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**CIVIL LIABILITY FOR PROSPECTUS
MISSTATEMENTS: SHOULD THE FAIR TRADING
ACT APPLY?**

**LLB(HONS) RESEARCH PAPER
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The paper ultimately decides that the Fair Trading Act should be excluded from the securities market. This is because of the inherent differences between investor and consumer protection. The former accepts risk of imperfect information and imposes liability where the preparation of information was without due care, while the latter imposes liability where loss is suffered regardless of the care taken. In that way it is inappropriate and unjust to impose liability where all due care has been taken.

Assuming the Fair Trading Act is excluded, it is clear that the Securities Act approach to disclosure will not be rendered deficient. This is because the respective approaches to misleading or untrue statements are very similar, if not the same. Therefore from both a liability and disclosure perspective the application of the Fair Trading Act should be excluded for the securities market.

WORD COUNT

The text of this paper (excluding contents page, appendices, footnotes and bibliography) comprises approximately 14,600 words.

ABSTRACT

This paper looks at civil liability for prospectus misstatement under the Fair Trading Act 1986 and the Securities Act 1978. The elements of each action are thoroughly discussed and compared. It will be shown that with the absence of defences under the Fair Trading Act, this cause of action is the predominant weapon of choice of plaintiffs. This paper seeks to address the question of whether this is justified.

The paper ultimately decides that the Fair Trading Act should be excluded from the securities market. This is because of the inherent differences between investor and consumer protection. The former accepts risk of imperfect information and imposes liability where the preparation of information was without due care, while the latter imposes liability where loss is suffered regardless of the care taken. In that way it is inappropriate and unjust to impose liability where all due care has been taken.

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Although the [Fair Trading] Act has found widespread employment in commercial litigation, enough ought now to have been seen of its operation that some cautionary notes can appropriately be sounded. There is no question, that, in common with its progenitors in both Australia and North America, this statute was originally conceived as consumer relief measure. But the courts have allowed the statute to float like oil across water. The water in this case is turning out to be practically the whole spectrum of commercial law. There are two effects to be concerned about here: such an approach raises the possibility of large chunks of established commercial law being swallowed up and, whilst remedial flexibility is a good thing, ... remedial incoherence would be quite another matter.¹

I INTRODUCTION

While the poignant words of Hammond J sound a warning as to the effect of the “cancerous”² Fair Trading Act,³ many have heralded the Act as a simple and flexible tool of the Court to fashion justice,⁴ having an important economic and social role in New Zealand’s legislative landscape. The attraction of allowing a plaintiff “to draw only one arrow from his quiver”⁵ and replacing the needless “compartmentalised Chinese cabinet”⁶ of legal complexity in favour of a simpler, more accessible remedy is, in the view of Asher, for the better.

Others disagree.⁷ They argue that to allow the “less refined provisions”⁸ of the FTA to “jettison hard-earned intellectual capacity carefully evolved by judges over several

¹ *Crump v Wala* [1994] 2 NZLR 331, 343 [*Crump v Wala*].

² *Crump v Wala* above n1, 343.

³ Hereafter referred to as the FTA.

⁴ See supporting comments made by Temm J in *Duncan v Perry* (13 August 1993) unreported, High Court, Auckland, CP 2042/91 [*Duncan v Perry*] and the approach of the Court of Appeal in *Goldsbro v Walker* [1993] 1 NZLR 394 [*Goldsbro v Walker*] where the Court, in order to do justice between the parties, held the amount of damages under section 43(2)(d) was entirely discretionary. This view is also taken by Raynor Asher “The Vile Intrusion/Magnificent Intervention of the Fair Trading Act into Contracts” [1996] 3 NZLJ 85 [Asher].

⁵ *Duncan v Perry* above n4, 2042.

⁶ Asher above n4, 85.

⁷ See *Crump v Wala* above n1 and *Watson v Gilbert* (1992) 5 TCLR 95, 112 per Blanchard J.

⁸ *Crump v Wala* above n1, 335.

centuries"⁹ would circumvent established commercial law.¹⁰ To do so, would disregard the warning of Lord Simmonds LC that "it is even possible that we are not wiser than our ancestors",¹¹ effectively facilitating law reform by a side wind.¹² Not surprisingly, there has been considerable judicial reluctance recognising this result.

Following the controversial Australian decision of *Fraser v NRMA Holdings Ltd*¹³ Asher's benign tumour¹⁴ had crept into another part of the legal body. The equity market was infected, and soon thereafter, the futures market.¹⁵ While these decisions can certainly not be regarded as the first,¹⁶ the Government led law reform that followed was.¹⁷

⁹ *Crump v Wala* above n1, 343.

¹⁰ This would include the common law doctrines of misrepresentation (in particular the doctrines of inducement and materiality), acceptance, affirmation, privity of contract and the warranty/condition distinction contained in the Sales of Goods Act 1908. It would also provide an alternative remedy for misrepresentation under Contractual Remedies Act 1979, misleading statements under the Securities Act 1978: *Fraser v NRMA Holdings Ltd* (1994) 124 ALR 548; 12 ACLC 855, affirmed by the Australian Full Federal Court (1995) 127 ALR 543; 13 ACLC 132 [NRMA], and for the torts of deceit, fraudulent misrepresentation and passing off. The FTA has also become synonymous with trade mark and copyright actions: *Levi Strauss & Co v Kimbr Investments Ltd* [1994] 1 NZLR 332; *Tot Toys Ltd v Mitchell* [1993] 1 NZLR 325; *Wineworths Group Ltd v Comite Interprofessionel du Vin de Champagne* [1992] 2 NZLR 327; *Hogan and Another v Koala Dundee Pty Ltd* (1988) 83 ALR 187. It could also be raised in the context of auditor and lawyer liability: see Helen Anderson "Auditors Liability: Is Misleading Conduct an Alternative to Negligence?" (1999) 17 Comp & Sec LJ 350.

¹¹ *Chapman v Chapman* [1954] AC 429, 444, quoted by Hammond J in *Crump v Wala* above n1, 343.

¹² For further comment see M Gillooly "Limiting Section 52 of the Trade Practices Act: The Side-Wind Argument" (1994) 24 West Aust L Rev 278 and Coote "Remedy and Relief under the Contractual Remedies Act 1979 (NZ)" (1993) 6 JCL 141.

¹³ *NRMA* above n10. For further comment see Robert Langton "Material and Immaterial Omissions from a Prospectus: Reflections of a Puzzled Observer on the Decision(s) in *Fraser v NRMA Holdings Ltd*" [1995] 6 Aust J of Corp Law 44; Jon Webster "The NRMA Case - Implications for Directors" (1995) Comp & Sec LJ 281; Robert Baxt "The NRMA Case on Appeal - Some Interesting Observations" (1995) 3 Aust Business LR 216; W J Koeck "The Implications of the *NRMA* Case - 'between the Scylla of the whole truth and the Charybdis of confusion'" [1995] 3 BCLB, para 55.

¹⁴ Asher above n4, 88.

¹⁵ *Australian Securities and Investment Commission v Nomura International Plc* (1997) unreported, Federal Court of Australia, No 3045/1997. For further comment see Tony Ciro "Misleading and Deceptive Conduct in Capital Markets" [1999] 5 NZBLQ 80.

¹⁶ There have been a number of successful foreign currency loan cases in Australia. As quoted by Ciro above n15, these include; *Westpac Banking Corp v Eltron Pty Ltd* (1987) 14 FCR 541; 74 ALR 45, *Kullock v Australia and New Zealand Banking Group Ltd* (1988) ATPR 40-861, *Chiarabaglio v Westpac Banking Corp* (1989) ATPR 40-971 and *Mehta v Commonwealth Bank of Australia* (1990) ATPR 41-026. These cases illustrate the application of section 52 by applicants who claimed that the banks had failed to properly advise them of the fluctuating nature of foreign currency denominated loans and that the dangers of borrowing in these currencies without adequate hedging. In *Milner v Delita Pty Ltd* (1985) 61 ALR 557, section 52 was used specifically in relation to a prospectus that contained wrongful statements regarding

The report of the Corporations Law Simplification Task Force recommended that conduct in relation to fundraising, takeovers and other dealings in securities be governed by the existing securities legislation, the Corporations Law, and not by the Australian equivalent of the FTA, the Trade Practices Act 1974 (TPA).¹⁸ After extensive public debate, including strong opposition by the Australian Competition and Consumer Commission (ACCC), these changes have subsequently been enacted.¹⁹

This paper examines whether a similar result should prevail in New Zealand. Thus in light of these Australian developments, and bearing the sentiment of Hammond J in mind, should the FTA be excluded from application to the securities market? And secondly, if the application of the FTA were to be excluded, would the existing securities law be rendered deficient?

In order to resolve these issues Part II of this paper provides a comprehensive overview of the background, legislative purpose and the relevant liability provisions of the FTA. This Part is intended to allow the reader an insight into the role of the FTA and the specific problems that have arisen since its enactment. Part III investigates the issue of disclosure at common law, and introduces the common law concept of materiality. Part IV gives an overview of the Securities Act 1978 and assesses the adequacy of the existing provisions. In doing so, this Part will show what effect, if any, the FTA provisions have on these sections. Part V will consider the Australian perspective, including an overview of the

the guava market. For a New Zealand example, in *Jagwar Holdings Ltd v Julian* (1992) 6 NZCLC 68,040 [*Jagwar Holdings*], the directors were held liable under section 9 for making misleading representations to buyers of the company shares.

¹⁷ Corporations Law Simplification Report *Section 52 Trade Practices Act and Dealings in Securities* (AGPS, Canberra, 1996) [Task Force Report].

¹⁸ More accurately, the provisions in Part V of the Trade Practices Act 1974, or the equivalent FTA's in each State and Territory.

¹⁹ Section 995A of the Corporate Law Economic Reform Program Act 1999 states that "the provisions of the State Fair Trading Acts do not apply to dealings in securities". Section 51AF of the TPA also excludes conduct in relation to financial services from the application of section 52. Financial services are defined by the Australian Securities and Investment Commission Act 1989 section 12BA and has the effect that a service supplied in relation to a security, including the service of advertising the security, amounts to a financial service.

relevant Australian law and the arguments supporting, and opposing, the exclusion of the TPA. It will also determine whether these arguments are equally valid in the New Zealand context.

The paper will ultimately conclude that the securities market should be regulated by the tailor-made securities legislation and the application of the FTA should be excluded. This is primarily due to the inherent differences in the securities market such as risk and imperfect information, and in that regard the imposition of a strict liability offence would be inappropriate and unjust.

II THE FAIR TRADING ACT

A Background

Conceived by the Fourth Labour Government to implement its 1984 election policy for "consumer law reform",²⁰ the FTA repealed the "hotchpotch"²¹ of provisions that previously existed in the consumer protection arena.²² These former Acts were perceived to be deficient because they did not set clear standards for trade descriptions and trading conduct, nor did they allow for direct remedy to the affected parties, and did not include a general product safety regime. Moreover many of the common law remedies were also seen to be especially difficult to satisfy because of the requirement of intention or fraud.²³ Access to remedies provided under contract were also regarded as extraordinarily complicated and in that way did not cater particularly well to the consumer context. With the enactment of the FTA many of these concerns were alleviated. Like other consumer protection legislation, the FTA focussed on the effects of the contravening conduct and in doing so conferred a civil remedy regardless of whether the person who supplied the

²⁰ Commerce Commission *The Fair Trading Act 1986: Explanatory Booklet* (Wellington, 1987) [Explanatory Booklet].

²¹ Lindsay Trotman *Misrepresentation and the Fair Trading Act* (Dunmore Press Ltd, Palmerston North, New Zealand, 1988) 1.

²² Among the other Acts repealed were the Employment Agents Act 1908, the Labour Department Act 1952, the Employment Agents Amendment Acts of 1960, 1967 and 1975, the Wool Labelling Act 1949 and the Safety of Children's Night Clothes Act 1977.

information caused the mistake, or had exercised due diligence to avoid the mistake which had occurred.

Therefore the Act was initiated to protect the consumer²⁴ containing implicit recognition that the assumption of equality of bargaining power was no longer valid, and that the consumer was not in the best position to look after their own interests.²⁵ As a companion to the Commerce Act 1986, the FTA was designed to enable consumers to take advantage of increased competition by ensuring they received accurate information in order to make rational choices in the marketplace. Thus the FTA provisions provide direct benefit to consumers in the protection it affords, but also give general economic benefit to New Zealand as a whole by allowing informed consumers to be the arbitrators of competitive rivalry.²⁶

Equally important functions, as mentioned by the long title, include the prohibition of certain conduct and practices in trade and the promotion of product safety. In this regard, it is not uncommon for rival traders to use the provisions of the FTA to terminate unfair practices employed by unethical traders. Following logically, it can be easily accepted that the Act can be validly applied to a wide range of strictly commercial and trading activities with little or no relevance to consumer protection. Such an approach has been reflected judicially, where the courts allowed the general provision to apply to a wide range of non-consumer transactions.

²³ For example, the torts of deceit and fraudulent misrepresentation.

²⁴ Dr Bill Sutton MP stated in support of the then Fair Trading Bill that "the purpose of the Bill is to protect the consumer": (11 December 1986) 476 NZPD 6090. This view was endorsed in *Trustbank Auckland Ltd v ASB Bank Ltd* (1989) 2 NZBLC 103,558, 103563; [1989] 3 NZBLR 385, 390, where the Court of Appeal stated that "consumer protection [was] a main object of the Act".

²⁵ Lynden Griggs "The Duty of Disclosure by Vendors in a Conveyance: If Caveat Vendor, Are We Allowing the Camel's Nose of Unrestrained Irrationality Admission to the Tent?" [1998] 7 APLJ 155, 166. Griggs suggests this was due to the rise of the limited liability corporation and the separate entity doctrine (in cases such as *Salomon v Salomon & Co Ltd* [1897] AC 22), and the consequent growth and development of the large institution (both private and government).

²⁶ *Explanatory Booklet* above n20.

This has raised some concern. By employing general concepts the FTA has the ability to replace existing common law doctrines, not to mention circumvent established legal regimes. Whether this is desirable has divided both academic and judicial comment and it remains unclear how far the Act's potentially wide-reaching effects will extend.

It is also important to add that the FTA was also introduced as a means of facilitating free trade between New Zealand and Australia under the Closer Economic Relations Agreement (CER).²⁷ To this end, incompatible consumer protection measures were regarded as an impediment to free trade. Therefore the Act is modeled closely on Part V of the Trade Practices Act 1974 and many of its provisions have been taken from, or are identical to, Australian legislation. Because of this, the New Zealand Court of Appeal commented in *Taylor Bros Ltd v Taylors Textile Services Auckland Ltd*²⁸ that as far as reasonably practicable, consistency in the application of the Australian and New Zealand Acts should be aimed at.

B Application of the FTA to the Securities Market

1 Introduction

The FTA only applies to conduct or statements that are "in trade". The word "trade" is defined in section 2(1) as meaning:²⁹

[A]ny trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods and services or to the disposition or acquisition of any interest in land.

²⁷ Y van Roy *Competition Laws* (CCH New Zealand Ltd, Auckland, 1991) 351, 351. For as the Hon. Margaret Shields, the then Minister of Consumer Affairs, noted: "the Bill brings the law substantially into line with provisions enforced in Australia since 1974, which have proved so successful ... [it] also represents a step towards compliance with article 12 of the Closer Economic Relations agreement, by harmonising the commercial laws of the two countries": (11 December 1986) 476 NZPD 6088.

²⁸ *Taylor Bros Ltd v Taylors Textile Services Auckland Ltd* [1988] 2 NZLR 1; (1988) 2 TCLR 447; [1988] 2 NZBLC 103,032 (CA) [*Taylor Bros*].

²⁹ In the Supreme Court of South Australia decision of *Esanda Finance Corporation v Peat Marwick Hungerfords* (29 September 1994) Unreported, Supreme Court of South Australia, BC9400806, Bolland J noted that the words "trade and commerce" are to be given the widest import.

Accordingly, the question of whether the FTA applies to the issue of securities turns on whether they fall within the definition of being a "good" or a "service". Securities are defined under the Securities Act 1978 in section 2D as "any interest or right to participate in any capital, assets, earnings, royalties, or other property of any other person and includes;

- (a) An equity security;
- (b) A debt security;
- (c) A unit in a unit trust;
- (d) An interest in a superannuation scheme;
- (e) A life insurance policy;
- (f) Any interest or right that is declared by regulations to be a security for the purposes of this Act; and
- (g) Any renewal or variation of the terms or conditions of any such interest or right."

Equity securities are primarily shares in a company and comprise of legal rights and obligations in relation to that company. They have been historically regarded as a chose in action. A chose in action is a legal expression used to describe all personal rights of property which can only be enforced by action, that is, by the taking of proceedings through the Courts, and not by taking physical possession. This is because these property interests are incapable of physical possession.³⁰

2 Are Shares Goods?

The FTA defines "goods" inclusively, which includes ships, aircraft and vehicles, animals and fish, minerals, trees, crops, gas and electricity.³¹ This same definition is contained within the Commerce Act 1986 and it is unclear whether this it would extend to include

³⁰ *Laws of New Zealand* (Butterworths, Wellington, 1992) Choses in Action, para 1, 1.

³¹ The FTA, section 2(1).

shares. Commonly cited as conclusive is the decision of *CBP Industries Ltd v Bowker Holdings No.16 Ltd*.³² In this decision Hardie Boys J states:³³

For the present purposes I assume, but do not decide, that shares are goods for the purposes of that definition and that therefore section 9 can apply to a takeover bid notwithstanding that a comprehensive code in relation to takeovers is set out in the Companies Amendment Act.

Because the decision itself was a interlocutory injunction application, there is scant analysis on this point. Nevertheless subsequent decisions, *Miln v Stratford Fisheries Ltd*³⁴ and *Jagwar Holdings Ltd v Julian*,³⁵ both cite *CBP Industries* as authority for the proposition that shares are goods. Furthermore it has been suggested that because the rights attaching to shares are encapsulated within a document, capable of being transferred, assigned or distributed, this would be within the Act's definition of "goods".³⁶ For the reasons outlined below, it is respectfully submitted that this conclusion is incorrect.

In *Electricity Supply Association of New Zealand Inc v Commerce Commission*³⁷ Neazor J cited the *Oxford English Dictionary* and *Black's Law Dictionary* and held that the "thread of tangibility"³⁸ ran through the ordinary meaning of 'goods'. Therefore because shares are typically intangible rights in companies, on this interpretation shares would not be included as goods for the purpose of the FTA. For this reason, shares were expressly

³² *CBP Industries Ltd v Bowker Holdings No.16 Ltd* (1987) 3 NZCLC 100,035 [*CBP Industries*].

³³ *CBP Industries* above n32, 100,038.

³⁴ *Miln v Stratford Fisheries Ltd* (1988) 4 NZCLC 64,428.

³⁵ *Jagwar Holdings* above n16.

³⁶ Seng Kok Chew "Implications of the Fair Trading Act 1986 for Commercial Conduct in New Zealand" unpublished LLB(Hons) paper, Victoria University of Wellington (1987), 111 [Chew].

³⁷ *Electricity Supply Association of New Zealand Inc v Commerce Commission* (1998) 6 NZBLC 102,555 [*Electricity Supply Association*].

³⁸ *Electricity Supply Association* above n37, 102,561.

excluded from the Sale of Goods Act 1908.³⁹ This conclusion has also received judicial support.⁴⁰

Furthermore the specific inclusion of electricity under the FTA, the Commerce Act and the Crimes Act 1961⁴¹ has been viewed as an intentional exception to the tangible definition. Following logically, because shares have not been expressly included in the definition, the clear legislative intent was to exclude all other intangibles, including shares. Therefore it is suggested that the meaning of the word 'goods' cannot stretch to include shares.

3 Are Shares Services?

Conversely, it has been argued that shares may more appropriately fall within the definition of "services". The FTA defines "services" widely as including "... any rights (including rights in relation to, and interests in, real or personal property), benefits, privileges, or facilities that are or are to be provided, granted, or conferred ...".⁴² Because shares are, in essence, a bundle of legal rights and obligations in relation to a company, it would appear that the rights attached to shares in a company is a right to, or an interest in, personal property.

Moreover under the definition of "services" insurance policies and long term investments with a bank are expressly included. Accordingly it would be conceivable that a unit in a unit trust, superannuation schemes and participatory securities could also fall within this definition. This is because each comprises of "rights in relation to, and interests in, real or personal property". This is supported by the width of the words "rights, benefits or privileges ... that are to be provided, granted, or conferred". On this basis, the writer

³⁹ Under the Sales of Goods Act 1908 section 2(1) states that goods "includes all chattels personal other than money or things in action".

⁴⁰ In *Pont Data Australia Pty Ltd v ASX Operations Pty Ltd & Anor* (1990) ATPR 41-007 the Federal Court of Australia held that the ordinary meaning of goods was confined to tangible items. This answered the question left open in *Toby Construction Products Pty Ltd v Computer Bar Sales Pty Ltd* (1984) 50 ALR 684 whether an intangible would constitute a good.

⁴¹ Crimes Act 1961, section 218. This section deems electricity capable of being stolen.

would assert that this view is preferable. Such an approach has been supported judicially, albeit reservedly, by the decision of *Fox v Douglas*.⁴³

4 Conclusion

In many decisions the courts have easily accepted that the FTA applies to dealings in securities. In doing so reliance is often placed on the assumption made in *CBP Industries* and do not therefore consider whether shares are “goods” or “services”. This can be illustrated by the decision of *Megavitamin Laboratories (NZ) Ltd v Commerce Commission*.⁴⁴ In this decision the court held that where a person takes an active part in the activities of the company, such as the sale of shares, the person may be acting “in trade” and therefore liable for their conduct. The court did not consider whether the share would be a “good” or a “service”. Needless to say, there are of course, countless other cases.⁴⁵

C Liability Under Section 9 - Misleading or Deceptive Conduct

1 Overview

Section 9 of the FTA is a statutory prohibition imposing civil liability at the courts discretion.⁴⁶ For the purposes of this paper section 52⁴⁷ of the TPA is materially identical to section 9 of the FTA, which provides:

⁴² The FTA, section 2(1).

⁴³ *Fox v Douglas* (1988) 4 NZCLC 64,287 [*Fox v Douglas*]. In this decision Eichelbaum J held that the plaintiff had raised an arguable case that shares were services under the FTA. Unfortunately, the Court did not proceed to decide the issue.

⁴⁴ *Megavitamin Laboratories (NZ) Ltd v Commerce Commission* (1995) 6 TCLR 231; (1995) 5 NZBLC 103,834.

⁴⁵ See, for example, *Jagwar Holdings* above n16; *NRMA* above n10, *Fox v Douglas* above n43; and other cases mentioned above, n16.

⁴⁶ The FTA, sections 41 and 43.

⁴⁷ Section 52 of the Trade Practices Act 1974 provides: A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

In many early decisions the courts felt compelled to add the extra requirement of a misrepresentation to the plain and ordinary words of the statute. The purpose of doing so was to limit the general provisions of the FTA and in this way preserve established common law doctrines. Eventually disproved, the approach of Deane and Fitzgerald JJ is typified in *Taco Co of Australia v Taco Bell Pty Ltd* where their Honours note:⁴⁸

Irrespective of whether the conduct produces or is likely to produce confusion or misconception, it cannot, for the purposes of section 52, be categorised as misleading or deceptive unless it contains or conveys, in all the circumstances of the case, a misrepresentation.

This was subsequently followed by the New Zealand Court of Appeal in *Unilever NZ Ltd v Cerebos Greggs Ltd*⁴⁹ and the High Court in *Bonz Group Pty v Cooke*.⁵⁰ However, the predominant view, and clearly the correct view, is that in all cases the essential issue will be whether or not the words of the statute apply to the particular facts established. This is because the provision employs general concepts and does not import common law interpretations and restrictions. In *Paper Plus NZ Ltd v Robert Mitchell Ltd*⁵¹ Thomas J succinctly said of section 9:

The section uses plain language and its meaning and intent are clear enough without refining or adding to its terms. It does not need a glossary.

Similarly in *Taylor Bros*⁵² McGechan J added:

⁴⁸ *Taco Co of Australia v Taco Bell Pty Ltd* (1982) 42 ALR 177, 202; ATPR 40-277, 43,751 [*Taco Co*].

⁴⁹ *Unilever NZ Ltd v Cerebos Greggs Ltd* (1994) 6 TCLR 187, 192 [*Unilever*].

⁵⁰ *Bonz Group Pty v Cooke* [1994] 3 NZLR 216; (1994) 6 TCLR 23.

⁵¹ *Paper Plus NZ Ltd v Robert Mitchell Ltd* (10 March 1993) unreported, High Court, Auckland Registry, CL 53/92.

⁵² *Taylor Bros Ltd v Taylors Textile Services Auckland Ltd* (1987) 2 TCLR 415, 440 (HC) affirmed above n28; *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191; (1982) 42 ALR 1; (1982) ATPR 40-307 [*Parkdale*].

[T]he provisions concerned are to be construed in their natural and ordinary meaning. In particular, they are not to be read down either by reference to other provisions of the legislation or by reference to the general law.

Analogous views have been taken in many other decisions.⁵³ Finally, it is also important to note that the section is not constrained by the more specific provisions of sections 10, 11, and 12 in respect of misleading conduct relating to the nature of goods, services and employment.

2 The Purpose of Section 9

The function of section 9 is to establish a minimum standard for conduct in trade or commerce. In doing so, the provision, rather than imposing a duty to disclose, maintains an obligation not to mislead or deceive. In effect therefore, section 9 is an attempt to prescribe, by statute, a minimum level of probity and fairness to which it is in the public interest that trading and commercial behaviour conform.

The FTA also serves as a valuable residual provision to catch newly conceived misleading and deceptive practices beyond the specific prohibitions, and in this way allows the courts to focus on the substance of the conduct rather than its form.

⁵³ See, for example, *Prudential Building & Investment Soc of Canterbury v Prudential Assurance Co of NZ Ltd* [1988] 2 NZLR 653, 658; (1988) 2 NZBLC 103,351, 103,356, also reported as *Prudential Assurance Co of NZ Ltd v Prudential Building & Investment Soc of Canterbury* (1988) 3 TCLR 62, 67 where the Court of Appeal rejected the requirement of a misrepresentation by noting that "while the tort of passing off involves proof of a misrepresentation ... the provisions of section 9 of the FTA require no more than conduct, in trade, which is 'misleading or deceptive or is likely to mislead or deceive'". In *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1988) 79 ALR 83, 93; ATPR 40-850, 49,151, Lockhart J was of the view that "it is erroneous to approach [section 9] on the assumption that its application is confined exclusively to circumstances which constitute some form of representation ... ultimately in each case it is necessary to examine the conduct, whether representational in character or not, and ask the question whether the impugned conduct of its nature constitutes misleading or deceptive conduct". See other similar comments in *Brown v The Jam Factory Pty Ltd* (1981) ATPR 40-213 and *Trustbank* above n24, 388.

Specifically applied to the securities market, any conduct, including advertising, the issue of and the statements contained within prospectuses or investment statements, and notices of meetings, is within the ambit of section 9. This includes conduct effecting both the primary and secondary market for securities. Furthermore, the obligation not to mislead or deceive is applied irrespective of any disclosure obligations required under the existing securities legislation.

3 What Constitutes 'Misleading Conduct'?

To determine whether section 9 has been breached the most helpful approach is that suggested by Tipping J in the Court of Appeal decision of *AMP Finance NZ Ltd v Heaven*.⁵⁴ On this approach it is necessary to establish three steps:

1. Ask whether the conduct was capable of being misleading;
2. Decide whether the plaintiffs were in fact misled by that conduct,⁵⁵ and
3. Decide whether it was reasonable for the plaintiffs to have been misled by that conduct.

(a) Misleading conduct

Misleading conduct can be an act, including a statement, or an omission to act or speak.⁵⁶ Silence itself is not misleading, but silence when there is a duty to speak, or where the silence would confirm another false meaning, is.⁵⁷ For, as Gault J commented in *Unilever*:⁵⁸

⁵⁴ *AMP Finance NZ Ltd v Heaven* (1997) 8 TCLR 144; (1998) 6 NZBLC 102,414 (CA). This approach has subsequently been followed by the Court of Appeal in *Lane Group Ltd v DI & L Paterson Ltd* (2000) 1 NZLR 129, and by the High Court in *Lawton v Norcross* (2000) 9 TCLR 338 per Paterson J, *Parore v Berryman* (23 September 1999) unreported, Nicholson J, High Court, Auckland Registry, CP 599/96 and *Looker v Till* (6 December 1999) unreported, Williams J, High Court, New Plymouth Registry, CP 17/95.

⁵⁵ This limb, while not explicit, introduces the concept of reliance. In addition, it has been held that a causative nexus must exist between the damage and the conduct: *Phyllis Gale v Elliot* (25 September 1997) unreported, High Court, Auckland Registry, HC 45/97.

⁵⁶ The FTA, section 2(2).

⁵⁷ The Task Force Report above, n17, 33, noted that "a failure to disclose a matter will normally only be misleading or deceptive if there is a relevant requirement for the matter to be disclosed or an expectation

The legal obligation is to avoid falsehood, it is not an obligation to provide compendious explanations. Of course silence in particular circumstances can amount to a misrepresentation as can literal truth but in each case only when as a result there is affirmatively conveyed another meaning that is false.

As Gault J makes clear, the obligation to avoid falsehood includes the obligation to avoid creating a misleading impression. Importantly, the court will look not only at the meaning that the maker of the statement intended it to convey, but also at the meaning that an ordinary person would take from the statement. This is because a statement, or an omission to act, will often convey a secondary meaning or further implications from what the maker of the statement has said or done.⁵⁹ Put simply, the critical question is whether the "overall impression" conveyed by any act, or omission to act, is accurate.

For example, in the High Court decision of *Hieber v Barfoot & Thompson Ltd*⁶⁰ the respondent real estate agent had marketed the property as having "magnificent sea and city views". Known by the real estate agent, but unbeknownst to the purchaser, the view was soon to be obscured by another building. After approving Australian jurisprudence,⁶¹ Kerr J held that in the circumstance there was a "reasonable expectation" that such a material fact would be disclosed, and that the failure to disclose created a misleading and deceptive impression.

that it will be disclosed". For similar comments see also *Des Forges v Wright* [1996] 2 NZLR 758 per Elias J and *Lyndsay v Milloy* (17 September 1999) Randerson J, High Court, Auckland Registry, CL 35/96, 55.

⁵⁸ *Unilever* above n49, 192.

⁵⁹ A Borrowdale (ed) *Butterworths Commercial Law* (4 ed, Butterworths, Wellington, 2000).

⁶⁰ *Hieber v Barfoot & Thompson Ltd* (1996) 7 TCLR 301; (1996) 5 NZBLC 104,179. For a similar example, in *P C Brixton Autos Ltd v Commerce Commission* [1990] NZAR 203, 208 [*P C Brixton Autos*], the appellant was found liable under section 9 for a false odometer reading. His Honour Holland J noted that; "a statement by a motor vehicle dealer that a vehicle he is proposing to sell has x kilometers on the odometer is, in the absence of qualification or explanation and in ordinary circumstances, a representation that the vehicle, since new, has traveled approximately the stated number of kilometers". In other words, the odometer conveyed a false impression to buyers that the car had in fact done less than the actual mileage.

⁶¹ Specifically, *Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Ltd* (1986) 12 FCR 477; 68 ALR 77; ATPR (Digest) 46-010; *Kimberley NZI Finance Ltd v Torero Pty Ltd* (1989) ATPR (Digest) 46-054; *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31; 110 ALR 608; (1993) ATPR 41-203 and *Warner v Elders Rural Finance Ltd* (1993) 41 FCR 399; 113 ALR 517; ATPR 41-238.

Such an analysis can be easily applied to the securities market. Because of the "inherent contradiction at the core of every prospectus",⁶² this being both a selling document and a disclosure document, prospectuses by their very nature can give rise to misleading impressions. And, because "it is a common human characteristic to believe easily what you desire earnestly"⁶³ it is imperative that prospectus statements are accurate, and the overall impression conveyed is true.

While there is no independent duty to disclose under the FTA, but rather an obligation to avoid misleading conduct, when coupled with the mandatory disclosure requirements under the Securities Act, the obligation becomes very extensive. This point was made clear by the Australian Full Federal Court where it was said in relation to the TPA.⁶⁴

Whilst section 52 does not by its terms impose an independent duty of disclosure which would require a corporation or its directors to give any particular information ... unless the information given constitutes a full and fair disclosure of all the facts which are material to enable ... a properly informed decision, the combination of what is said and left unsaid may, depending on the full circumstances, be likely to mislead or deceive.

In other words, what information is compulsorily required, and that which is not, must not be, in all the circumstances, misleading or deceptive. Indeed such a level of disclosure could be regarded as entirely justified in the securities market context; the obligation to provide information with strict and scrupulous accuracy to the investor for the purposes of making informed investment decisions. As will be seen, such a duty would be consistent with the concept of materiality at common law, and would enhance the mandatory disclosure philosophy embodied within the Securities Act.

⁶² Walker "A Model of an Initial Public Offering" (1993) NZULR 396, 414.

⁶³ *R v Baxter* (4 March 1998) unreported, Judge Erber, District Court, Christchurch, T111/97.

⁶⁴ *NRMA* above n10, ATPR 40,143.

On the other hand, it could be argued that any such disclosure is clearly beyond the legislative intent of the Securities Act and in this regard any extension of the disclosure would be entirely unjustified. Indeed, any extension of the disclosure obligation ought to be within the tailor-made confines of the Securities Act and any overlay a consumer related statute provides is clearly inappropriate.

However, in order to appreciate the argument it will be returned to later in the paper after a consideration of the mandated disclosure under the Securities Act.

(b) Reasonable to be misled?

Whether conduct is misleading or deceptive is to be determined objectively by the court in relation to one or more identified sections of the public.⁶⁵ While it is likely that the relevant section of the public will constitute the public at large, it also possible for the conduct, and the effects of such conduct, to be limited to an identified section. For example in *Unilever*, where the complaint was against misleading statements made on coffee products, the relevant section of the public was limited to the purchasers, or potential purchasers, of coffee.

In considering whether it was reasonable to be misled, the court can have regard to the identity, experience, and knowledge of the persons claiming to be misled or deceived.⁶⁶ Therefore the relevant question is; whether a reasonable person, in the shoes of the person who was misled and possessing their knowledge actual and implied, would have been misled.

4 Liability

⁶⁵ The public will include "the astute and the gullible, the intelligent and the not so intelligent, the well educated as well as the poorly educated, men and women of various ages pursuing a variety of vocations": quoted by Wilcox J in *Chase Manhattan Overseas Corp v Chase Corp* (1985) 8 ATPR 47,328, 47,336 from *Taco* above n48, ALR 202; ATPR 43-752.

In order for a successful action under section 9 reliance, causation and loss must be shown. This was helpfully summarised by the Court of Appeal in *Savill v NZI Finance Ltd* where it was said;⁶⁷

Before the court may make an order by way of relief under the Fair Trading Act for a breach of section 9 it is necessary for the appellants to show that their loss was caused by the conduct of the person who contravenes the Act. That is to say there must be proof of causation or nexus between the misleading and or the deceptive conduct and the loss or damage suffered.

In this context, while reliance must be shown, it need not be shown that the representation was the sole influence in the decision to rely on the misleading conduct.⁶⁸ In this way the element of materiality is introduced to the FTA: liability arises if the conduct is a material factor in a plaintiff's decision, and must be shown to be so by the plaintiff, even if only a relatively minor factor.⁶⁹ Similarly like section 56, section 9 does not require specific reliance on the misstatement, but rather on the advertisement or prospectus which contained the statement.⁷⁰

Finally, it is important to add that liability under section 9 does not require intention or knowledge. This was illustrated by *P C Brixton Autos Ltd v Commerce Commission*⁷¹ where the motor vehicle dealer, regardless of knowledge, fault or intention, was found to have contravened section 9 in supplying motor vehicles with falsified odometer readings.

Applied to the securities context, liability would be imposed under the FTA notwithstanding any personal or substantive defences afforded under the Securities Act. Such a result would clearly circumvent the clear legislative intention of the Securities

⁶⁶ *DSJ (PTE) Ltd v TPF Restaurants Ltd* (23 December 1997), Giles J, High Court, Auckland Registry, CP 168/96.

⁶⁷ *Savill v NZI Finance Ltd* [1990] 3 NZLR 135, 143.

⁶⁸ *Goldsbro v Walker*, above n4, 401.

⁶⁹ *Jagwar Holdings* above n16, 68,097.

⁷⁰ Peter Fitzsimons "If the Truth Be Known: The Securities Act 1978 and Directors Liability for Misstatements in a Prospectus (Part II)" (2000) 6 NZBLQ 235, 237.

Act. Assuming such circumvention is undesirable, this result supports the exclusion of the FTA.

5 Who can sue?

Under section 43(1) any person may apply for relief, whether or not they suffered the loss or damage, and any person who suffers loss or damage may be granted a remedy whether or not they are a party to the proceedings.⁷² Clearly this means that in many cases the complainant will not always be the plaintiff, and can be easily illustrated in instances where the Commerce Commission brings an action on behalf of affected consumers.

6 Who can be Sued?

The FTA attaches liability to any person who, by their conduct, contravenes the Act. Furthermore, liability is extended to those who aid, abet, counsel, or procure the contravention and will include any person who is in any way directly or indirectly knowingly concerned in, or party to, the contravention.⁷³

These respective provisions cast a wide net as to the scope of potential plaintiffs or defendants. It is evident that such an approach could be considered appropriate within the consumer protection confines in allowing deserving plaintiffs to achieve justice. However, in the securities context, such an approach raises the uncertain prospect of liability. While this concern has not been explored to its ultimate conclusion, it is explicitly clear that the FTA could apply to a wider range of defendants. Again, whether this is desirable is rather uncertain.

⁷¹ *P C Brixton Autos* above n60.

⁷² *BMW NZ Ltd v Pepi Holdings Ltd* (1996) 7 TCLR 357; 6 NZBLC 102,060 (digest) affirmed by *Pepi Holdings Ltd v BMW NZ Ltd* (25 August 1997) CA 22/97 per Elias J.

⁷³ The FTA, section 43(1)(a)(b) and (d). Section 43(1)(c) extends liability to those who induce by threats, promises or otherwise, and section 43(1)(e) includes those who conspire with any other person to contravene the Act.

7 Defences under the FTA

Under the FTA there are a number of criminal defences under section 44. Unfortunately, no statutory defences exist for a civil prosecution under section 9. While not aptly described as a defence, it is important to note that a reasonably held opinion does not constitute misleading conduct.⁷⁴ In this regard it is arguable that personal statements contained within a prospectus may not be misleading where the opinion in the circumstances was reasonable or that the opinion expressed was actually genuine. However such a 'defence' would not extend to those matters stated as fact. Therefore it is clear that an anomaly would result, a due diligence defence under the Securities Act although no protection from the FTA.

D Limiting the FTA

Led by the rousing dicta of Hammond J, the courts have sought to preserve the established commercial law from the "cancerous" FTA in a number of ways. Firstly, judges have attempted to place textual limitations on the wording of the provision. Unfortunately, because of the simplicity of section 9, it was evident that such an approach would be to no avail.⁷⁵ Instead the courts sought refuge in the secure common law, as was evident in *Taco* and *Cox & Coxon Ltd v Leipst*.⁷⁶ In *Cox & Coxon* the Court of Appeal applied the tortious measure of damages to section 43(2)(d) and did not follow the discretionary approach to remedies as pioneered by the same court in *Goldsbro v Walker*.⁷⁷

In *Goldsbro* the Court of Appeal decided that the power to award payment of the full loss or damage encompassed the power to award part of the amount, and thus illustrated the

⁷⁴ *Global Sportsman Pty Ltd v Mirror Newspapers Pty Ltd* (1984) 2 FCR 82; *Bateman v Slatyer* (1987) 71 ALR 553.

⁷⁵ Accepted by Hammond J in *Crump v Wala*, above n1, 343.

⁷⁶ *Cox & Coxon Ltd v Leipst* [1999] 2 NZLR 15; (1998) 8 TCLR 516.

⁷⁷ *Goldsbro v Walker* above n4. This decision was followed by *Quick Snax Ltd v Uncles Group (NZ) Ltd* (19 June 1998) unreported, High Court, Auckland Registry, CP1137/92, where Thorp J noted that section

discretionary nature of section 43(2)(d). In doing so, the Court rejected the common law rule where a tortfeasor whose wrongful conduct contributed to cause damage was liable for the whole damage to the plaintiff. Such a conclusion, according to Cooke P, allows the Act to work in accordance with its true intent, meaning and spirit and enables the Court to grant a remedy that gives effect to the policy of the Act without at the same time being draconian or doing injustice.⁷⁸

Such a result would be at odds with the sentiment of Hammond J. His Honour was concerned that by rejecting of the use of common law analogies the FTA would create remedial uncertainty and would open the door for the widespread circumvention of established common law doctrines. Be that as it may, these conflicting cases serve to illustrate the apparent dissent in the Court of Appeal over the use of common law analogies. It is clear that the majority in *Cox & Coxon*, Henry, Blanchard, and Gault JJ, sought to limit the applicability of the reasoning in *Goldsbro*, while the minority, Richardson P and Tipping J, followed the reasoning with educated conformity. It would appear that Hammond J would quite clearly agree with the majority, while Thomas J, speaking extra-judicially, expressed a clear preference for the minority.⁷⁹

Alternatively the courts have attempted to interpret the statute in accordance with, and subject to, other commercial legislation. Brennan J best summarises this approach to interpretation in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* where he said;⁸⁰

43 provided the court with a wide range of discretionary powers, "a special package of remedies" which supercede conventional common law rules.

⁷⁸ *Goldsbro v Walker* above n4, 399. In *Cumberworld Contracting Ltd v Foseco (NZ) Ltd* (1993) 5 (TCLR) 534 affirmed by *Foseco (NZ) Ltd v Cumberworld Contracting Ltd* (1997) 6 NZBLC 102,033, the court awarded damages that reflected the proportion of the damage actually caused by the defendant's conduct. Similarly in *Fletcher Construction NZ and South Pacific Ltd v Cable Street Properties Ltd* (9 September 1999) unreported, CA 271/98, the Court of Appeal reduced the damages awarded by the High Court by 50% in recognition of the respondents' contribution to their own loss.

⁷⁹ E W Thomas "An Endorsement of a More Flexible Law of Civil Remedies" in New Zealand Law Conference Civil Remedies Papers, April 1999, 9n.

⁸⁰ *Parkdale* above n52, 225; 27. For similar comments see *Concrete Constructions (NSW) Pty Ltd v Nelson* (1990) 169 CLR 594, 603-604 per Mason CJ, Deane, Dawson and Gaudron JJ and *Webb Distributors (Aust Pty Ltd v State of Victoria* (1993) 179 CLR 15, 37 per Mason CJ, Deane, Dawson and Toohey JJ.

Section 52 operates in a milieu of the external legal order, so that the character of conduct which falls for consideration under section 52 is to be determined by reference to the external legal order as it exists when the conduct is engaged in.

Thus in order to avoid displacing other established legal regimes the courts have attempted to view the provisions of the FTA coherently with other existing legislation. This would appear to be consistent with section 50(1) of the FTA where the operation of any other enactment is expressly preserved. This approach can be illustrated by the decision in *Parkdale* where Brennan J held that the defendant's copying of an unregistered design was impliedly permitted by the Designs Act 1906 (Cth) which provided for the registering of designs, so that it could not be considered misleading behaviour under the Australian TPA. In this way his Honour held that where a specific provision has been made for certain types of situation then to apply the FTA would provide a remedy by a side wind.

In the writer's opinion, while such a result is desirable, the approach of the court is untenable. It would seem absurd that the court would simply be able to ignore the clear provisions of the legislation. Indeed such an interpretation has not received judicial support. It is suggested that a better approach would be to interpret the statute within the external legal order by using the discretion inherent in section 43 of the FTA. This would allow the Act to be interpreted in harmony with its original purpose and by uninhibiting the wide and discretionary remedies of the FTA the courts would have the ability to administer justice to the particular circumstances of the case. By doing so, the courts would conform to the existing legislative landscape and would therefore provide certainty and consistency without circumventing established legal regimes.⁸¹

⁸¹ For example, the remedies provided for under the FTA should not circumvent the Contractual Remedies Act 1979, but should provide analogous remedies, and therefore preserve the inherent scope and purpose of such legislation.

In this way, the reasoning of *Cox & Coxon*, criticised for stifling the flexible approach to the Act and for neglecting the plain words of the statute,⁸² could be considered to have been decided wrongly. By using the courts discretion under section 43, and hence considering the existence of existing legislation, the same result would have been reached albeit without arbitrary restraints on the Courts ability to administer justice. The external legal order in this case would be the existence of the Contractual Remedies Act 1979 that was enacted in order to enforce contractual promises and thereby allowing the contractual measure of damages. Therefore by importing common law doctrines the decision undermined the 'basket of remedies' approach and, in effect, compromised the initiative of the FTA.

Undoubtedly, such an approach has its limitations. These would include, for example, where two legislative enactments cannot be reconciled, or where the provisions of the FTA cannot simply award a comparable remedy.⁸³ Applied to the securities context, in order to award a comparable remedy under the FTA personal and substantive defences must be given effect to under the discretionary section 43. Consistent with such an approach is the courts unwillingness to accept that a remedy under section 43 is conferred as of right.⁸⁴ This would potentially allow the existence of a due diligence defence to exclude liability under the FTA. While such an interpretation is possible, it is highly unlikely. It is unclear whether the dicta in *Goldsbro* could stretch that far and it would also seem inappropriate within the context of a consumer protection statute. It could also compromise the original intent of the legislation and give rise to great uncertainty. Moreover in many cases to date such an approach would have been simply considered absurd.

Of course, the most efficient method to relieve New Zealand's legislative landscape of the FTA's devastating effect is to legislate. In this regard the Task Force recommendations

⁸² Andrew Beck "Fair Trading Act Remedies" (1999) 4 NZLJ 97; Brian Keene "Fair Trading Act Damage: A Statutory Test" (1999) 4 NZLJ 107.

⁸³ An example of this is an exclusion clause, while effective under the Contractual Remedies Act 1979, under the FTA such a clause would have no effect.

provide clarity to Australian securities law, while New Zealand, arguably, is left with less than satisfactory common law solutions.

III DISCLOSURE AT COMMON LAW

In response to unscrupulous promoters selling securities to the public on false grounds, the common law attached a disclosure obligation of utmost good faith on promoters. Kindersley VC laid down this obligation in 1860 in *New Brunswick and Canada Railway and Land Co v Muggeridge*⁸⁵ by commenting:

Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as facts that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares.

Cited with approval, Lord Chelmsford added in *Central Rly Co of Venezuela (Directors) v Kisch*:⁸⁶

In my opinion the public, who are invited by a prospectus to join in any new adventure, ought to have the same opportunity of judging everything which has a material bearing on its true character, as the promoters themselves possess. It cannot be too frequently or too strongly impressed upon those who, having projected any undertaking, are desirous of obtaining the co-operation of persons who have no other information on the subject

⁸⁴ *Goldsbro v Walker*, above n4.

⁸⁵ *New Brunswick and Canada Railway and Land Co v Muggeridge* (1860) 1 Drew & Sm 363, 381 [*Muggeridge*]. This statement of the law was regarded by Page Wood VC in *Henderson v Lacon* (1867) LR 5 Eq 249, 262 as the "golden legacy".

⁸⁶ *Central Rly Co of Venezuela (Directors) v Kisch* (1867) LR 2 HL 99, 113 [*Kisch*]. This decision was followed by *Peek v Gurney* (1873) LR 6 HL 377 [*Peek v Gurney*] where the Court held that a prospectus must not misrepresent actual and material facts or conceal material facts that might properly influence the minds of potential investors.

than that which they choose to convey, that the utmost candour and honesty ought to characterise their published statements.

Under this duty, promoters were to exercise strict and scrupulous accuracy towards the companies they incorporated and to characterise their *published statements* with utmost candour and honesty. Therefore at common law non-disclosure was only actionable where as a result the prospectus became false or misleading.⁸⁷ A prospectus would only become false or misleading if, viewing the prospectus as a whole, an impression arose from statements present that the whole truth has not been disclosed. For example, in *R v Kylsant*⁸⁸ the English Court of Criminal Appeal convicted Lord Kylsant for making a statement which he knew to be “false in a material particular”⁸⁹ after purporting to be a profitable entity. The material omission was that the profit stated was inflated by reserves, and that the entity was actually making operating losses.

However, while the common law developed rules that dealt with the need to disclose information, it proved inadequate in dealing with misrepresentations. This was illustrated in the decision of *Derry v Peek*⁹⁰ where the House of Lords held that in order to succeed for a claim of deceit the plaintiffs needed to establish actual fraud, even though the action could be defeated if the directors showed honesty in belief, even if the belief was unreasonable, so long as it was not reckless. The English Parliament responded with the Directors’ Liability Act 1890 (UK), which held a director liable to any subscriber for “the loss or damage they may have sustained by reason of any untrue statement in the prospectus”.⁹¹ This was subsequently followed in New Zealand with the Promoters and Directors Liability Act 1891. Rather than focussing on the promoters’ disclosure obligation of utmost good faith towards the company, the Acts shifted the emphasis to the

⁸⁷ *Aaron’s Reefs Ltd v Twiss* [1896] AC 273; *Muggeridge* above n85, *Peek v Gurney* above n86, *Kisch* above n86.

⁸⁸ *R v Lord Kylsant* [1932] 1 KB 442.

⁸⁹ Larceny Act 1861, section 84.

⁹⁰ *Derry v Peek* (1889) 14 App Cas 337 (HL).

⁹¹ Directors’ Liability Act 1890, section 3(1).

philosophy of mandatory disclosure.⁹² In this way the Acts ensured that liability would attach for misstatements and did not allow relief be determined solely by the existing and somewhat burdensome common law actions.

IV THE SECURITIES ACT 1978

A Generally

The Securities Act 1978 was enacted in New Zealand in the wake of a series of financial collapses,⁹³ notably culminating in the Securitibank failure in 1976, that left many investors with substantial losses.⁹⁴ Many of those who invested did so without the benefit of a registered prospectus or disclosure document. The inevitable conclusion that followed was that the existing legislation was inadequate to protect the investing public and that there was a need for stronger investor protection laws.⁹⁵

The principal policy of New Zealand's securities law⁹⁶ is to regulate capital raising by detailed disclosure to the public. Provided investors are given the information necessary to make properly informed decisions, the individual is better able to determine what is in

⁹² Fitzsimons "If the Truth be Known: The Securities Act 1978 and Directors' Liability for Misstatements in a Prospectus (Part I)" (1999) 5 NZBLQ 164, 166.

⁹³ Other notable collapses include Cornish, Mark Craig Group, Circuit Developments, Perpetual Trustees Company, JBL, Gemco, and Universal Management.

⁹⁴ See Ministry of Economic Development and the Securities Commission *Review of the Securities Regulations 1983 (Stage one); Discussion Document* (July 2000) 6.

⁹⁵ Gaskell "Some Problems of Definition in the Securities Act 1978" unpublished LLB(Hons) paper, Victoria University of Wellington (1979), 3. For a detailed account of New Zealand's securities history see Lindroos and Walker "A Short History of Securities Regulation in New Zealand" and P McKenzie "Reforming Securities Regulation in New Zealand" in Walker and Fisse (eds) *Securities Regulation in Australia and New Zealand* (Oxford University Press, Oxford, 1994), 35-89; Walker "Reinterpreting New Zealand Securities Regulation" in Walker, Fisse and Ramsay *Securities Regulation in Australia and New Zealand* (2 ed, LBC Information Services, Sydney, 1998), 88 [Walker, Fisse and Ramsay] and Mark R Stuart "Civil Liability for Prospectus Misstatement: Is There a Need for a Reliance Requirement?" unpublished LLB(Hons) paper, Victoria University of Wellington (1996), 2-8.

⁹⁶ The terms 'securities law' or 'securities legislation' refer to the Securities Act 1978, the Securities Regulations 1983 enacted thereunder, and the Securities Amendment Acts. It is important to note the Securities Act and Securities Regulations regulate the primary market, while the Securities Amendment Act 1988 regulates the secondary market and is directed at insider trading, substantial shareholder disclosure and dealings in futures contracts. Lastly, the Amendment Act of 1996 introduced the two-tier

his or her best interests. Such an approach is generally based on the simple founding premise of Justice Brandeis of the US Supreme Court that "sunlight is the best disinfectant". In *Re AIC Merchant Finance Limited* Richardson J described the New Zealand approach by commenting that:⁹⁷

The pattern of the Securities Act and the sanctions it imposes make it plain that the broad statutory goal is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities. In that way the Act is aimed at the protection of investors. That aim is achieved by regulating the conduct of issuers of securities and by providing sanctions for infringement by those issuers and their officers.

Importantly, the other aims of the Securities Act include the increasing of investor and public confidence in the integrity of the capital market, and the maintenance of an internationally competitive investment destination. This is best summarised by the Kimber Committee report where it was said in relation to securities law generally:⁹⁸

To the extent that securities legislation is improved in the interests of investors, the securities industry will benefit from increased public confidence. To the extent that the industry becomes a more effective and efficient part of the economy, the general public will benefit.

Securities market regulation enables investors to distinguish good investments from bad in a cost-effective way. This is because promoters of bad products are unlikely to voluntarily disclose their flaws. In this way, non-disclosure will result in sub-optimal investment and an increase in overall search costs for those investors who are prepared to remain in the market. Therefore mandatory disclosure strengthens investment confidence and economic activity.

disclosure regime and extended the application of the Securities Act to unit trusts, superannuation schemes and life insurance policies.

⁹⁷ *Re AIC Merchant Finance Limited* [1990] 2 NZLR 385, 391.

⁹⁸ *Report of the Attorney General's Committee on Securities Legislation in Ontario* (Ontario, 1965) para 1.17 ('the Kimber Committee report') as quoted by Lindroos and Walker above n95.

In order to be effective, mandatory disclosure rules require an efficient non-compliance system. The more efficient and the greater the potential liability, investors confidence, and hence investment, are likely to rise. This confidence must be weighed against the cost of imposing liability, as fundraisers will continue to search for new information as long as the cost of doing so is less than the risk of exposure to liability. Therefore, the higher the potential liability, the greater the incentive to incur costs further. However in saying this, when compliance costs become too high, there are strong disincentives on fundraisers for seeking equity. Therefore, a system with an appropriate balance between imposing costs on fundraisers on the one hand, and attaching liability on the other, will foster an efficient capital market.

In this regard most securities legislation contains a due diligence defence to encourage fundraisers to incur reasonable losses in order to avoid liability. In doing so, investor confidence and compliance costs remain at an economical balance; investors are well informed, while fundraisers, although incurring reasonable costs, have access to a healthy capital market.

Lastly, it is important to note that the securities market is unique. Securities are unlike physical commodities. Valued by the rights they confer and containing no intrinsic value by themselves, securities are created rather than produced, and cannot be consumed. The rights that they confer are typically rights to income or capital distributions from a business enterprise, so their value depends upon assessing the value of the enterprise. In this way, securities are, by their very nature, speculative. Because of this, investors should not be deprived of the right to desire high returns or to assume higher risks. The role of the Government is not to insure the investor or to uphold a risk-free marketplace, but rather to facilitate adequate disclosure in order for rational investment decisions to be made. Legislation cannot prevent, nor should it, bad investment decisions by investors.

B Overview

The primary provision of the Securities Act provides that no security shall be offered to the public for subscription, by or on behalf of an issuer unless the offer is made in or accompanied by a registered prospectus, or is made in an authorised advertisement.⁹⁹ Any allotment of securities that is made without a registered prospectus is void.¹⁰⁰ Furthermore, any allotment of securities that is made without the subscriber receiving an investment statement, or where that investment statement is false or misleading, or where the prospectus has dated, is voidable.¹⁰¹

It is important to note that since 1 October 1997 the investment statement has replaced the prospectus as the primary disclosure document.¹⁰² Considered an advertisement under the Securities Act,¹⁰³ the investment statement is intended to provide, in a more concise and accessible form, the information required by a prudent person to make an informed investment decision. This does not, however, preclude the preparation and registration of a prospectus, although the prospectus need only be sent to a security holder or prospective investor on request.¹⁰⁴

C Disclosure Requirements

The disclosure requirements under the Securities Act are contained within the Securities Regulations 1983 and contain two types of information disclosure. Firstly, certain provisions, mostly contained within the schedules, require the prospectus to disclose particular specified information. This approach to disclosure obligations is often referred to as a scheduled or prescriptive approach. Secondly, general disclosure provisions require information that is not specifically required to be included, but which is

⁹⁹ Securities Act, section 33.

¹⁰⁰ Securities Act, section 37.

¹⁰¹ Securities Act, section 37A(1)(a)-(c).

¹⁰² The Securities Amendment Act 1996.

¹⁰³ Securities Act, section 2D.

¹⁰⁴ Securities Act, section 54B(3). Note that because a prospectus will contain detailed financial statements for the issuer and related persons, it will contain more information than an investment statement.

nonetheless relevant to the offer of securities, to be included in the prospectus. These include:¹⁰⁵

- Provisions requiring disclosure of “material” contracts;¹⁰⁶
- Provisions requiring disclosure of other “material matters” relating to the offer of securities that are not set out elsewhere in the registered prospectus;¹⁰⁷ and
- Regulation 5(1) of the Securities Regulations 1983, which requires “additional” information to be included in a registered prospectus if, without such information, a statement in the prospectus would be misleading.

These general provisions make it clear that the detailed disclosure requirements do not provide an exhaustive list of information that should be contained in a prospectus.

In addition, under section 65, the Securities Act preserves any other liability under any rule of law or other Act. This clearly allows other disclosure obligations and liability provisions, including the FTA, to apply to the securities market.

D Civil Liability under the Securities Act

1 Section 56

The Securities Act imposes civil liability for misstatements in prospectuses by virtue of section 56. This section provides that certain persons are “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 they may have sustained by reason of such untrue statement”. The following section will analyse the requirements of section 56 and in doing so compare them to those of the FTA.

¹⁰⁵ *Morisons Company and Security Law* (Butterworths, Wellington, 1998), para 16.5.

¹⁰⁶ Securities Regulations 1983, clause 17 of the First Schedule, clause 9 of the Second Schedule, clause 15 of the Third Schedule, clause 12 of Schedule 3A, clause 9 of Schedule 3B and clause 9 of Schedule 3C.

¹⁰⁷ Securities Regulations 1983, clause 40 of the First Schedule, clause 32 of the Second Schedule, clause 30 of the Third Schedule, clause 18 of Schedule 3A, clause 14 of Schedule 3B and clause 14 of Schedule 3C.

(a) Untrue statement

The first important element is the necessity for an untrue statement. This is defined by section 55 as:

- (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.

The first limb was considered in *R v Rada Corp Ltd (No 2)*¹⁰⁸ where Barker J held that a statement of intention could be misleading if it could be shown that the director did not have that intention. Therefore it is clearly open to dispute a stated intention by reference to the context in which it is included. This interpretation allows a misstatement to be established on the basis of an impression, or implications derived from the whole document, without any one statement to be shown to be false. Similar to the approach of the FTA, this approach may be balanced by favouring the defendants in cases of ambiguity or confusion.¹⁰⁹

The second limb of section 55, which deals with an omission of a material particular, has been considered a number of times by the courts.¹¹⁰ The leading New Zealand case on the meaning of material is *Coleman v Myers*.¹¹¹ Cooke J, as he then was, set out a broad test of materiality as "those considerations which can be reasonably be said, in the particular case, to be likely materially to affect the mind of a vendor or of a purchaser".¹¹² Moreover

¹⁰⁸ *R v Rada Corp Ltd (No 2)* [1990] 3 NZLR 453.

¹⁰⁹ Fitzsimons above n92, 177.

¹¹⁰ For a helpful summary see Fitzsimons, above n92, 178-194.

¹¹¹ *Coleman v Myers* [1977] 2 NZLR 225 [*Coleman v Myers*]. The case concerned the obligations of directors to disclose material information to shareholders when advising them on an offer for which the directors are the purchasers.

¹¹² *Coleman v Myers*, above n111, 334. The reasonable investor standard was also adopted by the United States Supreme Court decision of *Basic Inc v Levinson* (1988) 485 US 224, 231 [*Basic Inc v Levinson*] in

the information, while reasonably considered important, does not have to be determinative of the investor's decision, but only be taken into account by the investor.

While there is significant similarity compared with the disclosure requirements under the FTA, there is a slight difference for material omissions. Under the FTA, silence will only amount to misleading conduct where the plaintiff could reasonably have expected the defendant to disclose further facts that qualify the statement. This is based on the 'reasonable expectation' of disclosure approach as evident in *Hieber* and other Australian authority. For example, in *NRMA Gummow J* held that members were entitled "to reasonably expect that what was put before them involved no half truths and contained a full and fair disclosure of matters".¹¹³

Whereas under section 56, it is clear that there must be some positive statement as the mere omission to state a material fact will not give rise to a cause of action. Liability for the omission of a material fact will only arise where the omission is such as to make a positive statement in the prospectus false or misleading. In other words, no action would lie if the prospectus merely failed to include certain material information in the prospectus, however a cause of action would arise if it could be shown that the suppression of that material information resulted in a statement in the prospectus being false or misleading. Such a requirement is enforced by regulation 5(1) of the Securities Regulations 1983 which require the disclosure of any additional information if, without such information, a statement in the prospectus would be misleading.

However, where there is a positive statement, and the omission of a material particular, the approach of section 56 and the FTA are very alike. This is because the concept of materiality under the Securities Act is dependent on the reasonable investor. Any reasonable investor would reasonably expect an issuer to disclose any fact that would

relation to r 10b-5. In that case the court held that an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important.

render a positive statement made misleading or deceptive. In this regard, the reasonable expectation of disclosure approach adopted under the FTA is likely to be very similar, if not the same as, the definition of materiality under the Securities Act.

(b) Reliance

Secondly it is necessary to prove the causative nexus between the untrue statement and the loss suffered by the plaintiff. Unfortunately, because of the absence of case law, it is unclear what level of reliance is required. The prevailing view is that subscribing "on the faith" of a prospectus or advertisement requires only that the investor relied directly on the prospectus, and need not rely specifically on the untrue statement.¹¹⁴ Therefore a plaintiff will not have a successful claim where it can be shown that they did not rely on the prospectus when investing. Clearly this would include where the plaintiff has placed reliance on independent advice or their own judgement, or has simply not read the prospectus.¹¹⁵

This result raises some concern. It is arguable that where an investor has relied on the advice of an expert and that expert has in turn relied on the prospectus in giving that advice, that investor should be presumed to have relied on the prospectus and be able to claim for any misstatements in the process. With the Government's express recognition of the role of the investment advisor in the investment process with the enactment of the Investment Advisers (Disclosure) Act 1996, it would seem a little unfair for those who acted out of an excess of caution and sought professional advice. Indeed it does not appear that such a claim would be any less deserving than that of another who only glanced at the prospectus.

¹¹³ *NRMA* above n 10, ALR 673. This was qualified by the Full Federal Court by adding that this requirement was subject to the need to present a document that is intelligible to reasonable members and would be likely to assist rather than confuse.

¹¹⁴ See Halsbury's Laws of England (4ed, Butterworths, London, 1996 Reissue) vol 7(1) Companies, para 339. See also the observations of the Working Group on Improved Investment Product and Investment Adviser Disclosure *Implementation of Part 4 of the 1993 Accord on Retirement Income Policies: Recommendations for Improved Investment Product and Investment Adviser Disclosure: Final Report 31 December 1995* (Wellington, 1995) para 164 [Working Group Report].

Another difficulty has arisen with the enactment of the Securities Amendment Act 1996 in that many investors may not have received, or even read, the prospectus. It is clear that because the investment statement is an advertisement for the purposes of the Securities Act, on the clear words of section 56, should the investment statement contain a misstatement, and assuming the plaintiff could show loss, a remedy would result.

However what is unclear, is whether the investor, having relied on an investment statement, would be entitled to a remedy where the misstatement is contained within the prospectus. It is possible to argue that because the investment statement must state that an investor is able to receive a prospectus on request,¹¹⁶ and any statements referred to in an advertisement or prospectus are deemed to be included in an advertisement,¹¹⁷ that any statements in the prospectus are deemed to be included in the investment statement. From this analysis if an investor subscribes for the securities on the faith of the investment statement, they should have an action under section 56 for misstatements regardless of whether they relied on or even received the prospectus. The only requirement being, therefore, would be the need to show they relied on the investment statement.¹¹⁸

Again it is uncertain whether such a result is desirable. It is likely that because many investors will not have received the prospectus that most investment decisions will be based solely on the investment statement. In this regard it would be logical to assert that because no reliance has been placed on the prospectus, which contains the misstatement, no remedy should result.

¹¹⁵ *Jennings v Broughton* (1853) 43 ER 818; (1853) 5 De GM and G 126.

¹¹⁶ Securities Act, section 38E(1)(c).

¹¹⁷ Securities Act, section 55(1)(b)(iii).

¹¹⁸ This interpretation has been supported by the Working Group Report above n114, para 168, where it was briefly noted that "if any statement in an investment statement is untrue, the product provider will be liable to any person who subscribed on the faith of the investment statement. Potential liability extends to any statement incorporated into an investment statement by reference".

On the other hand, by actively encouraging the use of the investment statement as the primary disclosure document, many may not see the need to request a prospectus. Should the prospectus contain a misstatement that could directly or indirectly affect the value of the investment, those who relied solely on the investment statement would be denied a remedy. In this way, it could be argued that a remedy should result where it can be shown that reliance has been placed on either disclosure document, whether the investment statement or the prospectus. If this were not so, by denying a remedy to those who invested merely on the investment statement, would effectively preclude those the law is designed to protect. This would undermine the investment statement initiative, and may lead to many requesting the prospectus out of an excess of caution.

Although unclear, it is important to add that under the FTA it is doubtful whether a successful action could be brought where the investment statement was relied on and the prospectus contained the misstatement. Like section 56, the FTA requires only that the prospectus or investment statement contained the misstatement, although it need not be specifically relied on. With the absence of provisions incorporating prospectus statements into investment statements, and in the absence of clear policy to do so, reliance under the FTA is likely to be limited to the document actually relied on.

(c) Loss

Thirdly, the investor must show they suffered loss "by reason" of the untrue statement in the prospectus or advertisement. This is typically shown by a decrease in value of the security because of the untrue statement. Where, however, the decrease in value can be attributed to another factor unconnected to the untrue statement, such as a general downturn in the economic conditions, the plaintiff will be unable to show that they have suffered the requisite loss needed under section 56.

2 The Impact of Clause 40 of the First Schedule to the Securities Regulations 1983

As mentioned, the Securities Act employs general disclosure provisions that supplement the mandatory requirements imposed under the Act. These general provisions make it clear that the detailed disclosure requirements do not provide an exhaustive list of information that should be contained in a prospectus. Clause 40 requires the directors of an issuer to state in the prospectus that there are no other material matters "other than [the] matters set out elsewhere in the registered prospectus". While not specifically considering clause 40, the Commerce Commission recently interpreted the phrase "material matters" to incorporate the common law concept of materiality and in doing so said:¹¹⁹

We think that the 'material matters' which are here required to be disclosed cover all matters which the Courts have considered to be material at common law, namely, all matters which might reasonably affect the judgement of an intending investor under the prospectus when making an informed decision on whether or not to invest.

The Commission was also of the view that if no statement was made on an issue, then it doubted that clause 40 could apply and that even if clause 40 was breached by the prospectus failing to refer to a material matter, there would still be no untrue statement.¹²⁰

The Court of Appeal disagreed. In *R v Baxter*¹²¹ the Crown charged Baxter with having signed a registered prospectus that included an untrue statement. The untrue statement Baxter was said to have made was the clause 40 statement, stating there were no other material matters. In other words, the claim was essentially a claim as to a material omission that did not turn on a positive statement. Blanchard J in holding Baxter liable stated that:¹²²

¹¹⁹ Securities Commission *Report on Inquiry into a Registered Prospectus Issued by Agricola Resources Limited Dated 3 June 1986* (Securities Commission, Wellington, 1986) 27 [*Agricola Resources*]. The Commission also took this view in a subsequent report: *Securities Commission Report on an Inquiry into the Voting Securities of Air New Zealand Ltd* (Securities Commission, Wellington, 1991) 41-42. In this report it is notable that the Commission referred to the decisions of *Muggeridge* above n85, *Kisch* above n86 and *Basic Inc v Levinson* above n112.

¹²⁰ *Agricola Resources* above n119, para 15.7.1(a) and (c), and para 15.6.2.

¹²¹ *R v Baxter* [1998] 3 NZLR 144; (1988) 15 CRNZ 580 (CA) [*Baxter*].

¹²² *Baxter* above n121, NZLR 157; CRNZ 592.

It was not necessary for the Crown to show that [Baxter] acted dishonestly, merely that in putting his signature to a statement that there were not other material matters, he was making an untrue statement.

Therefore it is clear that if any matters that may reasonably affect the judgement of an intending investor have been omitted, although that information need not be decisive in that decision, an action under clause 40 may lie. And like the FTA, under the Securities Act there is a need to prove the materiality of the omitted information. Therefore this action is similar to, if not the same as, the 'reasonable expectation of disclosure' approach under the FTA. The only differences being therefore, is the absence of defences under the FTA, and the way the different regimes operate. The Securities Act still relies on the proving of a positive statement to be false, while non-disclosure under the FTA must be considered to be misleading or deceptive where, in the circumstances, there was a duty to speak.

It is also conceivable in the securities context that the 'reasonable expectation of disclosure' approach could be abandoned, or pleaded in addition to, a misleading or deceptive clause 40 claim. Should a clause 40 statement be false, this would be in itself misleading and deceptive conduct and could supplement a claim for a substantive misleading or deceptive omission. However because the substance of each claim relies on the proof of a material omission, there would be no actual difference between the causes of action.

Therefore if clause 40 can operate as a general 'catch-all' provision under the Securities Act, like that of the FTA, from a disclosure point of view it is possible to argue quite convincingly that there would be no justification for allowing the FTA to apply. And given the similarity between the two non-disclosure actions, there would be strong argument that such overlap is clearly unnecessary.

3 Who can sue?

Any person who has subscribed or purchased¹²³ securities on the faith of the prospectus has the right to bring an action. However under section 6, certain sections, including section 56, do not apply to previously allotted securities unless the security was originally allotted with a view for it to be offered for sale to the public in New Zealand and the security has not previously been offered for sale to the public in New Zealand.¹²⁴ However, assuming the requirements of section 6(2) are satisfied, under section 6(7) the subsequent purchaser could have a claim against the original issuer and the subsequent holder of the securities.

4 Who can be sued?

Under the section 56(1) the following persons can be liable:

- The issuer (if that issuer is an individual);
- Every person who signed the prospectus as a director of the issuer or on whose behalf the prospectus has been signed;
- Every person who has authorised themselves to be named as a director of the issuer of the prospectus;
- Every promoter of the securities.

It is important to note that unlike other jurisdictions, a cause of action will not arise in New Zealand against a corporation.¹²⁵ And, in the context of a promoter, the definition expressly excludes those acting solely in their professional capacity. Civil liability is also imposed on an expert under section 57 who makes untrue statements.

¹²³ The Securities Act section 2 defines "subscribe" as including purchasing.

¹²⁴ Securities Act, section 6(2).

¹²⁵ Section 85A of the Australian Corporations Law includes in the definition of a person, a body politic or corporate, as well as an individual.

Thus it is clear that the legislature has considered carefully those who will be civilly responsible for breach of the Securities Act. In this respect the potential of the FTA to cast a wider liability net may, in the case of securities, undermine the clear objectives of the legislature. For example it is clear that the FTA would apply to previously allotted securities, and it is quite likely that the FTA would allow the defendant issuer to include a corporation. Such circumvention of the clear legislative intention would serve as a strong argument against the application of the FTA to the securities market.

5 Defences

Under the Securities Act there a number of substantive and personal defences. In the case of substantive defences, different statutory standards will apply depending on the capacity in which the defendant is sued, and on the part of the prospectus in which the untrue statement appears.

(a) Substantive defences

Directors, issuers (where that issuer is an individual) and promoters are individually responsible for any untrue statement in the prospectus. Where the untrue statement is made by an expert, or is contained in any report or valuation by an expert, the director can avoid liability by proving:¹²⁶

- That the statement fairly represented the expert's statement, or was a correct and fair copy of, or extract from, the expert's report or valuation; and
- The defendant had reasonable grounds to believe and did, up to the time of the issue of the prospectus, the expert making the statement was competent to make it; and
- That the expert had given consent for the inclusion of the statement.

¹²⁶ Securities Act, section 56(3)(d)(i)-(iii).

More importantly, if the statement is made anywhere else in the prospectus, the defendant can only avoid liability by proving that he had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true.¹²⁷

Under the comparable liability provision for experts,¹²⁸ section 57, experts can escape liability by proving that they were competent to make the statement complained of, and had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true.¹²⁹ This is, of course, only in relation to any untrue statement made by the expert, or contained in any report prepared by him.¹³⁰

Therefore it is clear that Parliament intended the preparers of prospectuses to have a 'due diligence' defence,¹³¹ and by doing so, created an incentive for prospectus preparers to go to reasonable lengths to ensure the statements contained within the prospectus are true. In this way, the preparers of prospectuses will afford themselves a defence. Such a defence will only be available where the director themselves undertook a due diligence inquiry and did not simply rely on the advice of others. This point was made clear in *Adams v Thrift*¹³² where the English Court of Appeal noted:¹³³

Of course it is not necessary that [a] ...director should play the part of a lawyer or accountant by examining into facts or figures... But if he will sign a prospectus without obtaining or even asking for any information of this kind, it is quite clear that he cannot protect himself under [section 56] even though the directors who signed the prospectus before him might and did believe the statements contained in it to be true.

¹²⁷ Securities Act, section 56(3)(c).

¹²⁸ Note that the definition of expert expressly excludes a person acting in their capacity as an auditor.

¹²⁹ Securities Act, section 57(3)(c).

¹³⁰ Securities Act, section 57(1).

¹³¹ For more information on the due diligence defence see Hood and Boswell "Due Diligence Reviews for Fund-raising Under the Australian Corporations Law" in Walker, Fisse and Ramsay above n95, 88; Peter Fitzsimons "Prospectuses, Misstatements and the 'Due Diligence' Defence (Part I)" (2000) 4 Comp & Sec LB 48 and Peter Fitzsimons "Prospectuses, Misstatements and the 'Due Diligence' Defence (Part II)" (2000) 6 Comp & Sec LB 73.

¹³² *Adams v Thrift* [1915] 2 Ch D 21 [*Adams v Thrift*]; followed by *Bundle v Davies* [1932] GLR 379.

¹³³ *Adams v Thrift* above n132, 24 per Lord Cozens-Hardy MR.

Therefore it is clear that strict liability under the FTA will undermine the due diligence incentive of the Securities Act. Not only would market confidence be undermined but in order to avoid liability under the FTA, preparers' would need to go to unreasonable lengths to ensure statements contained within the prospectus are true. Even then they would not be assured of indemnity. Alternatively, and what would be considerably worse, is that no due diligence inquiry whatsoever would be undertaken as the defence afforded under the Securities Act would be, in effect, illusory. Undoubtedly such effects are obviously undesirable.

(b) Personal defences

The personal defences available under the Securities Act largely relate to the withdrawal of consent. A named director may avoid liability by proving that he withdrew his consent to becoming a director prior to the issue of the prospectus provided he gave written notice to the Securities Commission and that he did not authorise the prospectus.¹³⁴ Following the issue of the prospectus, a director can also avoid liability by proving that the prospectus was distributed or registered without his consent and that on becoming aware of the distribution or registration, he gave notice to the commission and reasonable notice to the public that the prospectus was registered without his consent.¹³⁵ On the finding of an untrue statement after the distribution of a prospectus, and prior to subscription, the director can avoid liability by proving he withdrew his consent to being named in the prospectus and notified the Registrar, the Commission, and gave reasonable notice to the public of his withdrawal.¹³⁶

An expert will also be able to escape liability if he withdrew his consent to the inclusion of his statement or report in the prospectus prior to the distribution of the prospectus,¹³⁷ or if he became aware of an untrue statement or omission in the prospectus before the

¹³⁴ Securities Act, section 56(2).

¹³⁵ Securities Act, section 56(3)(a).

¹³⁶ Securities Act, section 56(3)(b).

¹³⁷ Securities Act, section 57(2)(a).

securities were subscribed, he withdrew his consent and gave notice to the registrar, the Commission, and gave reasonable notice to the public.¹³⁸

Again because the FTA does not require intention or knowledge, these defences are unlikely to have effect. Such circumvention is clearly undesirable.

6 Is section 56 effective?

To date there have been no successful reported civil actions under section 56. Such a phenomenon has not been uncommon in Canada¹³⁹ and the United Kingdom.¹⁴⁰ In the New Zealand context, Fitzsimons¹⁴¹ attributes this to the ease of proving section 58,¹⁴² the fact that a civil action is of little value if the directors are insolvent, and because the individual bringing the action does not have to bear the costs of a criminal action and would not be personally liable for a claim for costs. Fitzsimons also notes that because an investor can only claim damages "by reason of such untrue statements" it may prove to difficult or too small an amount relative to the litigation costs. Undoubtedly part of the reason must also lie in the widely held view that actions for material omissions were previously unavailable under the Securities Act.

This raises the question of whether the system works appropriately because assuming untrue statements exist, no investors have received compensation and the only actions brought have been criminal. Whether this is due to the predominant use of the FTA is unclear, but it does serve to illustrate the possibility that many deserving plaintiffs may not have been indemnified for their losses. Moreover, such a result could provide a strong

¹³⁸ Securities Act, section 57(2)(b).

¹³⁹ See J Chapman "Class Proceedings for Prospectus Misrepresentations" (1994) 73 Can Bar Rev 492, 494.

¹⁴⁰ See A Hofler "Company Securities - Misinformation and Litigation" (1995) 16 The Company Lawyer 67,71.

¹⁴¹ Fitzsimons, above n70, 252-257. Fitzsimons suggests that the availability of class actions or the introduction of contingency fees could increase the number of civil actions.

¹⁴² This paper will not consider criminal liability under section 58. However, for completeness purposes, under section 58 it is unnecessary to prove that the statement caused any loss, nor is it necessary to prove intention (required under section 250 of the Crimes Act 1961).

argument for the application of the FTA as an alternate remedy, or conversely, provide incentives for possible law reform, maybe similar to that in Australia, to the liability provisions of the Securities Act.

VAUSTRALIAN DEVELOPMENTS

A Overview

In 1991 Australia experienced fundamental change in relation to fund-raising with the Corporations Law¹⁴³ coming into force. Reform was driven by the pressures of globalisation,¹⁴⁴ the need for the law to keep pace with the business environment and the need to avoid costly compliance burdens on Australian businesses from the rigidity and complexity of existing laws. The simplification process continued in 1997 with the launch of the Corporate Law Economic Reform Program (CLERP) having the overall objective of ensuring that business regulation was consistent with promoting a strong vibrant economy and to provide a framework that would assist businesses to change.

For the purposes of this paper, the most important change was the opting by the Australian Government to exclude the application of the TPA from the securities market. Other significant changes relating to disclosure and liability include:¹⁴⁵

- Substituting the “offer to the public” test with some broad prohibitions on offers without a prospectus, coupled with express exemptions in cases where the offer was essentially private or the offeree could look after itself;

¹⁴³ The Corporations Act 1989.

¹⁴⁴ For a detailed analysis of the impacts of globalisation on New Zealand see Gordon Walker and Mark Fox “Globalisation: Meanings and Implications” and Andrew Simpson “Securities Regulation for the Information Age” in Walker, Fisse and Ramsay above n95, 3-54.

¹⁴⁵ H A J Ford et al *Ford's Principles of Corporations Law* (9 ed, Butterworths, Sydney, 1999) para 22.190. For more information see Claire Grose “Will the Small Business Fundraising Reforms Proposed by CLERP Really Make it Easier for SME's to Raise Capital in Australia?” (1998) 16 Comp & Sec LJ 297; G W Hone “Fundraising and Prospectuses – The CLERP Proposals” (1998) 16 Comp & Sec LJ 311 and Sam Cadman “Offer Information Statements Under CLERP” (1998) 16 Comp & Sec LJ 394.

- Repealing the detailed content requirements for prospectuses, and substituting a broad “reasonable investor” standard of disclosure;
- Replacing detailed pre-vetting with post-registration examination by the Australian Securities and Investment Commission (ASIC); and
- Empowering the ASIC to issue a stop order if a prospectus proved to be deficient after it had been issued, and requiring the authors of the prospectus to issue a supplementary prospectus if there was a significant change of circumstances.

Further changes were introduced by the Corporate Law Economic Reform Program Bill 1999 in the wake of strong government and business opinion.¹⁴⁶ The main elements of the new provisions are:¹⁴⁷

- The removal of the existing overlap between the general prohibition on misleading conduct (contained within section 995 of the Corporations Law) and the prohibition on misleading statements in, or omissions from, a prospectus (contained in section 728 of the Corporations Law);
- Removing the requirement of materiality when establishing whether an offer document is misleading or deceptive in civil proceedings¹⁴⁸ and therefore allowing recovery for damages where loss can be shown as a result of the misstatement;¹⁴⁹
- Giving the issuer of a disclosure document, the directors or proposed directors and the underwriters potential liability in relation to the whole document, while others will only be liable for statements in the document made by them or based on their statements, where they have consented;¹⁵⁰

¹⁴⁶ These reports include: the Task Force Report above n17; Corporate Law Economic Reform Program, Proposals for Reform: Paper No 2, *Fundraising: Capital Raising Initiatives to Build Enterprise and Employment* (AGPS, Canberra, 1997); Corporations Law Simplification Program *Fundraising: Trade Practices Act, Section 52 and Securities Dealings* (AGPS, Canberra, 1995); The Financial System Inquiry *Final Report* (the Wallis Report) (AGPS, Canberra, 1997) and Industry Commission, Information Paper *Small Business Research Program* (AGPS, Canberra, 1997).

¹⁴⁷ Ford above n145, para 22.530.

¹⁴⁸ Corporations Law, section 728(1).

¹⁴⁹ Corporations Law, section 729(1).

¹⁵⁰ Corporations Law, section 729.

- Removing criminal liability unless the defect in the prospectus is materially adverse from the point of view of an investor;¹⁵¹
- Extending the liability provisions to a case where a new circumstance will arise since the disclosure document was lodged, which would have been required to be disclosed if it had arisen before lodgment;¹⁵²
- Allowing a uniform defence to civil and criminal actions upon proof that the person has made all inquiries that were reasonable in the circumstances and, after doing so, believed on reasonable grounds that the statement was not misleading or deceptive;¹⁵³
- Allowing a defence to civil and criminal actions where the person places reasonable reliance on information given by someone other than an employee or agent of the person¹⁵⁴ and where a person publicly withdraws their consent to being named in the disclosure document.¹⁵⁵

B The General Disclosure Requirement

Among many significant changes the Corporations Law replaced the “offer to the public” concept existing previously under the Companies Code with a general disclosure obligation. Put simply, the “offer to the public” concept required disclosure only when an offer was made to the public. This concept was based on the notion that private offers need not be regulated because the offeree could make ‘face-to-face’ inquiries of the offeror, and, in any event, the cost of preparation could not be justified. This was abandoned in Australia for a number of reasons. First, the test was troublesome in its application. It was extraordinary difficult to apply, and there was considerable uncertainty as to when a prospectus was needed. Secondly, the test was open to manipulation, particularly because of the exception for offers made to persons whose ordinary business was to buy or sell securities. An unsophisticated private client of a stockbroker might be

¹⁵¹ Corporations Law, section 728(3).

¹⁵² Corporations Law, section 728(1) and (3).

¹⁵³ Corporations Law, section 731.

¹⁵⁴ Corporations Law, section 733(1).

¹⁵⁵ Corporations Law, section 733(3).

persuaded to conduct his or her trading activities through a company formed specifically for that purpose, and in such case the exemption would be available.¹⁵⁶

Prospectuses are now required to include all information that a reasonable investor and their investors' adviser would expect to find in the prospectus to make an informed investment decision.¹⁵⁷ It is intended to ensure that the information presented to investors be of sufficient quality to enable them to make an informed assessment of the corporation and the investment. Coupled with the adoption of a regulatory post-vetting program, the onus was placed squarely on those preparing the prospectus to determine what information should be provided, and to comply with the disclosure requirements. Because of this, information disclosure has improved and has led to more relevant information being disclosed. However initially at least, it has also led to the disclosure of excessive amounts of information as issuers were uncertain how to deal with the new disclosure regime.

It has also been suggested that by being directly linked with the reasonable investor requirement, the general disclosure test will also be responsive to changes in market expectations, practices and products over time. Many also believe that such a test will no longer arbitrarily include information that may not assist investors. While this may be true, the checklist approach arguably allows for better comparability between investment prospectuses due to the standard form disclosure. The checklist also provides greater certainty to those who issue prospectuses.

It is arguable that general disclosure may led to better disclosure where the checklist approach includes information that is no longer relevant to the reasonable investor. However when compared to disclosure obligations with general "catch-all" provisions in addition to the prescribed information, it is clear that although it is possible for more information to be disclosed, the quality of the information should be the same.

¹⁵⁶ Ford above n145, para 22.180.

¹⁵⁷ Corporations Law, section 710. In addition, there are also mandatory requirements under section 711.

C Reasons to Exclude the TPA

With the enactment of section 995A of the Corporations Law by the CLERP Act 1999, a section 52 cause of action no longer applied to dealing in securities.¹⁵⁸ This allowed a uniform defence of due diligence to apply to any person who unintentionally makes a misleading or deceptive statement or a material omission in a prospectus. Thus a person will not be liable if they prove that they made such inquiries as were reasonable, they took reasonable care, and it was reasonable for them to have believed that the prospectus was not misleading.

In order to determine whether New Zealand should follow Australia's initiative, an assessment of the Australian developments should be made. If the same considerations could apply to the New Zealand securities environment, the argument for the abandonment of the FTA would be considerably stronger.

1 The Fundamental Difference

The strongest reason against the application of the TPA is that a fundamental difference exists in the way the two regimes operate. The Corporations law imposes a positive duty of disclosure on those responsible for providing information to the investing public. Such an obligation achieves investor protection by ensuring those involved in the preparation of information check and test the information with all due diligence before disseminating it. Implicit in this approach is that if investors suffer loss because they relied on information that was incorrect or incomplete, but those who prepared the information

¹⁵⁸ More accurately, section 995 of the Corporations Law did not apply. This section was based on section 52 of the TPA and has been interpreted and applied similarly. In *NRMA* above n10, 552, the Full Federal Court of Australia noted that because "the relevant proscription is expressed in identical terms ... the issues for determination would have been substantially the same". This is because "the applicants should not be able to avoid an unfavourable construction of section 995 in connection with a dealing in securities by resorting to section 52". Section 52 of the TPA ceased to apply to the securities market on 1 July 1998 with the passing of section 51AF of the TPA by the Financial Sector Reform (Consequential Amendments) Act 1998. This removed section 52's application to financial services. See above n19.

exercised due diligence, the investors have no cause of action. In this way, the law focuses on the thoroughness of the process of preparation.

In contrast, section 52 of the TPA does not impose a duty to disclose information. Rather, it sets out a standard of conduct in trade or commerce. In this manner the TPA, like other consumer protection law, concentrates on the effect of the information on the consumers to whom it has been disseminated. If they suffer loss by another's misleading conduct, they are thought to be entitled to recover regardless of whether the person who supplied the information caused the mistake, or had exercised due diligence to avoid the mistake which had occurred.

Given the obligations which the Corporations Law imposes on those involved with fundraising and takeovers to disclose all relevant information, defences play an important role. They ensure an appropriate balance is struck between the rights of investors and the obligations of business. This carefully chosen balance is undermined if investors can succeed in an action under the TPA where defences are not available, in circumstances where defences exist under the Corporations Law.¹⁵⁹

2 Assumption of Risk

By its very nature and unlike other consumer markets, the securities market is speculative. In this context, no degree of legislative intervention should insulate the investor from the realities of the business environment or from the competency of corporate management.¹⁶⁰ It is not possible, nor should it be possible, for legislation to prevent the public from making bad investment decisions. This risk is borne by the

¹⁵⁹ Corporations Law Simplification Program *Fundraising: Trade Practices Act, Section 52 and Securities Dealings* (AGPS, Canberra, 1995), 19.

¹⁶⁰ The *Report of the Ministerial Group on Securities Law Reform* (August 1991) (the 'Roche Report') 60,579 noted that "regulation cannot and should not attempt to relieve investors [of the need to assess the risk of an investment]. Regulation cannot remove the possibility of losses. It should not be the purpose of regulation to improve the outcomes for investors generally by 'second guessing' the market; regulation may, over time, inhibit desirable innovation which may reduce the choices available and thereby harm investors".

investor and the investor alone. The Government should not be expected to hold the investor's hand, but rather to ensure the adequate disclosure of the risks so that rational investment decisions can be made. This is done by virtue of the securities legislation.

Moreover, the investor should not be deprived of the right to desire high returns, albeit with the assumption of higher risk. Therefore, although the supply of information required under the securities regulation may prevent some people from putting money into suspect schemes, it will do nothing to prevent those who do so, or for those who suffer losses as a result of collapse, mismanagement or market failure. The investor accepts these risks.

It is also important to add that the imposition of strict liability will not reduce the risk inherent in the securities market. The risk that information exists which is material to an investment decision, but which no degree of care or inquiry will uncover, will always be present and must be accepted by the investor.

3 The Existing System is Adequate

Because the current regulatory approach to fundraising ensures the full disclosure of information to investors by requiring a positive disclosure obligation, specifying the information required, and imposing liability on those responsible to compensate investors who have suffered loss, many would regard this as sufficient. Furthermore, there are relatively few instances where a different result would be achieved in an action under the Corporations Law compared to one under the TPA. This would only happen in a damages action where loss has been suffered as a result of misleading or deceptive conduct of a kind that could not be discovered by making reasonable inquiries. In that case an action would succeed in an action under section 52 but not under the Corporations Law. This narrow window of opportunity given to plaintiffs is, in the context of the existence of a tailor-made securities regime, unjustified and inappropriate.

Without the application of the TPA investors will continue to have the benefit of full disclosure coupled with a very strong liability regime which, in effect, requires those involved in fundraising to actively search for relevant information and to fully disclose it in a manner which is not false or misleading. This regime is generally regarded as being as rigorous as any in comparable overseas jurisdictions.

4 Efficiency

There are several economic justifications for excluding the operation of the TPA. Firstly, the overlap of the two regimes creates uncertainty which is detrimental to the efficient operation of the capital market. This uncertainty undermines the market confidence and serves to inhibit capital raising, discourage new enterprise and deter innovation.

Secondly, the justification for the imposition of strict liability is unwarranted in the securities context. This is because the rationale for imposing strict liability is that, by imposing the cost of damage on the person who bears the least cost of preventing or minimising the loss, the possibility of damage is minimised to society. But in the securities market, excessive liability for those involved will, despite all reasonable precautions, raise the costs of fundraising inducing fundraisers to take precautions beyond what is reasonable. Even then they may nonetheless find themselves liable under the TPA. Thus while the person who has the least cost of preventing the loss is undoubtedly the issuer, it would be inefficient to require beyond what is reasonable, and even then, still impose liability.

Thirdly, it would be, because of the informational asymmetry gap that exists between the issuer and investors, economically more efficient for the fundraiser, rather than numerous investors, to undertake inquiries and disclose details about its own business. By imposing strict liability many fundraisers may neglect the need to do so, and in effect, place the burden on those investors who require the information to seek it themselves.

Fourthly, strict liability will not shift the loss involved from the investor to the corporation. This is because an investor who successfully sues a corporation of which they are a member, in relation to loss suffered from a deficient prospectus, will in turn suffer loss by the reduction in the value of the corporation. Similarly, any additional strict liability compliance costs will inevitably flow to the investor, irrespective of whether they lead to any additional benefit in the form of better disclosure. In this regard, in light of the uncertain benefit received, if at all, many investors may prefer to assume the risk of imperfect information rather than incur the costs of the efforts to remove it.

Fifthly, strict liability would lead to less efficient disclosure in prospectuses. Because of the ever-present threat of strict liability, issuers may prefer to omit relevant information rather than risk making statements that are misleading. Furthermore, many may not engage in such a process at all and would distance themselves from the process in order to avoid liability. It is clear that these factors would lead to inefficient disclosure in prospectuses and would undermine the principles and objectives embodied within the securities legislation.

5 International Comparability and Consistency

Removing the application of the TPA would allow Australian law to be consistent with the approach adopted by other jurisdictions, such as England, the United States and Canada. As is evidently clear, these comparable jurisdictions do not allow a general misleading and deceptive provision to apply in the securities market context.¹⁶¹

6 The Difference in Enforcement Powers

Under the Corporations Law prospectuses are required to be lodged with the ASIC before they are issued to potential investors. While the Commission does not engage in detailed pre-vetting, many of its examinations result in alterations prior to investors are exposed to risk. In fact, in the first year of post-vetting 14% of prospectuses examined required

remedial action.¹⁶² In addition, the ASIC has the power to issue administrative 'stop orders' in relation to prospectuses which do not meet the disclosure requirements. This enables the ASIC to act quickly before investors sustain losses.

Unless an injunction is sought through the courts, under the TPA loss must be suffered before the Act can be invoked. Such delay could allow losses to be sustained by investors. This difference in administrative powers, and hence the clear legislative intent, has often been cited as a strong reason to exclude the ACCC from the securities market, and with it, the application of the TPA.

D The Argument for the Retention of the TPA

Of those who were opposed to the exclusion of the TPA, the strongest was from the ACCC. The following arguments are essentially built from those advocated by the consumer protection agencies such as the ACCC.

1 Floodgates

The TPA is economy-wide consumer protection legislation setting minimum standards of business for all sectors of the economy. Any exemptions for particular industries or sectors of the economy will inevitably harm the reach and effect of the legislation. This is because many groups would inevitably seek exemptions. Once a precedent is in place for one sector, this will be hard to deny to others. In addition, any exemptions granted will distort the clear message of what is and what is not acceptable conduct. This will lead to complicating the educational task of the ACCC.

The case for different treatment for the securities market is based on the special features of the Corporations Law regime for fundraising and takeovers. In this regard the 'floodgates' argument ignores the merits of the proposal in relation to the Corporations

¹⁶¹ See Appendix One for a summary of these international laws.

¹⁶² ASIC Bulletin Releases (CCH Australia, Sydney) para 158,213.

law. The existing legislation, by imposing positive disclosure obligations and providing due care defences, accommodates for the inherently uncertain securities market. By its very nature consumer legislation does not focus on dealing with forward-looking matters which involve as many complexities as the prospects of a trading enterprise. Therefore to reject the proposal to exclude the TPA based on a 'floodgates' argument does not consider the particular characteristics of the securities market in general or the purpose of the existing legislation. And thus in avoiding to do so, negates the compelling force in the submission.

2 Reduction in Consumer Protection

It is clear that the removal of strict liability will diminish investor protection. Protection will not be afforded where imperfect information is provided and all reasonable care has been taken. Because of this it is feared that many unsophisticated investors will be exposed to potential losses.

Such a paternalistic attitude to an inherently uncertain market seems misplaced. Investors must accept the risks of imperfect information. For, as this paper has already mentioned, it is not the role of the law to hold the investors' hand, but rather to ensure that all reasonable precautions are taken to enable informed investment decisions. Should the TPA apply liability would be imposed even when prospectus preparers have engaged in unreasonable measures to ensure the accuracy of the included statements. Even then, the risk that the information is imperfect would still be present. To place an unreasonable burden on those preparing the prospectus seems to ignore the inherent uncertainty in the marketplace. It would also seem unjust to require beyond that which is reasonable when it is unlikely that the information provided will improve.

3 Who Should Bear the Risk?

The ACCC argued that by excluding the application of the TPA this would have the effect of redistributing the risk towards investors. It would be wrong, not to mention

economically inefficient, that investors rather than issuers bear the costs of mistakes in prospectuses. This is because those who issue prospectuses are in the best position to check the accuracy of the information supplied to investors, and in this regard, they should be held responsible for their errors.

The ACCC also submitted that strict liability encourages suppliers of investment products to ensure the information provided is accurate. With the removal of strict liability, this may encourage higher risk ventures to enter the market as they will be unable or unwilling to ensure the accuracy of the information provided.

This criticisms are flawed. While it is true that an informational imbalance exists between the issuer and the investor, it would be uneconomical to require the issuer to go beyond that which is reasonable to ensure the accuracy of the statements provided. Furthermore, because the securities market is speculative, the risk of imperfect information is ever present. Even when the most exhaustive enquiries are made the possibility that information has not been uncovered is still at hand.

Secondly, the ACCC seems to deny the right of investors to invest in riskier, and hence more rewarding, ventures. Any encouragement of these enterprises to enter the market should be endorsed, albeit with the knowledge that the law requires mandatory disclosures of the associated risks involved. Such disclosure, together with due care defences, still provides incentives for market participants to ensure the accuracy of the information provided. This has not been removed with the exclusion of the TPA.

E Application to the New Zealand Context

The arguments against the application of the TPA are very compelling. With the exception of the difference in administrative powers, these reasons are equally valid in the New Zealand context.

There is another reason that could be cited for the exclusion of the FTA. It is embodied with the Latin phrase *generalia specialibus non derogant* (generalities do not derogate from particular provisions). For as was made clear in *Barker v Edger*:¹⁶³

When the legislature has given its attention to a separate subject, and made provision for it, the presumption is that a subsequent general enactment is not intended to interfere with the special provision unless it manifests that intention very clearly. Each enactment must be construed according to its own subject matter and its own terms.

Accordingly on this authority it would seem clear that the general provisions of the FTA should not apply to the specific tailor-made regime under the Securities Act. And, in the absence of a deficient securities regime in New Zealand, there is strong argument for the exclusion of the FTA.

VI CONCLUSION

When the mandatory disclosure requirements of the Securities Act are coupled with the obligation not to mislead or deceive under the FTA, the requirements on those who issue prospectuses seem to be rather onerous. Information that is compulsorily required, and that which is not, must not be, in all the circumstances, misleading or deceptive. At first glance this appears to be beyond that which is required under the Securities Act. However after further consideration, it is clear that material omissions are dealt with in a similar way under clause 40 of the First Schedule of the Securities Regulations 1983. This clause requires the directors of an issuer to state in the prospectus that there are no other material matters "other than [the] matters set out elsewhere in the registered prospectus". In this way while still reliant on the proving of a positive statement to be false, the mere omission of a material matter can be considered an untrue statement under the Securities Act. Therefore following logically, from a disclosure point of view the application of the FTA has been made redundant and need no longer apply.

¹⁶³ *Barker v Edger* (1898) NZPCC 422, 427. In *Marac Life Insurance v CIR* [1986] 1 NZLR 694, 702, Cooke J, as he then was, noted that "general provisions do not override special ones".

From a liability perspective it has been shown that with the absence of defences under the FTA, this, in the securities context, is unfair and inappropriate. For while it is undoubtedly right that the law should attach liability on those responsible for prospectus misstatements where they are at fault, but where they are not, or have taken all due care, imposing liability would clearly be unjust. Moreover because the securities market is inherently uncertain and speculative, the risk of imperfect information will always be present, and may exist regardless of any exhaustive attempts by issuers to uncover the relevant information. In this regard, imposing liability despite all due care taken, would amount to holding fundraisers liable for the inherent risk and imperfect information that exists in the securities market. This risk is accepted by the investor. It would also significantly increase the cost of fund-raising and would serve to dampen the overall market confidence.

Therefore this paper concludes that the "cancerous" Fair Trading Act should not be allowed to apply to the New Zealand securities market. The FTA provides an unnecessary overlap to the existing securities regime, and undermines the carefully chosen balance between the rights of investors and the obligations of business. The Australian initiative should be followed to allow the securities industry to function without restraint. This will increase public confidence and in turn will permit the securities market to become a more effective and efficient part of the economy, therefore allowing the general public to benefit.

APPENDIX ONE

A *International Disclosure Laws*

1 *England*

Following the enactment of the Directors' Liability Act 1890 England recognised the importance of imposing liability for prospectus misstatements. Incorporated into subsequent Companies Acts any disclosure obligations have been accompanied with associated due care defences.¹⁶⁴ In addition, the Code on Takeovers and Mergers encourages full disclosure of material information in the making of takeover offers. For any inadequate disclosure the Takeovers Panel has the ability to administer disciplinary proceedings. No general prohibition against misleading or deceptive conduct exists in United Kingdom law. The above statutes, the Misrepresentation Act 1967, and the common law provide these remedies.¹⁶⁵

2 *United States*

Civil liability and associated defences in relation to fundraising are governed in the United States of America by the Securities Act 1933. A plaintiff may also have a claim under section 10(b) of the Securities Exchange Act 1934 and Securities Exchange Commission Rule 10b-5 although in both cases intention must be proven. In addition, under Federal law 'tender offers' are regulated by the Securities Exchange Act, as amended by the Williams Act 1968. The Williams Act was designed to protect investors through mandatory disclosure. Material misstatement or omissions in disclosure

¹⁶⁴ In England offerings of listed and unlisted securities are subject to different statutory regimes. The Financial Services Act 1986 and the London Stock Exchange Listing Rules regulates listed securities while unlisted securities are regulated by the Public Offers of Securities Regulations 1995 and the Companies Act 1995. Due diligence defences are contained within sections 150 and 151 of the Financial Services Act 1986 for listed securities and in Regulations 14 and 15 of the Public Offers of Securities Regulations 1995 for unlisted securities.

¹⁶⁵ These include rescission, actions for damages for the tort of deceit, damages for negligent representation, and damages for breach of contract.

documents give rise to an action for damages for loss suffered where the plaintiff proves reliance on the misstatement or omission. A defence of good faith and absence of knowledge that the statement was false or misleading is provided.

Section 5(1)(a) of the Federal Trade Commission Act 1914 provides a similar provision to section 52 of the TPA.¹⁶⁶ This provision is mirrored by most states providing for liability damages for unfair and deceptive practices. The general rule is that state consumer legislation does not cover securities fraud¹⁶⁷ because either securities transactions are outside the scope of a 'consumer transaction' or because securities are regulated under another act or agency.¹⁶⁸

3 Canada

In Canada most provinces have legislation based on the American Securities Act 1933. Section 52(1)(a) of the Federal Competition Act makes it an offence to make a representation to the public that is false or misleading in a material aspect for the purpose of promoting the supply or use of a product or for the purpose of promoting any business interest. Both civil and criminal liability are subjected to a defence of reasonable precautions and the exercise of due diligence. At State level, the Ontario Business Practices Act, generally regarded as the leading province in securities regulation, expressly excludes securities from the definition of goods for false or misleading conduct.

¹⁶⁶ Section 5(1)(a) provides that "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful".

¹⁶⁷ *Robertson v White* 633 F Supp 954 (1986).

¹⁶⁸ For example in *Allais v Donaldson, Lufkin & Jenrette* 532 F Supp 749 (1982) securities fraud was held to be outside the scope of the Texan Deceptive Trade Practices and Consumer Protection Act because shares were outside the definition of goods. Furthermore the Court held that the consumer law did not apply because it would circumvent the Texas Blue Sky Law (securities disclosure law) which had due diligence defences.

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