecast was no longer the probable outcome. Further, the assumptions on which the forecast were based were no longer reasonable. The prospectus therefore contained a misleading and untrue statement.

Was the reversal of the MIP provision the main reason Feltex achieved the FY04 EBITDA forecast?

[232] Mr Houghton argued that the reversal of the provision for Feltex's obligations to management under the MIP was the main reason that the EBITDA forecast for FY04 was achieved despite the failure by Feltex to achieve the FY04 revenue forecast. He argued that this meant that it was not open to Feltex to argue that the failure to achieve the FY04 revenue forecast was not of significance because it did not affect EBITDA and, more generally, profitability. He emphasised that the FY04 forecast in the prospectus assumed MIP payments would be payable in April, May and June 2004 and the subsequent reversal of this anticipated liability inflated EBITDA for FY04 and

[214] The Court of Appeal noted that the purpose of the meeting was to check whether any "material adverse circumstances" had arisen since the date of registration of the prospectus: *Houghton* (CA), above n 2, at [90].

contradicted the respondents' submission that the achievement of the FY04 EBITDA forecast was attributable to improved margins on carpet sales.

High Court

[233] Dobson J said that it was reasonable for Feltex to remove the provision for MIP payments in the management accounts for May 2004 and this did not make the forecast for FY04 misleading. It was noted that this point had not been pleaded and it was not pressed in closing.[215]

Court of Appeal

[234] In the Court of Appeal, Mr Houghton argued that the removal of the provision for MIP payments showed Feltex had cut costs to meet the EBITDA target. The Court of Appeal rejected this. It found the poor sales meant the MIP scheme did not entitle the beneficiaries of the scheme to the payments for which the provision was reversed.[216]

Our assessment

[235] In the minutes of a strategy meeting of directors on 24 June 2003 it was noted that the "Management Incentive Plan will be based on the Profit Improvement Plan targets plus individual goals. The profit improvement targets will open the MIP gate". The profit improvement plan had been adopted in June 2003. Mr Tolan's evidence was that the payment of MIP was not based on the level of gross sales but was payable if certain profitability objectives were met. He did not elaborate. The evidence from Mr Tolan was that the provision for MIP payments was reversed because it was by then clear they would not be payable.[217]

[236] It is thus not clear in the evidence the exact basis on which MIP payments were to have been made. The Courts below, however, accepted that the provision was rightly reversed and nothing has been pointed to that would throw doubt on that conclusion. We thus have to assume that the provision for MIP payments was rightly

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215 *Houghton* (HC), above n 2, at [195]–[196].
216 *Houghton* (CA), above n 2, at [108].
217 This was confirmed by other witnesses, including Ms Withers.

contained in the forecast when it was first done and that there was thus a possibility at that stage that they would still be payable. We also have to assume that, at the time of its reversal, because of the final April and the anticipated May results, the MIP payments for which the provision was reversed were definitely no longer payable.

[237] The reversal contributed to EBITDA being above forecast in the final results for FY04 to the tune of $1.6 million. The MIP cost was not incurred, however, for the very reason that the April and May results were poorer than anticipated, meaning the shortfall in those months and the removal of the provision for MIP payments are inextricably intertwined. It was thus not a cost saving that was independent of the shortfall in the sales revenue forecast. The reversal of the MIP provision reduces the significance of the FY04 EBITDA forecast being exceeded, and undermines the argument that the failure to achieve the FY04 revenue forecast was insignificant because Feltex did achieve the FY04 EBITDA forecast.

Were sales in FY04 artificially bolstered by the offering of extended credit?

[238] Mr Houghton's argument is that the FY04 actual results were artificially inflated during the forecast period (the last three months of FY04) through the bolstering of sales by the offering of extended credit terms by Feltex[218] and that this also reduces the significance of the EBITDA and net surpluses being met.

High Court

[239] On the forward dating of invoices, the argument for Mr Houghton in the High Court had been that readers of the prospectus would have been unable to assess the strength of Feltex's existing and projected business because they were inadequately informed of the extent to which the forecast figures for FY04 were bolstered by sales transacted on forward dated invoices.[219]

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218 Feltex had a practice of forward dating of invoices, which was itself a method of providing more attractive payment terms to customers and can also be considered as "extended credit". The evidence was that Feltex's auditors, Ernst & Young, had confirmed that sales made on forward dated invoices were correctly recorded in Feltex's accounts.

219 *Houghton* (HC), above n 2, at [430].

[240] Dobson J said that there was scope for inferring that Feltex resorted to sales on extended credit terms to an increased extent in the last quarter of FY04. He referred to figures provided by an expert witness for Mr Houghton, Professor Newberry, showing an increase of some 5.2 per cent in the proportion of sales that were dealt with in that way. Annualised, the extent of the increase over the prior period was some 2.6 per cent. The total sales transacted on forward dated invoices in FY04 amounted to some 3.7 per cent per cent of the overall total.[220] Dobson J did not accept that this was material. He noted again that his attention had not been drawn to any specific statements in the prospectus that were rendered untrue by the omission.[221] Dobson J had said earlier that Mr Houghton was required to identify a particular statement which was rendered misleading. But his conclusion would have been the same in any event, even if it was "assessed at large", as Mr Houghton contended.[222]

Court of Appeal

[241] In the Court of Appeal, Mr Houghton argued that the extended credit provided in the last months of FY04 was an "emergency-style" sales technique. Because the extended credit offers were a new practice, a false impression was created that sales were going well. Mr Houghton argued that this meant the results for FY04 were not comparable to any other period. The Court of Appeal rejected this. It considered the provision of extended credit was not a matter of concern because it was not a new practice that had been introduced during the three month period to which the forecast for FY04 related (April–June 2004).[223]

Our assessment

[242] Mr Houghton said the Court of Appeal was wrong in saying extended credit was not a new practice in April–June 2004. He accepted that forward dating was not new, but argued different forms of extended credit were introduced in April–June 2004 and that these had the effect of artificially inflating sales, which in turn inflated the EBITDA and net surplus results for Feltex so that the FY04 forecast EBITDA and net surplus were achieved when they otherwise would not have been. He also argued that

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220 At [443].
221 At [444].
222 At [431].
223 *Houghton* (CA), above n 2, at [110].

the failure to disclose these extended credit terms in the prospectus meant the prospectus was in breach of cl 9 of sch 1 to the Securities Regulations.

[243] There are two aspects to this argument. The first is an allegation that new extended credit offers were made in April–June 2004 as an emergency-style sales technique. While there was evidence from Mr Magill of a "growth incentive plan" being implemented in the last quarter of FY04, there is no basis to find this amounted to an emergency-style sales technique.[224] We therefore agree with the Court of Appeal's rejection of that allegation.

[244] The second is the allegation that sales in April–June 2004 were artificially high because they were inflated as a result of extended credit terms being offered. That argument does not depend on the extended credit offers being new. We accept that there were extended credit terms offered in April–June 2004. But we do not have any basis to determine what impact they had on sales in that period. If the offers of extended credit had artificially augmented sales, that may have meant that EBITDA was artificially inflated in April–June 2004 which, in turn, would have made the fact that Feltex achieved the forecast FY04 EBITDA of less significance. However, we are not able to make a finding as to whether this occurred. Nor are we able to determine whether the provision of extended credit was such that disclosure of the practice and its impact on sales was required.

Should problems with tufters have been disclosed?

[245] Before examining whether the FY05 projection was an untrue statement, we first deal with the tufter issue. The prospectus outlined that Feltex had installed new tufting technology which was projected to contribute to Feltex's revenue and earnings growth.[225] This was a reference to two machines acquired in June 2003. The first was a cobble level cut loop (LCL) machine which was projected to help meet increased demand for textured residential carpets. The second was a single end servo scroll (SESS) machine which was projected to help meet increased demand for textured commercial carpets.

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224 See at [207] above.
225 See above at [147](c).

[246] The allegation is that the SESS tufter acquired in June 2003 was not capable of operating with wool and that this difficulty was known prior to allotment and should have been disclosed in the prospectus. This would have been significant for the FY05 projection in particular because the projection had been based in part on market advantage said to arise from the new tufters in the woollen market.

High Court

[247] Difficulties with tufters was one of the reasons put forward by Mr Houghton in the High Court for the FY05 projected increase in sales revenue being unachievable.[226] Dobson J did not, however, deal with this allegation.

Court of Appeal

[248] The Court of Appeal did not allow Mr Houghton to pursue this issue on appeal. This was because the allegation had not been pleaded and the evidence on this issue was unsatisfactory.[227] Before that Court Mr Houghton had relied, among other things, on Mr Magill's answer in evidence about difficulties with the first machine and the resulting $3 million shortfall. He also relied on a capital review document of November 2005.[228]

[249] The Court of Appeal considered that to allow the issue to be pursued (even through an amendment to the pleading) would cause unfair prejudice to the respondents,[229] as they had no notice of the issue and no chance to call evidence on it. In addition, the executives who would have been best able to assist were not cross-examined on this issue (although some of the directors were).

[250] The Court of Appeal said that in any event, the state of the evidence was so unsatisfactory that it could not provide a basis for concluding that the factual basis on which the FY05 projection proceeded was wrong.[230]

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226 See *Houghton* (HC), above n 2, at [316].
227 *Houghton* (CA), above n 2, at [135].
228 At [131]–[132].
229 At [134]–[135].
230 At [143].

Our assessment

[251] We agree with the Court of Appeal, for the reasons it gives, that this issue cannot be dealt with on appeal.[231] In any event, even with the full document of November 2005 provided to us,[232] we find ourselves in no better position than the Court of Appeal to assess Mr Houghton's submissions. The evidence on this issue is fragmentary, not directed to the SESS issue and in some cases has been misinterpreted by Mr Houghton.

Was the FY05 projection a misleading statement?

[252] As noted above,[233] the FY05 projection in the prospectus was for total operating revenue of $348,147,000; for EBITDA of $51,683,000; and a net surplus of $23,889,000. Mr Houghton argued that the FY05 projection in the prospectus was a misleading statement.

[253] The actual results for FY05 were set out in Feltex's 2005 annual report. In particular:

(a) total operating revenue was $299,380,000 (projection $348,147,000);

(b) EBITDA was $31,328,000 (projection $51,683,000); and

(c) net surplus was $11,750,000 (projection $23,889,000).

[254] Feltex's 2005 annual report attributed the lower than projected operating revenue to increased imports, intense competition, lower demand in Australia and exchange rate issues. The lower than expected EBITDA was attributed to lower margins due to increased competition, higher than expected raw material costs, exchange rate issues, higher sampling costs, corporate overheads and restructuring costs. The lower net surplus was said to be due to similar factors, and also higher

231 This means Mr Houghton's application made in his written submissions to amend the pleadings cannot be addressed by this Court. Mr Houghton did not make an application to amend his pleading in the Court of Appeal, see above n 2, at [135].
232 In the Courts below every second page was missing.
233 Above at [32] and [151].

interest costs (offset by lower depreciation and taxation). The annual report noted the Board's view that the drop in profitability was "not a result of a short-term seasonal dip in sales, but was the result of structural shifts in the market that were unlikely to reverse in the near future".

High Court

[255] Mr Houghton argued in the High Court that the assumption underlying the FY05 projection of a one per cent increase in market share was unreasonable.[234] Further, he pointed out that the projected revenue for FY05 would require a 4.7 per cent increase in sales over FY04 and, indeed, an even greater increase when the shortfall in FY04 as against forecast was taken into account.[235]

[256] It was accepted by the High Court that the sales revenue figures eventually adopted in the FY05 projection reflected the views of the various managers who were close to the respective aspects of revenue and costs being projected.[236] It was also accepted that the FY04 sales volume and revenue for all of the months of the 2004 calendar year to date (except March) were substantially below budget[237] and that sales and volume were known to be below forecast for April and May. Margins, however, were improving and EBITDA and net surplus forecasts would be met.[238] Further, the directors and the due diligence committee were told some of the sales revenue shortfall would be recovered in June.[239] In all these circumstances the Court held that the assumption of a one percent increase in market share was reasonably open to the directors.[240]

[257] The High Court also rejected a range of other allegations[241] that various components of the FY05 projection were not reasonably achievable.[242] In particular, the High Court rejected the contention that the trading conditions at the time the

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234 *Houghton* (HC), above n 2, at [312].
235 At [315].
236 At [320].
237 At [318].
238 At [321].
239 At [318].
240 At [323].
241 At [324]–[325].
242 Some of these criticisms had not been properly put to the relevant witnesses: see at [325].

projection was done did not justify optimism that the FY04 deficiency could be made up and that additional sales could be added in order to achieve the projected revenue figure.[243]

[258] The High Court accepted the submission that, from the directors' perspective, the anticipated shortfall in the FY04 revenue forecast did not trigger a need to reassess the reasonableness of the FY05 projection.[244] This is because the FY05 revenue projection had been built up by work undertaken by management in light of the reasonable expectations for Feltex's trading in the ensuing years and advice from outside experts, such as BIS Shrapnel. Further, Mr Houghton's expert, Mr Meredith, accepted in evidence that he had not considered the reasons advanced for assuming that Feltex could increase its market share. Nor had he undertaken any analysis of the effect of the new tufting equipment.[245]

[259] The High Court held that, in light of all the information available, the assumptions relied on and the projected numbers in the FY05 projection were reasonably open to the directors and were therefore not misleading.[246]

Court of Appeal

[260] The Court of Appeal upheld the High Court's analysis, accepting the submission that the process utilised in setting the FY05 projection was one of estimating future sales rather than applying a percentage increase to the FY04 figures.[247]

When is a projection an untrue statement?

[261] A projection will be or become untrue and misleading only if:[248]

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243 This contention relied in part on subsequent events, which the Judge dubbed "classic hindsight thinking": at [334].
244 At [334] and [337]. See also at [329].
245 At [335].
246 At [337].
247 *Houghton* (CA), above n 2, at [124].
248 See the definition set out by Dobson J above at [31].

(a) an assumption on which it is based was not reasonable in a way that affects the projection; or

(b) the projected outcome was not reasonably assessed as within the range of possible outcomes in light of the stated assumptions.[249]

Our analysis

[262] The projection for FY05 was based on a one per cent increase in Feltex's market share. This was measured by volume.[250] The relationship between the assumption of a one percent increase in market share and the 4.7 percent increase in revenue over the FY04 forecast figures is not entirely clear. However, presumably, if the revenue projections were met, then the one percent increase in market share would also have been met.[251]

[263] We accept that the FY05 sales revenue projection was not arrived at by adding a percentage increase to the FY04 forecast figure. In our view, however, this does not answer Mr Houghton's point, which is that it was unrealistic, in light of the history of the company and in particular the bad results in January, February, April and May, to consider that Feltex could achieve the level of sales projected for FY05.

[264] There are a number of points that support Mr Houghton's submission. The first is that Feltex's strategy had been to concentrate on margin rather than volume and in particular to concentrate on the middle and premium markets in residential. There does not appear to have been a decision to abandon this strategy. Rather, the increase in volume was projected to occur in those higher margin products and not in the mass market. This would make it harder to achieve the one percent increase in market share, which was measured by volume, because the mass market made up the greater proportion of the market. We also accept the submission that a 4.7 per cent increase

249 See above at [252]–[253]. As with a forecast it could also be untrue if risks had intensified or new risks had emerged that may affect the projection.
250 See above at [152].
251 Mr Magill accepted in cross-examination in the High Court that he had mentioned in his due diligence interview that there could be a downturn in the residential market in Australia in the first half of FY05. But he did not seek to have this reflected in the FY05 projection because management accepted various research papers put to the Board that indicated the housing market would be strong throughout 2005.

in revenue was ambitious and that this was even more so after the results in April and May. We also note that the results in the first six months of FY05 would suggest in hindsight that the sales projection was in fact unrealistic.[252]

[265] As pointed out in the Courts below, however, the evidence called by Mr Houghton did not challenge the reasons given for assuming an increase in revenue. We are thus not in a position to examine their validity or otherwise. While the sales revenue shortfall against projection[253] began immediately in July and worsened over the next months, there are dangers in judging by hindsight. The due diligence committee and the directors did have information before them which suggested the market in FY05 would be buoyant.[254]

[266] We are therefore not able to hold it proved that, at the time of the allocation of shares, the FY05 sales revenue projection was not reasonably assessed as within the range of possible outcomes and thus an untrue statement.

Conclusion on whether the prospectus contained an untrue statement

[267] For the reasons set out above, we conclude that the FY04 forecast was an untrue statement. We stress that this stage of the inquiry is to determine if the prospectus contained an untrue statement. We have not considered the materiality of the shortfall.[255] This is because materiality is, contrary to the approach of the High Court, not relevant when considering if a statement is untrue.

[268] We have rejected Mr Houghton's submission that he had proved that there were other untrue statements in the prospectus.

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252 Sales were below budget (in volume terms by 1,079,000 m^2 and in revenue terms by NZD 22,182,000) in this period and below the figure for the corresponding period in the previous financial year (in volume terms by 624,000 m^2 and in operating revenue terms by 7.4 per cent according to the Interim Report).

253 It was accepted in evidence that the budget had figures broadly similar to the IPO projection figures.

254 See above at [156].

255 We have thus not discussed the expert evidence of Mr Cameron or Professor van Zijl as this was concerned with materiality. See *Houghton* (HC), above n 2, at [184]–[185].

Stage 2 hearing and loss

[269] As already mentioned, the High Court ordered that there should be a split trial.[256] The stage 1 hearing was to deal with Mr Houghton's claim in its entirety. The stage 2 hearing was to deal with individual aspects of the claims of the represented plaintiffs (such as reliance and loss), on the basis that issues that were common to all plaintiffs and decided at the stage 1 hearing would be binding on all. The Court of Appeal commented in its judgment that, if Mr Houghton's appeal to that Court failed, there would be no need for a stage 2 hearing.[257]

[270] Mr Houghton did not adduce evidence of loss at the stage 1 hearing, instead relying on the "but for" argument dealt with above.[258] As an alternative, he sought an inquiry into damages. He took that approach even though the respondents had made what the High Court Judge called a "relatively extensive case challenging the existence of any recoverable loss".[259]

[271] Mr Houghton maintains the claim in this Court that an inquiry into damages should be held. He also challenges the Court of Appeal's comment that there should be no stage 2 hearing.

High Court

[272] In the High Court, Dobson J said that, if he had found the respondents in breach of the Securities Act, he would not have accepted Mr Houghton's submission that there should be an inquiry into damages. He said he would have required Mr Houghton to establish in the substantive hearing that the market remained unaware of the true position in relation to the aspect of Feltex's business affected by the untrue statement for the approximately nine month period until the share price dropped below the IPO price.[260] That would respond to the respondents' position that, given that Feltex shares traded within an otherwise explicable range of the IPO price for that nine month period, the IPO price could not be shown as over-valuing the shares.[261]

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256 See above at [17].
257 See above at [17]; and *Houghton* (CA), above n 2, at [33].
258 See above at [111]–[118].
259 *Houghton* (HC), above n 2, at [709].
260 At [710].
261 At [711].

Court of Appeal

[273] The Court of Appeal upheld Dobson J's refusal to adjourn so an inquiry into damages could take place. Rather, it said Mr Houghton needed to have proved his loss at the stage 1 hearing. It agreed with Dobson J that the measure of loss was the difference between the price paid for the securities and the estimated value had there been full disclosure.[262]

[274] As noted earlier, the Court of Appeal, although accepting the shortfall in the FY04 forecast was untrue, held that it was not sufficiently material to have affected a notional investor's decision to invest.[263] This finding (based as it was on an objective standard) meant that it would not be possible for any of the other plaintiffs represented by Mr Houghton to succeed in their claim. The Court's view must have been that the shortfall in the FY04 forecast was incapable in any circumstances of causing loss.

Our assessment

[275] It will be obvious from what we have said above, when discussing the significance of the shortfall as against the forecast for FY04,[264] that we do not agree with the Court of Appeal that the untrue statement relating to the FY04 forecast was incapable of causing loss. Further, the investors, other than Mr Houghton, have not had any opportunity to call evidence on loss. This means that the issue of whether the untrue statement did in fact cause loss must be determined at the stage 2 hearing.

[276] In order for the stage 2 hearing to be able to consider the issue of loss, it is necessary to quash the Court of Appeal's finding that the untrue statement in relation to the FY04 forecast was not capable of being material to the investment decision and therefore could not have caused loss.[265]

[277] In the normal run of things in order to prove loss at the stage 2 hearing, the investors would need to prove that the $1.70 paid for each Feltex share was greater

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262 *Houghton* (CA), above n 2, at [311].
263 See above at [184]–[189].
264 See above at [210]–[221].
265 The Court of Appeal's finding that the untrue statement does not constitute a breach of s 9 of the Fair Trading Act will also need to be quashed, see below at [321]–[325].

than the value the shares would have had if the untrue statement had not appeared in the prospectus.[266] As Dobson J foreshadowed, it will be necessary to determine at what date the assessment should be made. The respondents' arguments that the value of the Feltex shares, as reflected in its market price after the IPO, was at least equal to the IPO price will need to be assessed, as will their arguments that the reasons for the fall in the market price of the shares in Feltex in 2005–2006 were unrelated to the untrue statement in the prospectus. The argument made by Mr Houghton that the shares were worthless from inception will also need to be assessed.[267]

[278] We do not think we should pre-empt the airing of these issues at the stage 2 hearing by saying more.

[279] We reject Mr Houghton's submission that there should be an inquiry into damages: rather loss is an issue to be determined at the stage 2 hearing, at least for those investors who did not participate in the stage 1 hearing (those other than Mr Houghton himself). We therefore leave undisturbed the High Court's refusal to order an inquiry as to damages. As Mr Houghton did not prove at the stage 1 hearing that he sustained loss by reason of an untrue statement, his Securities Act claim would, in the normal run of things fail.[268] However, as there is now to be a stage 2 hearing to determine issues relating to loss in relation to the Securities Act claim for all other investors, we consider there may be an argument that it would be unfair to exclude Mr Houghton from that process. In order to participate, he would need to persuade the High Court Judge that the terms of the minute of French J referred to earlier should be amended to allow this.[269] We make no comment on whether, if such an application to amend the terms of the minute is made, it should be allowed.[270]

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266 This is not however an invariable rule and the High Court will need to decide the appropriate measure of loss: *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254 (HL) at 265 per Lord Browne-Wilkinson.

267 Even if Mr Houghton is not part of the stage 2 hearing.

268 He chose instead to rely on the "but for" argument we have rejected above.

269 See Minute of French J, above at n 20. This was subsequently adopted in the 2012 judgment of French J, above at n 20, at [39]. We note that, if any application to amend is not granted, this will be the end of Mr Houghton's case on the Securities Act.

270 Mr Houghton can participate in the stage 2 hearing in relation to his Fair Trading Act claim, as noted below at [325].

Is a due diligence defence available to the respondents?

[280] The respondents relied on the defence set out in s 56(3)(c) of the Securities Act in the event they were found to be in breach of s 56(1).[271] Dobson J and the Court of Appeal referred to this as the due diligence defence and we will do the same. As we have found that the only breach related to the FY04 revenue forecast, we will consider the possible application of the due diligence defence to that breach.

[281] The due diligence process adopted by Feltex is described above.[272]

[282] The respondents also pleaded and advanced the defence available under s 63(1) of the Securities Act. That section gives the court power to excuse from liability a person who might be liable in respect of negligence, default, breach of duty or breach of trust in connection with an offer to the public or allotment of securities. The court can grant such relief if it determines that the person has acted honestly and reasonably and, having regard to all the circumstances of a case, ought fairly to be excused. The grant of such relief by the court may be made on such terms as the court thinks fit.

High Court

[283] Section 63(1) was discussed only briefly in the decision of Dobson J. He simply noted that if it were found that the due diligence defence under s 56(3) was unavailable, he was not in a position to make any findings of any distinguishable circumstances in which any of the defendants would nonetheless be entitled to some measure of relief under s 63(1).[273] He said the matter would need to be reargued if the application of s 63(1) became an issue. Section 63(1) was not referred to by the Court of Appeal and was not the subject of argument in this Court. We will confine our attention to s 56(3)(c), but we note that Dobson J's observation that, if any of the respondents were found to be liable under s 56(1) and unable to avail themselves of the defence under s 56(3)(c), then the availability or unavailability of relief under s 63(1) would need to be reargued.[274]

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271 Section 56(3)(c) is set out above at [43].
272 At [26], [34] and [155]–[174].
273 *Houghton* (HC), above n 2, at [557].
274 The respondents specifically maintained the "defences" under s 56(3)(c) and s 63 if they were found to be otherwise liable under s 56.

[284] Dobson J set out a detailed description of the due diligence process and it is not necessary for us to repeat the description here.[275] He rejected a submission made on behalf of Mr Houghton that the process was essentially a charade.[276] He noted that the proposition that directors had not directly participated in considering the accuracy of the content of the prospectus was not squarely put to any of them.[277] He noted that there was no requirement for directors to undertake relevant research personally, and in that respect referred to the definition of "due enquiry" in s 2B of the Securities Act.[278]

[285] Dobson J concluded as follows:

> [554] 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.

Court of Appeal

[286] The Court of Appeal agreed with Dobson J that the due diligence process had been "thorough in both its conception and execution".[279] Like Dobson J, however, the Court considered that the issue of whether the process had been sufficient to provide reasonable grounds to believe in the truth of the statement for the purposes of the s 56(3) defence was an issue that could not sensibly be considered in the absence of a proved material untruth.[280]

[287] There was no challenge to these findings as to the thoroughness of the due diligence process in this Court. We do not have any reason to question them.

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275 *Houghton* (HC), above n 2, at [543]–[546].
276 At [549]–[550].
277 At [551].
278 At [553].
279 *Houghton* (CA), above n 2, at [213].
280 At [213].

[288] More significantly for present purposes, however, the Court of Appeal also addressed the applicability of the due diligence defence in a situation where an untrue statement in a prospectus is known by the issuer, directors and promoter to be an untrue statement in terms of s 55, but the relevant defendant considers that the inaccuracy in the statement is immaterial. The Court said:

> [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".[281]

The respondents' case

[289] In this Court, Mr Smith QC, who argued this part of the appeal for the respondents, argued that the Court of Appeal was wrong to find that the due diligence defence did not apply where an untrue statement in a prospectus was known by the issuer, directors and promoter to have been untrue. He argued that a statement was untrue for the purposes of s 55(a)(i) only if it was untrue to a material extent. So, he argued, a statement that was immaterially untrue was not "untrue" for the purposes of s 55(a)(i). We have already come to the contrary view that materiality is not a required element of s 55(a)(i).

[290] The respondents said that the issuer, directors and promoter in this case had reasonable grounds to believe that the likely failure to achieve the FY04 revenue forecast was immaterial because it was likely to be only $7.5 million – $9 million lower than forecast and that was less than three per cent of the forecast revenue for the year ended 30 June 2004. They argued that, if (contrary to their submission) the FY04 revenue forecast was materially untrue, then they should be able to avail themselves

[281] Securities Act, s 58(2) (emphasis added).

of the due diligence defence because they had reasonable grounds for believing that the inaccuracy in the forecast was not untrue to a material extent. This amounted to an argument that s 56(3)(c) should be read as referring to reasonable grounds to believe and actual belief that the statement was immaterial, on the basis that a statement that is immaterially untrue is, in terms of s 55, not an untrue statement.

Our assessment

[291] We reject this submission, essentially for the same reasons as it was rejected by the Court of Appeal. Section 55(a)(i) does not contain a materiality threshold and s 56(3)(c) refers to a belief that a statement is true, not a belief that a statement is untrue but only to an immaterial extent. If the directors knew as at 2 June 2004 that the FY04 revenue forecast was no longer the most probable outcome based on the assumptions stated in the prospectus or that the assumptions were not reasonable assumptions, then they knew that the FY04 revenue forecast was a misleading statement, i.e. it was untrue. They cannot claim they had reasonable grounds for believing it was a true statement when they knew it was not. They may be able to establish that they believed it was untrue only to an immaterial extent, but s 56(3)(c) does not provide a defence in those circumstances as the Court of Appeal found. We also agree with the Court of Appeal that the contrast between s 56(3)(c) and the equivalent provision in s 58, which expressly refers to immateriality, supports the proposition that s 56(3)(c) does not apply where the issuer, directors and promoter knew a statement was untrue but reasonably believed it was immaterially untrue.[282]

[292] The unavailability of the s 56(3)(c) defence does not prevent any respondent found to be in breach of the Securities Act from arguing that s 63(1) should be applied to relieve them from liability. As mentioned earlier, we did not hear argument on the application of that section and, if a decision needs to be made about its application, it will have to be made at the stage 2 hearing.[283]

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282 See *Houghton* (CA), above n 2, at [210]. See also above at [86].
283 Above at [283].

Can the Feltex directors and Credit Suisse be liable under the Fair Trading Act?

[293] Mr Houghton's claims were made under both the Securities Act and the Fair Trading Act.[284] He sought relief under the Fair Trading Act and, in this Court, he argued that the appropriate remedy under that Act would be a declaration that the contract pursuant to which Mr Houghton acquired shares in Feltex be declared void under s 43(2)(a) of the Fair Trading Act. Alternatively, he sought an order requiring CSAMP and Feltex to return the money they received from him in respect of his shares under s 43(2)(c) of the Fair Trading Act.

[294] The respondents argued in the High Court that they could not be found liable under the Fair Trading Act if it was found that their conduct did not amount to a breach of the Securities Act. As things have transpired, we have found them to have been in breach of the Securities Act, so the issue for them is whether they are potentially exposed to liability under the Fair Trading Act as well as the Securities Act. The position is different for CSAMP, which is not liable under s 56 of the Act for the reasons given above.[285] So for it, the resolution of this issue will determine whether it could be liable under the Fair Trading Act for conduct for which it cannot be liable under the Securities Act.

[295] The respondents' submission relied on s 63A of the Securities Act and s 5A of the Fair Trading Act.

[296] Section 63A of the Securities Act 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.

[284] Mr Houghton did not pursue a claim against the joint lead managers under the Fair Trading Act in this Court. References in this section of the judgment to "the respondents" are to the Feltex directors, CSAMP and CSPE.

[285] CSAMP is not liable under s 56 of the Securities Act for the reasons given above at n 56.

[297] Section 63A was added to the Securities Act by s 14 of the Securities Amendment Act 2006, which came into force on 25 October 2006, well after the allotment of Feltex shares to investors in the IPO but well before the present proceedings were commenced.

[298] Section 5A of the Fair Trading Act 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—
>
> (a) that is regulated by the Securities Act 1978 if that person would not be liable for that conduct under that Act:
>
> (b) that is regulated by the Securities Markets Act 1988 if that person would not be liable for that conduct under that Act.

[299] Section 5A was added to the Fair Trading Act by s 4 of the Fair Trading Amendment Act 2006. It came into force on 29 February 2008, a few days after the statement of claim was filed in relation to the present proceedings.

[300] Both s 63A and s 5A came into force after the events founding Mr Houghton's claim (May–June 2004). On their face they prevent Mr Houghton succeeding in a claim under the Fair Trading Act if the respondents are found not to be liable under the Securities Act, given that there is no doubt in the present case that the relevant conduct is regulated under the Securities Act.

[301] Mr Houghton argued in the High Court and Court of Appeal that neither s 63A nor s 5A applies in relation to his claim. He argued their application in the present proceedings would mean they contravened s 7 of the Interpretation Act 1999, which provides that enactments do not have retrospective effect.

[302] There were no transitional provisions in the Fair Trading Amendment Act. There was, however, a transitional provision in the Securities Amendment Act. Section 24 of that Act provided:

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:

…

(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; …

…

[303] The transitional arrangements set out in s 24 applied not just to s 63A, but also to a number of other provisions in the Securities Amendment Act altering the regime for civil and criminal liability for breaches of the Securities Act.[286]

High Court

[304] Dobson J found that s 63A of the Securities Act and s 5A of the Fair Trading Act applied to exclude causes of action under the Fair Trading Act in relation to the conduct in issue in the proceedings, because that conduct was regulated by the Securities Act.[287] The essence of his reasoning was:[288]

(a) Section 63A does not constrain the commencement of proceedings in which causes of action invoke both the Securities Act and the Fair Trading Act. Rather, s 63A and s 5A prohibit a finding of liability under the Fair Trading Act if the claim relates to conduct regulated by the Securities Act where the defendant would not be liable for that conduct under the Securities Act.

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286 Those substantive changes do not affect the present proceedings, which are governed by the Securities Act as it was prior to the coming into force of the Securities Amendment Act.
287 *Houghton* (HC), above n 2, at [629].
288 At [622]–[629].

(b) Neither section prevented a claim being made under both the Securities Act and the Fair Trading Act. A court could exclude the prospect of finding a defendant liable under the Fair Trading Act only after a determination had been made that the conduct complained of was regulated by the Securities Act.

(c) On that interpretation, no retrospectivity issue arose. There was nothing stopping Mr Houghton from claiming under both the Securities Act and the Fair Trading Act. It was only when there was an admission or finding that the conduct complained of was regulated by the Securities Act that the court would be deprived of jurisdiction to make a finding under the Fair Trading Act.

(d) Thus there was no need for a transitional provision for s 5A or s 63A: the transitional provision in the Securities Amendment Act was required in relation to other substantive amendments, but not in relation to s 63A.

(e) As a matter of policy, the specific civil liability regime in the Securities Act should not be subverted by the overarching consumer protection provisions of the Fair Trading Act, otherwise issuers and directors may face liability regardless of fault, which will discourage fundraising and result in disproportionate due diligence.[289]

Court of Appeal

[305] The Court of Appeal reversed this finding by Dobson J. The Court was divided. The majority, Randerson and Winkelmann JJ, considered that applying s 63A and s 5A in the present proceedings was to give them retrospective effect.[290] Ellen France P dissented. She would have upheld the decision of Dobson J on this

289 At [627]–[628], citing similar concerns in relation to the same issue in Australia: Australian Government Corporate Law Economic Reform Program *Fundraising: Capital raising initiatives to build enterprise and employment – Proposals for Reform: Paper No 2* (1 April 1997) at 41.

290 *Houghton* (CA), above n 2, at [295].

point, for the reasons he gave.[291] We will address the Court of Appeal's reasoning when we deal with the respondents' arguments.

The respondents' case

[306] The respondents filed a notice supporting the judgment of the Court of Appeal on other grounds, arguing that this Court should reverse the majority decision of the Court of Appeal on this point and restore the decision of Dobson J, with which Ellen France P agreed.

[307] The notice supporting the judgment of the Court of Appeal on other grounds also raised a more general argument to the effect that the due diligence defence in s 56(3)(c) of the Securities Act is available to the respondents to defeat both Securities Act and Fair Trading Act liability for the FY04 forecast. That foreshadowed a more generic argument made by the respondents that the Fair Trading Act, as a generic consumer protection law, should be interpreted so as to make it consistent with what counsel called the "lex specialis", the Securities Act. That argument was made on a standalone basis and also in support of the argument that s 63A and s 5A should be interpreted as applying to the present case.

Interpretation

[308] We will deal with the more general argument first. Mr Smith argued that, as a matter of statutory interpretation, the Fair Trading Act should be interpreted so that a person who is not liable under the Securities Act for conduct specifically regulated by that Act is not liable under a different standard imposed in the general regime in the Fair Trading Act. The essence of that argument was that a person who could claim a due diligence defence under the Securities Act should not face jeopardy under the Fair Trading Act, which has no similar due diligence defence.[292] He argued that the remedial discretion provided in s 63 of the Securities Act (to excuse parties from liability) and s 43 of the Fair Trading Act (which makes the remedies provided in that section discretionary) provided a means to give effect to that principle of statutory interpretation.

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291 At [296].
292 We do not view the defence in s 44(1) of the Fair Trading Act as applicable to the present case.

[309] There is some support in two Australian authorities for the proposition that the generic provisions of the Australian equivalent of the Fair Trading Act should be read down in situations where conduct at issue is also subject to more specific legislation that contains quantifications that are absent from the generic provision.[293] Given the focus of the respondents' case on the absence of a due diligence defence in the Fair Trading Act, their case would be that s 9 of the Fair Trading Act should be read as if it contained a due diligence defence or the discretions as to remedy in the Fair Trading Act should be influenced by the fact that the respondents would have had a due diligence defence if the matter were evidenced under the Securities Act. As we have found they have no due diligence defence under the Securities Act, there would be no practical benefit to them from adopting the approach to interpretation that they argue for.

[310] However, the matter may need closer consideration if any of the respondents are granted relief from liability under s 63(1) of the Securities Act. In that event, that respondent could argue that, having been excused from liability under the Securities Act, he or she should not be liable for the same conduct under the Fair Trading Act. In essence, that would be an argument that the court should refuse to make an order against that respondent under s 43 of the Fair Trading Act in the exercise of the discretion given to the court under that section. It is not possible for us to resolve whether such an argument should succeed without knowing the nature of the Securities Act liability and the reasons for the respondent being excused under s 63(1). We do not therefore express a view on whether such an approach to the interpretation of the Fair Trading Act is available and whether the discretion under s 43 of the Fair Trading Act should be exercised in favour of the relevant respondent.

Retrospectivity

[311] We turn now to the retrospectivity issue.

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293 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 (FCAFC) (conduct governed by Corporations Law and s 52 of the Trade Practices Act 1974 (Cth)); and *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 224–225 per Brennan J (conduct governed by the Designs Act 1906 (Cth) and s 52 of the Trade Practices Act).

[312] The Court of Appeal said that the rationale behind s 7 of the Interpretation Act was that Parliament does not intend statutes to cause unfairness.[294] They considered that the application of s 63A in the present case would be to give that provision retrospective effect because that would have the effect of taking away from Mr Houghton and the claimants he represents substantive rights which had already accrued prior to the coming into force of s 63A. While neither s 63A nor s 5A would prevent Mr Houghton from making a claim under the Fair Trading Act, they would deprive him of access to a remedy for breach in the event that his claim that the Fair Trading Act had been breached was successful. That rendered his right of action worthless. Removing the right to a remedy removes substantive rights.[295]

[313] The majority said there was no indication in the language of s 24 of the Securities Amendment Act or in s 63A itself to indicate there was an intention that s 63A should have retrospective effect. Nor did they see the absence of a transitional provision in the Fair Trading Amendment Act as indicating that s 5A was intended to have retrospective effect.[296] In the absence of any indication from Parliament that s 63A and s 5A were intended to have retrospective effect, it would be inappropriate to give them such effect. This reflected the fact that, in the majority's view, there would be unfairness created by applying s 63A retrospectively.[297]

[314] We agree with the majority of the Court of Appeal that there is no indication in the Securities Amendment Act or the Fair Trading Amendment Act that Parliament intended that s 63A and s 5A should have retrospective effect. As the Court of Appeal noted, it would be an odd outcome if s 63A applied to Mr Houghton's claim when none of the substantive provisions introduced into the Securities Act by the Securities Amendment Act do.[298] That is a factor against applying s 63A in this case.

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294 *Houghton* (CA), above n 2, at [291], citing *Secretary of State for Social Security v Tunnicliffe* [1991] 2 All ER 712 (CA) at 724.
295 At [292].
296 At [293]–[294].
297 At [295].
298 At [295]. The substantive changes simplified the civil liability regime and allowed the Securities Commission to obtain a declaration of civil liability upon which investors could rely in their claims for compensation orders. The Commission could also apply for compensation orders on investors' behalf.

[315] We also agree with the majority in the Court of Appeal, essentially for the reasons they gave, that if the effect of applying s 63A and/or s 5A in the present case was to deprive Mr Houghton or any of the other plaintiffs of a remedy for a breach of the Fair Trading Act they would otherwise have had, that could be seen as an unfair outcome. While neither s 63A nor s 5A would prevent a claimant from suing under both the Securities Act and the Fair Trading Act, the practical reality is that applying s 63A and s 5A would mean that a claimant was deprived of the opportunity to claim relief under the Fair Trading Act that he or she would have had if the claim had been dealt with before s 63A and s 5A came into force. That can be seen as creating an unfairness to the claimants.

[316] On the other hand, we accept there are good policy reasons for restricting the exposure of issuers and directors to the civil liability provisions of the Securities Act. The Securities Act and Securities Regulations create a comprehensive disclosure regime, requiring that information be set out in a publicly available document that must be made available to potential investors. The imposition of these disclosure obligations is balanced by the availability of a due diligence defence where an untrue statement appears in a prospectus despite a rigorous process of checking the information. It is unfair to those on which the disclosure obligation is placed if they are exposed to liability under the Fair Trading Act without the balancing factor of a due diligence defence. It also undermines the Securities Act regime, by creating a greater risk to those involved in fundraising activities than was intended by Parliament when enacting the Securities Act.[299]

[317] Mr Smith argued that the Court of Appeal's focus on the unfairness to Mr Houghton of being deprived of the opportunity to obtain relief under the Fair Trading Act was misplaced. The real unfairness, he said, was the unfairness to the respondents of, in effect, being deprived of an effective due diligence defence. We accept that the unfairness cuts both ways but, as it turns out, the Feltex directors and CSPE do not have the benefit of a due diligence defence under the Securities Act in the present case. We agree with the Court of Appeal majority that there is nothing in

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299 A similar situation in Australia led to reform: see Australian Government Corporate Law Economic Reform Program, above n 289, at 41 and, more generally, Michael Gillooly "Misleading or Deceptive Conduct under Section 995 of the Corporations Law" in Colin Lockhart (ed) *Misleading or Deceptive Conduct: Issues and Trends* (Federation Press, Sydney, 1996) at 43.

the language of s 24 of the Securities Amendment Act or in s 63A itself to indicate that s 63A should have retrospective effect, that is affect the outcome of a proceeding dealing with events that occurred well before it came into effect. In the absence of language indicating an intention that the section should apply to proceedings about events pre-dating its enactment, we consider the correct approach is to treat s 63A as applying only to conduct occurring after it came into force.

Breach of the Fair Trading Act?

[318] We have found that, in terms of s 56 of the Securities Act, the prospectus contained an untrue statement in relation to the FY04 revenue forecast. The statement was untrue because, as provided in s 55(a) of the Securities Act, it was misleading in the form and context in which it was included in the prospectus. It follows from this that the Feltex directors and CSPE were in breach of s 9 of the Fair Trading Act, which prohibits engaging in conduct that is misleading or is likely to mislead or deceive. And, as there is nothing in the Fair Trading Act to absolve CSAMP from responsibility for its part in the preparation and distribution of the prospectus, we think it also follows that CSAMP is also in breach of the Fair Trading Act, even though it cannot be liable under s 56 of the Securities Act.

[319] The position of the joint lead managers is more problematic. Mr Houghton's statement of claim includes a pleading against the joint lead managers for breach of the Fair Trading Act. Mr Houghton's claim under the Fair Trading Act against all respondents failed in the High Court for the reasons set out above.[300] So the distinct position of the joint lead managers did not need to be addressed. The Court of Appeal reversed the High Court decision as to the applicability of the Fair Trading Act but found no breach, so, again, the separate position of the joint lead managers was not addressed. The joint lead managers submitted in this Court that, as Mr Houghton did not contend in his submissions in this Court that the joint lead managers had primary liability under the Fair Trading Act for statements in the prospectus, the joint lead managers could not be liable under that Act. Counsel for Mr Houghton did not respond to that submission.

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300 Above at [304].

[320] The upshot of all this is that we have nothing before us from Mr Houghton in support of his pleaded claim that the joint lead managers are liable under the Fair Trading Act, but nothing conceding that they are not liable. The pleaded claim against the joint lead managers alleges misleading conduct that goes far beyond the misleading statement in the prospectus about the FY04 revenue forecast and, to the extent it relates to matters other than that, must be taken as having failed. To succeed against the joint lead managers in a claim of primary liability under the Fair Trading Act in relation to the misleading statement about the FY04 revenue forecast, Mr Houghton would need to establish that that misstatement was a statement by the joint lead managers (his allegation that they were parties to misleading and deceptive conduct has not been pursued). He has not drawn our attention to any evidence to that effect. In those circumstances, and in light of Mr Houghton's failure to advance this aspect of his claim before us (or the Court of Appeal), we are unable to uphold it.

Remedies under the Fair Trading Act

[321] Mr Houghton alleged that the loss he suffered as a result of the breaches of the Fair Trading Act was the loss of the purchase price for his shares and of the dividend yield he expected to receive (based on the projection in the prospectus) or, alternatively, the difference between the $1.70 issue price and the lower value he says the shares had because the breaches had inflated the issue price.

[322] The remedies sought by Mr Houghton for the alleged breaches of the Fair Trading Act included:

(a) an order declaring his subscription void; or

(b) an order requiring the relevant respondents to refund his subscription and pay an amount equal to the anticipated dividend yield; or

(c) judgment for the loss as described at [321] above.

[323] Section 43(1) of the Fair Trading Act gives the court power to make orders of the kind sought by Mr Houghton if it finds that "a person … has suffered … loss or damage by conduct of any other person that constitutes [a breach of the Fair Trading

Act]". In *Red Eagle Corp Ltd v Ellis*, this Court said the language of s 43 requires a common law practical or common-sense concept of causation.[301] While it was not necessary that the impugned conduct was the sole cause of the plaintiff's loss, "it must be an effective cause, not merely something which was, in the end, immaterial to the suffering of the loss or damage".

[324] Applying this approach, the Court of Appeal decided that, as the only statement that it found to be misleading was the FY04 revenue forecast, and that it had found that misleading statement to be immaterial, there was no tenable basis for the argument that Mr Houghton had suffered loss by misleading conduct on the part of the relevant respondents. We have quashed the Court of Appeal's finding to the same effect in relation to potential liability under the Securities Act and, for similar reasons, we also quash its finding in relation to loss in terms of the Fair Trading Act.

[325] There are no findings in the Courts below on causation under the Fair Trading Act or the appropriate remedy in the event that there is a finding that investors (including Mr Houghton) are found to have "suffered … loss or damage by conduct of" all or any of the respondents. Those issues will need to be left for resolution at the stage 2 hearing.[302]

Were the joint lead managers "promoters" for the purposes of the Securities Act?

[326] Section 56(1) of the Securities Act imposes civil liability for misstatements in a registered prospectus on the issuer (if an individual), directors of the issuer and "every promoter of the securities".[303]

[327] Section 2(1) of the Securities Act defines "promoter":

> **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

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301 *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [29].
302 With regard to Mr Houghton, this would have to be considered on the basis of the evidence he led at the stage 1 hearing, unless the High Court allows him to adduce further evidence.
303 Section 56(1)(d).

> (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

[328] First NZ and Forsyth Barr are sharebrokers and investment bankers. They were joint lead managers on the Feltex IPO. In that capacity they acted as organising participants for NZX listing rule purposes. They advised on regulatory requirements, the content and structure of the prospectus and offering itself, and the due diligence process. They managed the IPO book build and provided final recommendation to Credit Suisse on price. They attended the due diligence committee, in an observer capacity. In the prospectus directory they were listed as "Organising Participants and Joint Lead Managers". The prospectus directory specified CSPE as "Promoter".

[329] The joint lead managers agreed to take a specific share allocation. They also agreed to a further allocation – the "bond shortfall amount" – up to a maximum of $30 million. We discuss this later at [356]. In consideration of this, and other services supplied, the joint lead managers received a mixture of fees (including a discretionary incentive fee) and brokerage. Credit Suisse and Feltex also agreed to indemnify the joint lead managers for any losses, claims, fines or penalties arising from performance of their agreed services.

[330] Two questions arise. First, what is meant in the Securities Act by the expression "promoter"? Secondly, were the joint lead managers "promoters" in that sense (and, as part of that question, does the "professional capacity" exception in para (c) of the definition apply to them)?

High Court

[331] Dobson J considered the wording in the definition contemplated a relatively close measure of personal involvement at 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".[304] "Instrumentality" implied that a promoter "will generally have been an important contributor to the offer being

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[304] *Houghton* (HC), above n 2, at [580].

initiated, exercise significant decision-making power, and have responsibility over the form and execution of the offer".[305]

[332] The Judge cited examples of the joint lead managers' prospectus recommendations being rejected. Dobson J considered the fact they did not share the power to make relevant decisions as an important factor taking them outside the definition of promoter.[306] Instructions came from Credit Suisse and Feltex. He did not consider the indemnity a pointer to the joint lead managers being promoters. There was not, for instance, evidence of some "covert acknowledgement" that their involvement qualified them in that way.[307]

[333] In addition, Dobson J concluded the joint lead managers fell within the exception in para (c) of the definition of "promoter" – i.e. "a person acting solely in his or her professional capacity". That definition necessarily included a body corporate acting in that manner.[308] Specifically, Dobson J held that the joint lead managers' economic interests were conventional for a broker acting in a professional capacity.[309]

Court of Appeal

[334] The Court of Appeal took a different view of the interpretation of "promoter" in the Securities Act. However it divided on the application of principle to the facts.

[335] In the Court's view, someone was "instrumental" for the purposes of being a promoter "if they are a means by which the plan or programme [pursuant to which the securities are offered to the public] is formulated".[310] The Court thereby applied a lower threshold than Dobson J. 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". The promoter must also "have been party to the preparation of the registered prospectus or the impugned

305 At [580].
306 At [583].
307 At [585].
308 At [593]–[596].
309 At [595]–[596].
310 *Houghton* (CA), above n 2, at [255].

part thereof".[311] A decision-making role in formulating a plan may be evidence of promotership, but is not a necessary element of that status.[312]

[336] Randerson and Winkelmann JJ went on to hold the joint lead managers fell within the definition of "promoter" because they were actively involved in the formulation of the plan to offer the securities. They worked "as part of the group that developed the plan and were a means by which it was implemented".[313] They "were able to shape aspects of the offer", even if they did not have decision-making powers.

[337] Ellen France P took a different view: the joint lead managers did not fall within the definition because their role was only to *assist* with the offer. She did not consider a decision-making role necessary before a person was a promoter, but "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".[314]

[338] As the issue was not dispositive of the appeal, and in the absence of full argument, the Court of Appeal did not express a concluded view on whether the joint lead managers' services were undertaken "solely in [their] professional capacity".[315]

Meaning of "promoter" in the Securities Act

[339] The Securities Act uses the expression "promoter" in a number of provisions. Those of most significance are ss 41(b), 56(1) and 59. Section 41(b) requires a to-be-registered prospectus to be signed by the issuer, the issuer's directors and "every promoter of the securities". It clearly contemplates there may be multiple promoters, but also that they are sufficiently prominent to be mandatory signatories to the prospectus. Section 56(1), dealing with civil liability for misstatements we have reviewed already. Section 59 provides criminal liability for contravention of the Securities Act on the part of the issuer, principal officers of the issuer and "every

311 At [256].
312 At [257].
313 At [264].
314 At [266].
315 At [273].

promoter of the security". Fines of up to $300,000 plus, for continuing offences, up to a further $10,000 a day are provided for.

[340] The definition of "promoter" in s 2 emphasises three considerations. The first is instrumentality: that the promoter must be a person who is "instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public". The second is that a promoter is distinct from the issuer. The third is that it excludes a person acting "solely in his or her professional capacity".

[341] The *Oxford English Dictionary* defines "instrumental" as "Of the nature of an instrument (material or subservient); serving as an instrument or means; contributing to the accomplishment of a purpose or result."[316] The *Cambridge English Dictionary* places the required degree of participation at a higher level than mere contribution: "If someone or something is instrumental in a process, plan, or system, that person or thing is one of the most important influences in causing it to happen."[317] It is clear a functional spectrum for instrumentality exists. We turn now to context, to locate the place of s 2 within that spectrum.

[342] The Court of Appeal traced the pedigree of the s 2 definition of "promoter" to s 3(2) of the Promoters' and Directors' Liability Act 1891 which, in circular terms, defined a promoter as "a promoter who was a party to the preparation of the prospectus".[318] It also incorporated the professional capacity exception – though omitting the word "solely". As the Court pointed out, that definition carried through into the Companies Acts of 1903, 1908, 1933 and 1955. But the 1978 Securities Act, perhaps recognising the definitional circularity, moved from participation to instrumentality: "a person who is instrumental in the formulation of a prospectus relating to the security". The more limited professional capacity exception – "solely" – arrived at the same time. (It may be observed that the final form of the definition changed significantly when reported back from Select Committee. As introduced, a "promoter" meant "a person acting in respect of the security on behalf of the issuer".[319]

316 JA Simpson and ESC Weiner (eds) *The Oxford English Dictionary* (2nd ed, Clarendon Press, Oxford, 1989) vol VII at 1051.
317 Cambridge English Dictionary "Meaning of 'instrumental' in the English Dictionary" <dictionary.cambridge.org>.
318 *Houghton* (CA), above n 2, at [248].
319 Securities Advertising Bill 1977 (173–1), cl 2.

The reason for the change is not adverted to in either the Select Committee report or the ensuing parliamentary debates.)

[343] The Court of Appeal took the view that the current definition must be read in light of its equitable antecedents, an approach we endorse.[320] Equity devised its own rather flexible definition of a promoter in order to impose a fiduciary duty for the benefit of the company formed.[321] This it did at a time, the mid-nineteenth century, when little legislative investor protection existed.

[344] A knot of decisions in the 1870s shaped the modern equitable sense of promotership. Foremost among them is the decision of the House of Lords in *Erlanger v New Sombrero Phosphate Co* where a syndicate forming a company secured a large undisclosed profit when the company, as planned, took a lease from the syndicate.[322] Lord Blackburn described the expression as 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".[323] Lord Cairns LC went further: "They have in their hands the creation and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision, it shall start into existence and begin to act as a trading corporation", although it cannot be inferred that a less decisive role would have excluded a participant from liability as a promoter in his Lordship's view.[324]

[345] In *Twycross v Grant*, another syndicate profit case (in a Court of Appeal of four that divided equally) Cockburn CJ (with whom Brett LJ agreed) described a promoter as a person who "undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose".[325]

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320 *Houghton* (CA), above n 2, at [238].
321 *Foss v Harbottle* (1843) 2 Hare 461 at 489, 67 ER 189 (Ch) at 201. See for example Peter Watts, Neil Campbell and Christopher Hare *Company Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2016) at 107; and Paul Davies and Sarah Worthington *Gower's Principles of Modern Company Law* (10th ed, Sweet & Maxwell, London, 2016) [*Gower's*] at 102–105.
322 *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218 (HL).
323 At 1268.
324 At 1236.
325 *Twycross v Grant* (1877) 2 CPD 469 (CA) at 541.

[346] In *Emma Silver Mining Co Ltd v Lewis & Son*, a fraudulent scheme to float a company to purchase an American silver mine of known doubtful value, Lindley J for a unanimous Court of Appeal held that "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".[326]

[347] Finally in this sequence, in *Whaley Bridge Calico Printing Co v Green* Bowen J said:[327]

> 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.

[348] Referencing Lindley J's analysis in *Emma Silver Mining*, Bacon VC held in *Re Great Wheal Polgooth Co Ltd* that a solicitor who unwittingly prepared a false prospectus for a valueless mining enterprise on instruction from a fraudster named Reynolds was not a promoter.[328] The duty he owed the company as solicitor was distinct from that owed by a promoter: "I find that the only promoters of the company were Mr Reynolds, and the other persons engaged in getting up the company, preparing prospectuses, and in taking subscriptions."[329] On that basis it is accepted that those who act in the formation of a company or flotation of its shares in a purely ministerial manner are not to be regarded as promoters. On the other hand the concept of promoter is not necessarily limited to *initiation* of the corporate enterprise (or, here, its offer). It has long been established that active arrangement in the floating of capital of an established enterprise is, in Equity, promotership.[330]

[349] Mr McLellan QC submitted that the authorities indicate that a promoter must have an influential role in the initial conception and procurement of the offer,

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326 *Emma Silver Mining Co Ltd v Lewis & Son* (1879) 4 CPD 396 (CA) at 407.
327 *Whaley Bridge Calico Printing Co v Green* (1879) 5 QBD 109 (QB) at 111.
328 *Re Great Wheal Polgooth Co Ltd* (1883) 53 LJ Ch 42 (Ch).
329 At 47.
330 *Gower's*, above n 321, at 103.

substantive decision-making power, and a significant commercial interest in the outcome of the offer, so that, in all the circumstances, it is appropriate to impose upon them similar obligations and duties to those of a director. He submitted that the Court of Appeal's requirement that a promoter play only an "active part" in forming the offer plan understated the threshold for liability.

[350] Equity did not offer any thorough definition of a promoter, in part deliberately – to avert exploitation of exceptions by those engaged in the promotion of companies and their shares.[331] Nor did Parliament, though as we have noted in 1978 it altered the limited statutory definition from "party to the preparation" to "instrumental in the formulation".

[351] Whether the change made by Parliament from "party to the preparation" to "instrumental in the formulation" was intended to contract or extend the level of a person's involvement in a public offering of securities required in order for that person to come within the definition of promoter is a matter of debate. The panel has not been able to agree on this point. We do not consider it is necessary for us to record our differing views or to resolve the point one way or the other, because it is clear that the point will not be dispositive in the present case, for the reasons that follow. Further, because there is no equivalent definition in the legislation that has replaced the Securities Act (the Financial Markets Conduct Act), the present case will not create a precedent on this point either.

The joint lead managers' role

[352] It is clear on the evidence that the joint lead managers did not initiate the IPO. That was not challenged in cross-examination. Rather, Credit Suisse initiated it. The two joint lead managers were leading firms of investment bankers and stockbrokers. Two of the leading IPO practitioners in New Zealand were engaged. Cross-examination of the witnesses called by the joint lead managers in fact emphasised their professionalism and professional standing. The involvement of an

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[331] Joseph Gross "Who is a Company Promoter?" (1970) 86 LQR 493 at 498. Professor Gross describes the promoter as the "illegitimate child of the law – actively known, and formally ignored": at 495.

"organising participant" NZX member in the IPO was obligatory under NZX's Listing Rules. In this instance there were two organising participants.

[353] The relationship between the joint lead managers, Credit Suisse and Feltex was governed by a formal mandate letter some 12 pages in length. The evidence was that it was a "standard" mandate letter of its kind. The mandate letter provides that the essential role of the joint lead managers was to provide investment banking and broking services, to "assist the Issuers in defining a structure for" the offer in a way that "conforms to applicable legal and regulatory requirements and is acceptable to investors". Throughout it refers to the services to be provided in terms of "advise and assist" (or one or the other). The mandate records "the Issuers will remain solely responsible for the underlying business decision to proceed with the Listing and the Offering". One of the joint lead manager witnesses, Mr Paviour-Smith of Forsyth Barr, stated in evidence that "[a] mandate letter such as this did not extend any discretion or decision-making authority to us; those matters remained with [Credit Suisse] and Feltex and its Board". He was not challenged on that assertion. It is clear the joint lead managers co-ordinated the offering and assisted in preparation of the prospectus. However the evidence was that it was usual for lead managers in an IPO to undertake that role. As investment bankers, the joint lead managers had more experience on the management of a public offer than their clients, the issuers.

[354] Some particular aspects of the joint lead manager roles call for comment. First, the mandate letter provided that the joint lead managers were to "manage the book-build process and provide recommendations to the Issuers on final pricing and the basis of allocation of Securities to investors". The evidence was that that was an ordinary activity for a lead manager and organising participant in an IPO, identifying available pricing from institutional and NZX firms and recommending final pricing to the issuers. It was uncontested that the final price was set by Credit Suisse and Feltex.

[355] Secondly, the joint lead managers were required to assist the issuers with the due diligence process. It is clear that although the joint lead managers attended the due diligence committee "as observers", it was expected that they "contribute" – and they did. But it is also clear that the decision-making in the due diligence committee was ultimately the responsibility of the Boards of Credit Suisse and Feltex.

[356] Thirdly, the mandate letter required the joint lead managers to take a firm allocation of the shares being issued. As Dobson J found, that is a relatively standard action for a large broking firm.[332] As the respondents noted a total of 21 firms (including the two joint lead managers and their two co-managers) took firm share allocations. The joint lead managers also agreed to a "bond shortfall obligation". That was an increased allocation in the event of a shortfall in bond conversions to shares by existing bondholders (these bonds had initially been allotted under the 2003 bond prospectus), to a maximum exposure of $30 million.[333] In fact this allocation ended up being some $12.8 million, split equally between the joint lead managers; less than expected because the great majority of bondholders did convert. The arrangement was given only sparing attention in evidence. In one sense it might be seen as underwriting the bond conversion aspect of the offer. That proposition was put rather tentatively in cross-examination, but was ultimately not accepted. The proposition was re-advanced on behalf of Mr Houghton in argument before us. However Mr Carruthers QC was constrained to accept that it was not, strictly speaking, an underwrite. We agree. Such labels are apt to mislead. The bond shortfall obligation was expressly treated as an additional firm allocation obligation in the mandate letter. It amounted to a simple promise to take unconverted bonds up to a certain level. It was devoid of the usual complex conditions associated with underwriting, as First NZ's managing director, Mr Hamilton, explained in evidence. He also explained that firm allocations to organising brokers was a fairly standard feature of IPOs in New Zealand. That evidence was practically unchallenged.[334]

[357] Fourthly, the joint lead managers were compensated for their responsibilities by a lead management fee (0.75 per cent of the aggregate securities allotted under the offering, excluding allotments to directors and management), a firm allocation fee (0.5 per cent of the securities allotted to brokers and institutions in the book build), a bondholder exchange fee (0.75 per cent of those securities) and brokerage of 1.25 per cent on other allotments. A termination fee of $500,000 was payable if the agreement was terminated by the issuers pre-launch. A fixed fee of $300,000 was also

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[332] *Houghton* (HC), above n 2, at [595].
[333] The 2003 bond prospectus is discussed above at [24].
[334] We express no view as to whether it would make any difference to our analysis if the joint lead managers had also been underwriters or all or part of the offer.

paid for the joint lead managers assuming the bond shortfall obligation. There was no evidence that the level of fees paid was unusual for the obligations assumed by the joint lead managers. Evidence on their behalf that the fee levels were relatively standard for brokers acting in an IPO of this kind went unchallenged by Mr Houghton.

[358] Fifthly, significant attention was given in evidence to a "share lock-up" requirement. That is, that directors and managers of Feltex be required to hold their shares for a period of 12 months. On that the prospectus provided:

> [These] shares may not be transferred without the prior written consent of the Joint Lead Managers, unless transferred to a related party of that Director, Senior Manager or associate who agrees to be similarly bound, or if Feltex is the subject of a successful takeover offer pursuant to the Takeovers Code.

The evidence does not indicate that the joint lead managers required or insisted on this provision, although it does suggest they strongly recommended it. The evidence was also that such a lock-up is relatively standard practice in an IPO to make the offer more attractive to investors.

[359] Sixthly, the joint lead managers received, in the mandate, a wide-ranging indemnity for any losses, claims, damages, fines, penalties or liabilities arising out of omissions by the issuers (or their agents) or arising out of the joint lead managers' own services under the mandate (except where they were themselves in breach). One of the witnesses, Mr Stearne of First NZ, explained that such indemnities are generally provided because joint lead managers are "both reliant on information provided by the issuers and subject to the final decisions made by the issuers". The indemnity formed part of the mandate, said in evidence to be standard for the market. There was no evidence that the indemnity was not also standard market practice. Although some attention was given to the indemnity in argument, if anything it suggests reinforcement of the independence of the joint lead managers in this case, making it less likely that they had assumed a role of promotership. As Dobson J put it, the indemnity added nothing to Mr Houghton's argument.[335]

[335] *Houghton* (HC), above n 2, at [585].

[360] Finally, that apparent independence is consistent with the evidence which demonstrated a number of instances where recommendations made by the joint lead managers were rejected by the issuers, who exercised the relevant decision-making power over the final form of the offering. Recommendations made by the joint lead managers, but rejected by Credit Suisse and Feltex, included a recommendation that sale receipts be payable by instalment, a two-stage sale, FY05 numbers being expressed as a forecast rather than projection, and a lower indicative price range being stated. In none of those matters were the joint lead managers' recommendations accepted.[336]

Were the joint lead managers "instrumental"?

[361] In that factual context, we are in agreement, despite the difference of view noted above,[337] that, if para (c) were put aside altogether, the joint lead managers might legitimately be said to be persons instrumental in the formulation of the plan pursuant to which the shares were offered to the public. Their role involved more than just taking an active part in the formulation of that plan. They had the capacity to influence significantly the form the prospectus took. And they exercised that opportunity, albeit they had no determinative power and were overruled on some recommendations. They were neither bystanders nor bit part players.

Does the "professional capacity" exception apply?

[362] The question then is whether the "professional capacity" exception in para (c) applies. We agree with the succinct characterisation of the exception given by Darvell and Clarke in their text, *Securities Law in New Zealand*, published shortly after the Securities Act was enacted:[338]

> It is submitted that an underwriting or stockbroking firm managing a flotation or issue on a normal retainer basis will be within para (c). But if the firm is itself responsible for initiating the float, or it receives remuneration more akin to a profit on a venture than normal professional charges, the exception will probably not apply.

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336 See above at n 134.
337 See above at [351].
338 RP Darvell and RS Clarke *Securities Law in New Zealand* (Butterworths, Wellington, 1983) at [2.55].

[363] The joint lead managers did not initiate the IPO. While they had the capacity to influence the form of the offering, they lacked the power to determine it. The regulatory requirements associated with the offer required the involvement of a broker who was a primary market participant member of the NZX.[339] The mandate letter was relatively standard for the industry given that regulatory requirement.

[364] The role of the joint lead managers ultimately was ministerial and advisory in character. We do not consider the evidence sustains Mr Houghton's argument that the activities of the joint lead managers, as described above, went beyond the normal professional responsibilities of an organising participant broker acting in a professional capacity.

[365] We accept that an unusually high level of reward-based remuneration might also take a broker outside the exclusion in para (c). But that was not the case here. The remuneration the joint lead managers received was in part dependent on the success of the offering. But it also involved exposure to significant loss in the event that the offering was unsuccessful, with shares allocated to them being sold at lower than expected prices – together with the risk in respect of the bond shortfall commitment. We agree with the conclusion that Dobson J reached on this point:[340]

> 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.

[366] The remuneration received by the joint lead managers was not beyond such reasonable scope as might be attributable to a person (here an organising participant broker) acting solely in a professional capacity. Nor, for the reasons given above at [359], was the indemnity to the joint lead managers inconsistent with their acting solely in a professional capacity, and their remuneration was not of such a level as additionally to constitute them "promoters" for the purpose of the Securities Act.

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339 That was required by r 5.1 of the then NZX Listing Rules to ensure regulatory compliance.

340 *Houghton* (HC), above n 2, at [595].

Conclusion

[367] We conclude, therefore, that the joint lead managers were not "promoters" for the purposes of the Securities Act.

Summary

[368] There are three stages to the inquiry under s 56 of the Securities Act:[341]

(a) Was there an untrue statement? At this stage there is no inquiry as to materiality.[342]

(b) If so, did the investor invest on the faith of the prospectus? The term "on the faith of" means there is an inference that investors invested in reliance on the truth of the publicly registered document which informs the market.[343] It does not require investors to have seen or read the prospectus.[344]

(c) Assuming (a) and (b) are satisfied, was there any loss by reason of the untrue statement?[345]

[369] This judgment resolves the issue at [368](a). On that issue, we have reached the same conclusion as the Court of Appeal: that the FY04 revenue forecast was, at the time of allotment of the shares offered in the prospectus, an untrue statement.[346] We therefore that find the FY04 forecast was an untrue statement for the purposes of s 56(1).

[370] We uphold the findings of the Court of Appeal in relation to the unavailability of a due diligence defence.[347]

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341 We have taken a different view on the requirements of s 56 to that taken in the High Court (see above at [95]–[96]) and the Court of Appeal (see above at [97]–[100]).
342 See above at [81]–[86]. With regard to forecasts and projections see the discussion above at [193]–[194] and [261].
343 See above at [126]. The inference would be displaced if an investor knew the truth and invested anyway. Whether it could be displaced in other circumstances is left open. See above at [127].
344 See above at [127].
345 See above at [130]–[136].
346 *Houghton* (CA), above n 2, at [116].
347 See above at [291] and [307]–[310].

[371] We have set out our views on the approach to be taken to the issues at [368](b) and (c) above, but, except in relation to Mr Houghton himself, the application to the position of individual investors of the approaches we have set out to those issues will occur at the stage 2 hearing.[348] Whether the investors other than Mr Houghton invested on the faith of the prospectus and whether they have sustained loss by reason of the untrue statement (the FY04 forecast) and, if so, the quantum of loss, will thus be for resolution at the stage 2 hearing.[349] Mr Houghton's appeal with regard to s 56 succeeds to this extent.

[372] Because the above matters fall to be determined at the stage 2 hearing, it is necessary to set aside the Court of Appeal's findings that the untrue statement did not give rise to liability under s 56 of the Securities Act.

[373] Mr Houghton has not succeeded in his arguments relating to cl 9 of sch 1 to the Securities Regulations,[350] "but for" loss,[351] the MIP,[352] extended credit,[353] tufters[354] and the FY05 projection.[355] Nor have we accepted Mr Houghton's request to order an inquiry into damages.[356]

[374] Mr Houghton did not succeed in disturbing the finding of the High Court that the joint lead managers were not promoters.[357]

[375] We uphold the finding of the majority of the Court of Appeal on the applicability of the Fair Trading Act and that s 63A of the Securities Act does not have retrospective effect.[358] We also hold that, contrary to the finding of the Court of

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348 See above at [128] and [279]. As noted at [279], Mr Houghton's position relating to loss could be subject to a further application to the High Court.
349 The issue of relief under s 63(1) of the Securities Act will also be for the stage 2 hearing: see at [292].
350 See above at [88]–[92].
351 See above at [114]–[118].
352 See above at [235]–[237].
353 See above at [242]–[244].
354 See above at [251].
355 See above at [262]–[266].
356 See above at [279].
357 See above at [352]–[367].
358 See above at [311]–[317].

Appeal, there was a breach of s 9 of the Fair Trading Act by reason of the untrue statement (the FY04 forecast).[359]

[376] We have found in favour of the joint lead managers in relation to the claim against them under the Fair Trading Act.[360] Whether any of the respondents, other than the joint lead managers, are liable to provide any remedy under the Fair Trading Act will need to be determined at the stage 2 hearing.[361]

[377] We allow the appeal to the extent described above. Whether that ultimately means the investors succeed in their claim and, if so, to what extent, will not be known until resolution of the issues to be determined at the stage 2 hearing.

Result

[378] The appeal in relation to the fourth and fifth respondents is dismissed.

[379] The appeal in relation to the first, second and third respondents is allowed to the limited extent described below.

[380] The Court of Appeal's finding that the forecast of revenue for the financial year ended 30 June 2004 (the untrue statement) was, at the time of allotment of the shares offered for subscription in the Feltex prospectus, an untrue statement for the purposes of s 56 of the Securities Act 1978, is upheld.

[381] The Court of Appeal's findings that the untrue statement did not give rise to liability under s 56 of the Securities Act 1978 and was not in breach of s 9 of the Fair Trading Act 1986 are set aside.

[382] We find that the untrue statement was in breach of s 9 of the Fair Trading Act 1986.

[383] The questions of whether plaintiffs represented by the appellant:

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359 See above at [318].
360 See above at [319]–[320].
361 See above at [325].

(i) invested on the faith of the prospectus in terms of s 56 of the Securities Act 1978 and, if so;

(ii) suffered any loss by reason of the untrue statement in terms of s 56 of the Securities Act 1978 and, if so, the quantum of such loss; and

(iii) are entitled to any remedy under the Fair Trading Act 1986[362]

are left for resolution at the stage 2 hearing.

[384] In all other respects, the appeal in relation to the first to third respondents is dismissed.

Costs

[385] As is apparent from the above summary, each party has had a measure of success in the appeal, with the joint lead managers being successful in resisting the claims against them in their entirety. The question of costs in this Court and in the Courts below will need to be considered in light of that.

[386] We would normally resolve issues of costs in our substantive judgment and, if necessary, direct that costs be reconsidered by the Courts below in light of the result in this Court. In the present case, we do not know what costs awards have been made in the Courts below and the mixed outcome in this Court makes the issue of costs in this Court potentially complex as well.

[387] We therefore seek submissions from the parties on costs in this Court and in the Courts below. These submissions should address whether costs should be decided now or deferred until after the stage 2 hearing, whether the awards of costs in the Court of Appeal and High Court should be quashed, and if so, whether those Courts should be asked to consider costs issues afresh in light of this judgment and issues of quantum of costs (if any) to be awarded in this Court. Those submissions should be filed and served in accordance with the following timetable:

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362 This aspect of the stage 2 hearing will also apply to Mr Houghton, as noted above at [325].

(i) Appellant: 20 working days after the date of this judgment.

(ii) First to third respondents: 10 working days after the appellant's submissions are filed.

(iii) Fourth and fifth respondents: 10 working days after the first to third respondents' submissions are filed.

(iv) Appellant in reply: 10 working days after the fourth and fifth respondents' submissions are filed.

[388] We have a tentative view that the costs issues can be resolved on the basis of the written submissions and without the need for a further oral hearing. If the parties disagree, they should indicate this in their submissions with reasons why they consider a hearing is required.

Solicitors:
Wilson McKay, Auckland for Appellant
Bell Gully, Auckland for First Respondents (except Mr Horrocks)
Clendons, Auckland for Mr Horrocks
Russell McVeagh, Wellington for Second and Third Respondents
Fee Langstone, Auckland for Fourth Respondent
McElroys, Auckland for Fifth Respondent