IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2008-409-348
[2014] NZHC 2229

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

Hearing:	17-21 March, 24-28 March; 31 March-4 April; 7-11 April; 14-17 April; 28 April-2 May; 5-9 May; 12-16 May; 19-23 May; 3-6 June; and 9-12 June 2014
Counsel:	A J Forbes QC, P A B Mills, A J F Wilding and T J P Gavigan for plaintiff A R Galbraith QC, D J Cooper, S V A East and L M Campbell for first defendants (except Mr Magill) T C Weston QC and D J Cooper for Mr Magill J B M Smith QC, A S Olney and C J Curran for second and third defendants D H McLellan QC, J S Cooper and R M Stewart for fourth defendant A C Challis, D P Turnbull and H N McIntosh for fifth defendant
Judgment:	15 September 2014

RESERVED JUDGMENT OF DOBSON J

Contents

[1] This proceeding is brought on behalf of shareholders for losses claimed to arise from reliance on an allegedly misleading prospectus. A summary of my findings is set out, after an outline of the context and the claims, at [50] to [55] below.

Background

[2] Feltex Carpets Limited (Feltex) was a long-established and widely recognised New Zealand manufacturer of carpets. In May 2000, it completed the acquisition of an Australian carpet manufacturing business from Shaw Industries Inc (Shaw) of the United States.

[3] At that time, Feltex was owned by the third defendant, Credit Suisse First Boston Asian Merchant Partners LP (CSAMP). CSAMP is constituted as a limited partnership in the United States under the General Corporation Law of the State of Delaware. CSAMP's interest as owner of Feltex was managed by the second defendant, Credit Suisse Private Equity Inc (CSPE), a company duly incorporated in the United States under the laws of New York. CSAMP and CSPE were at pains to emphasise their different status, particularly as they treated only CSPE as a promoter for the purposes of the prospectus. They denied that CSAMP qualified as an individual issuer and consequently denied that it had any potential liability in that capacity. For the most part, it is unnecessary to distinguish between them in dealing with the narrative of events, and they can conveniently be referred to jointly as Credit Suisse. I will consider later in the judgment the competing claims as to the capacity in which CSAMP participated.[1]

[4] Credit Suisse resolved to sell Feltex. On 5 May 2004, Feltex issued a combined investment statement and prospectus to make an initial public offering (IPO) of all the 113,523,099 existing shares in Feltex. An additional component of the IPO was that Feltex would itself issue a further $50 million worth of shares (that would result in the issue of between approximately 25,600,000 and 29,400,000 new shares, depending on the final price).

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1 See [597]–[612] below.

[5] The prospectus referred to an indicative range of share prices between $1.70 and $1.95. It advised that the share price would be decided upon after a book build process that was to be undertaken part way through the period in which the offer was open. The book build process is the subject of one of the criticisms of the prospectus and is addressed in more detail below.[2]

[6] Although the prospectus identified numerous risks to the achievement of forecast and projected outcomes, it generally portrayed an improving financial position for Feltex. At the price subsequently settled as a result of the book build of $1.70 per share, the prospectus predicted a price earnings ratio pre-goodwill amortisation of 9.8 times, and a gross dividend yield of 9.6 per cent per annum.

[7] The plaintiff (Mr Houghton) subscribed for 11,765 shares in Feltex in the IPO. The offer closed on 2 June 2004, on which day the shares were allotted. The shares were listed on the New Zealand Stock Exchange (NZX) and trading in the shares commenced on 4 June 2004. Mr Houghton subsequently bought a further 5,000 shares on market.

[8] On 24 August 2004, Feltex announced its result for the year ended 30 June 2004 (FY2004). The first defendants[3] (the directors) authorised a final dividend for FY2004 at six cents per share, in accordance with the indication that had been given in the prospectus. On 23 February 2005, the company announced its interim result for the six months to 31 December 2004, which was up 7.1 per cent on the result for the first six months of the previous financial year. The company declared an interim dividend of six cents per share, which was 15.4 per cent above the interim dividend projection in the prospectus.

[9] On 1 April 2005, Feltex issued a profit downgrade warning, announcing the view of the directors that the company would not achieve the level of profitability projected in the prospectus. At the time of that announcement, the shares were trading at $1.50. They dropped to $0.88 in the following two days. The directors

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2 See [495] to [517] below.

3 Messrs Timothy Saunders, Samuel Magill, John Feeney, Craig Horrocks, Peter Hunter and Peter Thomas and Ms Joan Withers.

made a second revised earnings announcement on 30 June 2005. That caused a prompt drop in the share price from $0.70 to $0.44, before recovering to $0.63.[4]

[10] On 22 September 2006, Feltex's bank appointed receivers over the directors' opposition to that course. In October 2006, the receivers sold the assets of Feltex to an Australian competitor, Godfrey Hirst. That effectively left the shares worthless. The company was placed in liquidation on 13 December 2006.

[11] The Securities Commission conducted an inquiry into the adequacy of disclosure in the prospectus. It concluded in a report issued in October 2007 that the prospectus was not misleading in any material respect. The plaintiff made relatively extensive references to transcripts of evidence given by directors and executives of Feltex to that inquiry, but urged that I should not place any reliance on the Commission's determination. Mr Forbes QC made the point that I had no way of reliably identifying the extent of matters of fact and opinion that were traversed in the Commission's inquiry.

[12] For their part, the defendants made passing reference to the Commission's decision as tending to confirm the stance they all advanced in defence of the present proceedings. None of the defendants submitted that the Commission's decision prevented the plaintiff making out any of the present causes of action. Although I have considered some extracts of the transcripts of evidence given to the Commission, I have not read its determination.

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

[14] Mr Houghton commenced these proceedings on 26 February 2008 in a representative capacity on his own behalf, and on behalf of other shareholders who

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[4] I was not provided with a daily record of the market transactions in Feltex shares. I have taken these prices from exhibit 2 to Professor Cornell's evidence, and figures 1 and 3 in Mr Cameron's evidence, the accuracy of which was not challenged.

purchased shares in the IPO and subsequently suffered loss on that investment.[5] The supervision of pre-trial issues was made more difficult by the absence of class action provisions in the High Court Rules, but the lack of procedural guidance that would be provided by such rules does not impact on the substantive determination.

[15] Earlier directions authorised those who were promoting the shareholders' claims to canvass all shareholders who acquired shares in the IPO as to whether they would "opt out" of the proceedings.[6] Subsequently, the basis for joining the proceedings was transformed into a requirement for shareholders to "opt in" to the proceedings.[7] A succession of dates was ordered by the Court as the final date by which that step could be taken, as circumstances relevant to shareholders' decisions on the point evolved. The final cut-off date was 30 May 2013, except for shareholders who subscribed via a Forsyth Barr (ForBar) nominee company, Forbar Custodians Limited, for whom the cut-off date was 21 June 2013. By then, 3,689 shareholders had opted in.

[16] In August 2012, the Court ordered that issues raised by the proceedings should be dealt with in two stages.[8] The first stage, which this judgment addresses, was to determine Mr Houghton's own claim, together with the issues that were common to the claims of all the other shareholders whom he represents. The remaining issues arising for the other shareholders who have opted in were to be determined at a second trial.

The parties

[17] Mr Houghton has sued:

(a) the first defendants, all of whom were directors of Feltex at the time of the IPO;

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5 The proceedings were also commenced on behalf of shareholders who had bought shares on market, after the IPO. Some of their causes of action were struck out in *Houghton v Saunders* (2008) 19 PRNZ 173 (HC) at [93]. In addition, the representative plaintiff for that group was denied standing to sue for others, and the claims for that second group of shareholders have not proceeded.

6 *Houghton v Saunders* HC Christchurch CIV-2008-409-348, 26 February 2008.

7 *Houghton v Saunders*, above n 5, at [170].

8 *Houghton v Saunders* [2012] NZHC 1828, [2012] NZCCLR 31 at [39]. .

(b) the second and third defendants, CSPE and CSAMP, alleging that they were both promoters of the prospectus, and CSAMP as the vendor and issuer of the majority of the shares offered in the IPO;

(c) the fourth defendant, First New Zealand Capital (FNZC), which was, at the time of the IPO, a partnership in business in New Zealand; and

(d) the fifth defendant, ForBar, which is a duly incorporated company having its registered office at Dunedin.

[18] FNZC and ForBar participated as joint lead managers (JLMs) of the IPO. Mr Houghton alleged that both FNZC and ForBar had the status of promoters of the IPO for the purposes of statutory liability under the Securities Act 1978 (the SA). Mr Houghton also claimed that the nature and extent of involvement by FNZC and ForBar in the IPO gives rise to liability against them on other causes of action.

The preparation of the prospectus

[19] On 16 March 2004, Credit Suisse requested and authorised Feltex to proceed with an IPO, and the Feltex Board (the Board) resolved that it would proceed to do so. The Board approved the appointment of a Due Diligence Committee (DDC) to oversee the preparation of the prospectus. The Chairman of Directors, Mr Saunders, was on the DDC, as was Mr Thomas, the latter in his capacity as representative of the Credit Suisse entities. Mr Magill in his capacity as Chief Executive Officer (CEO) of Feltex, and Mr Tolan, in his capacity as Chief Financial Officer (CFO), were both members of the DDC. Mr Peter Rowe, a senior commercial solicitor at Minter Ellison Rudd Watts who had been retained on behalf of CSAMP, was also a member.

[20] Bell Gully acted as the solicitors for Feltex on the IPO and two of its partners, Messrs Gilbertson and Downs, were also members of the DDC. They proposed a relatively elaborate structure of steps for the DDC to oversee and check the content of the prospectus. That process involved allocating responsibilities to appropriate members of senior management of Feltex for drafting and/or verifying various components of the prospectus that addressed the nature of Feltex's business.

This was done for both historical and prospective financial information, and the assumptions relied on for the prospective financial information.

[21] Although not represented on the DDC, Ernst & Young had representatives at all of its meetings in their capacity as Feltex's auditors. Mr Stearne from FNZC and Mr Mear from ForBar were observers to the DDC in their capacity as representatives of the JLMs.

[22] The DDC met nine times, generally by telephone conference. The meetings included interviews of 11 senior managers in respect of component parts of the prospectus for which those managers were attributed responsibility. The DDC requested input from the various managers in writing, in terms that emphasised the importance of their answers being absolutely correct, and citing dire consequences if the details in the prospectus were wrong.[9] The prospectus was registered with the Registrar of Companies on 5 May 2004, and the offer was open from that day. On 24 May 2004, Feltex announced to the NZX that the final price was $1.70 per share.

[23] From the outset, the due diligence process included provision for the DDC to hold a final meeting to "bring down due diligence". That ninth meeting occurred on the day the offer closed, 2 June 2004. The task at that meeting was to confirm that no material adverse circumstances had arisen between the date on which the prospectus was issued, and the allotment of the shares, as is required under the SA.[10]

[24] The prospectus contained 148 pages. The table of contents listed 25 topics that were addressed. The majority of the document was in narrative form, under headings such as "Investment Features", "Details of the Offer", "New Zealand and Australian Carpet Industry", "Business Description", "Feltex Management" and "Overview of the Vendor and Promoter". The remaining sections provided quantitative data, such as a summary pricing table and summary financial information, prospective financial information and historical five year summary financial information, together with consolidated financial statements.

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9 DD1 000042–000046.

10 SA, s 37A(1)(b).

[25] Because the document was a combined prospectus and investment statement, it was required to include content from sch 3D of the Securities Regulations 1983 (the Regulations). That schedule specifies content that is considered to be appropriate for the shorter form of disclosure. Page one of the document stated at the outset:

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

[26] Thereafter, under the heading "Choosing an Investment", readers were told:[11]

> When deciding whether to invest, consider carefully the answers to the following questions that can be found on the pages noted below:

There followed a list of the 11 questions required to be addressed by sch 3D of the Regulations. Those questions included "What Are My Risks?", directing the reader to a section under that heading at page 125.

[27] That section contained some four pages of risks relating to the carpet industry and to Feltex's business, and a further page and a half describing risks under the headings "General Business Risks" and "Other Risks". These parts of the prospectus included statements in bold in the following terms:[12]

> It is therefore imperative that before making any investment decisions, investors give consideration to the suitability of Feltex in light of their investment needs, objectives and financial circumstances.

And, addressing the uncertainty of forward looking statements:[13]

> Given these uncertainties, investors are cautioned not to place undue reliance on such forward looking statements in this Offer Document. In addition, under no circumstances should the inclusion of such forward looking statements in this Offer Document be regarded as a representation or warranty by the Vendor, Feltex or any other person with respect to the achievement of the results set out in such statements or that the assumptions underlying such forward looking statements will in fact be true.

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11 Prospectus at 2.
12 Prospectus at 125.
13 Prospectus at 130.

[28] When the terms of some of the risks stated in this section were put to Mr Houghton, he characterised them as generic statements that could be found in every prospectus – "frankly they all look the same".[14] He seemed inclined to dismiss the stated risks, including those specifically addressing Feltex's business, as "legal mumbo-jumbo", so it is difficult to evaluate the impact of other aspects of the prospectus on his individual considerations, when he appears not to have considered that other content in light of the risks to which the prospectus drew his attention.[15]

The claims

[29] The first cause of action was against all the defendants and was for breach of the Fair Trading Act 1986 (the FTA). It related to the defendants' respective contributions to the representations in the prospectus as to the state of financial health of Feltex at the time of the IPO, the forecast for FY2004 and the projection for the year ended 30 June 2005 (FY2005). The plaintiff alleged that components of the prospectus were misleading, and that omissions from the prospectus left a misleading impression overall for potential investors.

[30] As anticipated in the description of the book build process in the prospectus, Feltex made an announcement to the market by means of a statement that was released to NZX on 24 May 2004 (the 24 May announcement). The 24 May announcement was in the names of Messrs Saunders and Magill as Chairman of Directors and CEO respectively. The 24 May announcement reported what Feltex saw as positive progress with the IPO and confirmed that the final price would be $1.70 per share. At that time, the offer was still open for potential investors who would commit to shares via firm allocations that had been made by the JLMs to themselves and to various other brokers in New Zealand.

[31] Mr Houghton alleged that the content of the 24 May announcement added to the misleading nature of the prospectus.

[32] A second cause of action under the FTA was pleaded solely against Mr Magill as the only executive director in relation to his conduct after the allotment

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14 NoE at 62/9–10.
15 NoE at 63/22.

of shares. It alleged that Mr Magill was responsible for overstating the extent of debtors owed to Feltex, which contributed to a misstatement of its financial position in the period after the IPO, thereby disguising the availability to subscribers for the shares of a statutory remedy under s 37A of the SA to avoid the allotment of shares, and obtain repayment of their subscriptions.

[33] Very little was made of this separate claim throughout the evidence, and in closing. Although Mr Forbes' instructions did not permit him to formally abandon the cause of action, no tenable basis for it emerged. In particular, the elements of it were not squarely put to Mr Magill.

[34] The third cause of action was a claim against all defendants for breach of relevant provisions in the SA. The civil liability regime prescribed by the SA was amended on 24 October 2006.[16] Because the prospectus was issued prior to this date, the SA as it existed in 2004 continues to have effect for the purposes of this proceeding as if it were not amended.[17]

[35] It was alleged that the prospectus contained statements that are deemed untrue in the statutory sense, thereby triggering liability for the defendants to pay compensation for the loss sustained by shareholders by reason of the untrue statements. Directors signing a prospectus, and those who participated in the prospectus as promoters, are rendered liable for such untrue statements.[18] FNZC and ForBar both denied that their participation brought them within the statutory definition of a promoter. CSAMP also denied that it was a promoter.

[36] All defendants denied that the prospectus contained untrue statements in the statutory sense. In the alternative, they argued that if the content is found to include an untrue statement, then they ought to be excused from liability because they contributed to the prospectus on the terms it was issued, after they had made all due enquiry and that they had reasonable grounds to believe, and did believe, the statements made in the prospectus were true (the due diligence defence).

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16 Securities Amendment Act 2006, ss 6–10.
17 Section 24.
18 SA, s 56(1)(c) and (d).

[37] In addition to denying that they had status as promoters, in the alternative FNZC and ForBar joined the other defendants in arguing that the prospectus did not contain any untrue statements. FNZC and ForBar also argued that if, contrary to their primary position, they were indeed promoters for the purpose of statutory liability under the SA, then the due diligence defence would be available to them.

[38] Mr Houghton claimed in a fourth cause of action against all defendants that they owed him and shareholders in the same position a duty of care in tort, and that they breached that by way of negligent misstatements in the prospectus, and in the 24 May announcement.

[39] The defendants raised limitation defences in a number of contexts. The second and third defendants led arguments that the loss claimed under the FTA was reasonably discoverable by December 2006. Parts of the FTA cause of action were added during and after 2010 and, on the defendants' argument, would have been commenced after the three year time limit elapsed.[19] In addition, amendments to the allegations made in 2010 and 2013 under other causes of action were challenged as out of time because they were more than six years after the events giving rise to claims. The defendants argued that these new allegations constituted new causes of action because they were sufficiently different from the type of allegations to which they were added.

[40] Notwithstanding the sequence of these causes of action, I have undertaken the primary factual analysis of the criticisms of the prospectus by reference to the cause of action under the SA. Mr Forbes argued for a different scope of what might amount to misleading conduct under the FTA, relative to what constitutes an untrue statement under the SA. He also contended for the prospect that a different test might apply to ascertaining whether there had been a negligent misstatement for the cause of action in tort.

[41] The defendants argued that when the relevant conduct is regulated by the SA, there could be no prospect of liability under the FTA. They also argued that once their conduct and potential liability is regulated by the SA, that takes any imputed

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[19] FTA, s 4(5).

relationship that might otherwise give rise to a duty of care outside the circumstances in which a tortious duty should be recognised. A practical alternative is that any duty of care should not be imposed on any different terms to those required under the SA.

The range of pleaded criticisms

[42] The criticisms of the prospectus were pleaded in diffuse and overlapping terms. In four amended statements of claim, the criticisms grew to some 34 pages of particularised allegations of misleading content and omissions. The allegations relate to some 21 passages in the prospectus. If the particulars in support of criticisms of the prospectus were given status as separate criticisms, then they would total approximately 80 criticisms.

[43] A number of the criticisms relied on acknowledgements made by Mr Saunders, and another director, Mr Thomas, at the Feltex AGM on 1 December 2005 (the 2005 AGM). Messrs Saunders and Thomas attempted to explain certain reasons, as they identified them at that time, for the deterioration in Feltex's business. On the basis that the directors knew or ought to have appreciated the risks of such adverse factors at the time of the IPO, the statement of claim alleges that statements inconsistent with the position acknowledged in December 2005 were misstatements, and failures to acknowledge adverse circumstances as recognised in December 2005 amounted to material omissions from the prospectus in relation to those points.

[44] The defendants pursued a number of pre-trial applications seeking orders for further particulars of the statement of claim. In many respects, those initiatives were attempts to seek a rationalisation of the criticisms in a more focused way. Pre-trial, the plaintiff asserted an entitlement to plead the criticisms extensively and by way of cross-reference, to reflect the range and relevance of what were considered to be misleading content and omissions.

[45] The extensive range of criticisms made it difficult to confine the scope of the evidence. In some respects, objections raised on behalf of the defendants were warranted in that the scope of issues explored extended to an extensive, if not exhaustive, review of the adequacy of the prospectus in a general sense.

[46] Mr Forbes' opening addressed the criticisms by reviewing the text of the prospectus, together with a summary of the criticisms that would be addressed by each witness. On 21 May 2014, after 37 days of hearing, Mr Forbes provided a list of six topics that were not being pursued. Only in closing did the plaintiff rationalise the criticisms, by addressing them under 15 headings.

[47] The defendants responded to the criticisms under a more or less consistent list of headings as they perceived the requirement for them to be answered. In the end, there remained differences between the plaintiff and the defendants as to the extent of pleaded allegations that the defendants considered had not been addressed in evidence or argument, and criticisms advanced which the defendants considered were not pleaded.

[48] After considering all contributions to the arguments, I have adopted my own sequence for considering and determining the criticisms. In that process, numerous particulars of the criticisms pleaded inevitably have to be subsumed within larger topics to which they relate. It would unjustifiably lengthen my reasoning for the conclusions I have come to if I dealt with each individually. I am satisfied that the impact of all pleaded criticisms (and some that were not) is reflected in my analysis.

[49] I have analysed the pleaded criticisms under headings that are intended to reflect their essential character. I deal with the criticisms in a sequence that is intended to aid an understanding of the prospectus in the context of the criticisms made of it. The sequence does not necessarily reflect the strength of the plaintiff's case on respective criticisms, nor their relative importance. The headings I have adopted are as follows:

A Undisclosed adverse trends in current trading

These deal with two allegedly material adverse trends in the current period of trading that arguably should have been disclosed in the prospectus, together with the allegedly misleading effect of removing a provision for incentive payments to management in the current year's financial statements.

B Misstatements or statements omitted as to risks confronting Feltex

These deal with qualitative comments in the narrative sections of the prospectus that describe the nature of Feltex's business, the environment in which it operated and the risks it faced.

C Misleading or unreasonable assumptions in predicting future performance

These criticisms challenged many of the assumptions relied on to predict Feltex's performance in the forecast for FY2004 and the projection for FY2005.

D Misleading presentation of historical and prospective financial data

These were criticisms of the manner in which various components of the quantitative data in the prospectus was presented.

E Misstatements as to the nature and effect of the equity incentive plan

These criticised the adequacy of disclosure of pre-existing contractual arrangements between Credit Suisse and directors and senior managers, where part of the benefits of those arrangements were being applied by many of the directors and senior managers to subscribe for shares.

F Misstatements as to the book build process/content of the 24 May announcement

These criticisms related to alleged discrepancies between the description of how the final price for the shares would be set, and how that was actually done, plus a challenge to the accuracy of matters stated in the 24 May announcement.

G An unwarranted positive tone was conveyed by the prospectus

These raised miscellaneous criticisms that the tone of the prospectus painted Feltex in a more positive light than was justified, and that it misrepresented the shares as being good or fair value at $1.70.

Summary of the outcome

[50] Although a number of the criticisms of the content of the prospectus had some justification, none of them made out material misleading content or omissions

that would trigger liability on the test as I have applied it under the SA. In addition, I have decided that because relevant conduct is regulated by the SA, the prospect of liability does not arise under the FTA. Nor are the circumstances of any relationship between the directors and other defendants on the one hand, and investors in the IPO on the other, such as to give rise to the prospect of a duty of care in tort being imposed.

[51] Those findings would be sufficient to determine the claims on the views I have come to. However, I was told repeatedly during the hearing that appeals would be inevitable. In those circumstances it is appropriate to record findings on numerous other issues which were the subject of extensive evidence and argument, and which would become relevant in the event that I am subsequently held to be wrong in dismissing the claims of misleading content in, or omissions from, the prospectus.

[52] Whether the defendants could avail themselves of the due diligence defence in the event they were found liable for misleading content or omissions might require re-argument, depending on the nature of any misleading content or omissions that might be accepted by an appellate court, and the circumstances in which that content or omission appeared or was omitted from the prospectus. However, I have considered the availability of the due diligence defence in the context of the process for preparation of the prospectus on the extensive evidence that was adduced. I have found that the defence would be available to the defendants in relation to the criticisms that were focused on.

[53] I have found that the JLMs were not promoters in the sense used in the SA. Nor was CSAMP. I have also made findings that uphold part of the defendants' arguments on time limitations that apply to components of the claims.

[54] I have also upheld the defendants' argument that even if misleading content or omissions were made out, then the plaintiff has not made out any recoverable loss.

[55] The sequence in which these issues are addressed in the remainder of this judgment is as set out in the table of contents at the outset.

The test under the SA cause of action

[56] New Zealand securities legislation does not seek to limit the extent of risk to which investors may be exposed when making particular investments. Rather, the aim is to require adequate and accurate disclosure of matters relevant to the nature of the risks involved in an investment, to enable potential investors to make fully informed decisions. That is reflected in a requirement for those promoting investment in either debt or equity securities to do so by means of a prospectus registered with the Companies Office. Since 2 September 1996,[20] the essence of the narrative description of an offer might also be conveyed in the shorter form alternative of an investment statement. Such documents have to refer to the availability of a registered prospectus.

[57] The SA prohibits offer documents from containing untrue statements. Section 58 imposes criminal liability on all directors of an issuer for documents, including prospectuses, that contain any untrue statements. Section 56 imposes civil liability for untrue statements on directors of the issuer and promoters.

The test for assessing whether a statement in a prospectus is untrue

[58] The definition of an untrue statement for the purposes of the liability regime under the SA is:

> **55 Interpretation of provisions relating to advertisements, prospectuses, and registered prospectuses**
>
> For the purposes of this Act,—
>
> (a) A statement included in an advertisement or registered prospectus is deemed to be untrue if—
>
> (i) It is misleading in the form and context in which it is included; or
>
> (ii) It is misleading by reason of the omission of a particular which is material to the statement in the form and context in which it is included:
>
> …

[20] Securities Amendment Act 1996.

(In considering the application of this definition, I will refer to the two possible elements as "misleading content or omissions".)

[59] The plaintiff urged that whether all or any of the allegations of misleading content or omissions were made out had to be assessed by considering the prospectus overall. In effect, the totality of the document might be found to be misleading because of an impression conveyed by the tenor of its contents.

[60] Mr Forbes submitted that s 55 is cast as a deeming provision, so that the definition of misleading content that will render a prospectus untrue in the statutory sense should not be treated as an exhaustive one. To achieve the statutory purpose, the misleading nature of a prospectus had to be assessed at a more general level than considering individual statements in isolation. He argued that if the definition of untrue statements in s 55 was treated as an exhaustive one, then that would run counter to the object of the SA. Because "statement" is not defined for the purposes of s 55, it might in appropriate circumstances be substantially more than a particular sentence.

[61] Mr Forbes cited from Heath J's decision in *R v Moses*:[21]

> The authorities make the obvious point that it is the overall impression conveyed by the offer document that is important, not a painstaking analysis of individual sentences contained in it.

[62] That observation was in dealing with a defence criticism of the adequacy of the particulars of the criminal charges arising out of a finance company prospectus. The authorities cited by Heath J included numerous older authorities, pre-SA, as well as the 1990 *R v Rada Corporation Ltd* decisions.[22] Later in his judgment, Heath J summarised his findings:[23]

> It is the combination of statements and material omissions that conveyed a false impression to investors about the true nature of Nathans' business, the actual state of its financial health and the risks of the investment.

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21 *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [20].

22 *R v Rada Corporation Ltd* [1990] 3 NZLR 438 (HC) at 446-447 and *R v Rada Corporation Ltd (No 2)* [1990] 3 NZLR 453 (HC) at 474.

23 *R v Moses*, above n 21, at [215].

[63] The findings in that case were of pervasive misstatements and omissions on a range of topics that were particularised by the Crown, and which contributed to an inability of readers to assess the risks of investing in the issuer.

[64] Mr Forbes also supported his submission that misleading content or omissions had to be assessed by considering the impression given by the document overall, with the nineteenth century observation by Lord Halsbury LC in *Arnison v Smith*:[24]

> This [requiring a plaintiff to establish particular reliance on a specified passage in the prospectus that was alleged to be false] is quite fallacious, it assumes that a person who reads a prospectus and determines to take shares on the faith of it can appropriate among the different parts of it the effect produced by the whole. This can rarely be done even at the time, and for a shareholder thus to analyse his mental impressions after an interval of several years, so as to say which representation in particular induced him to take shares, is a thing all but impossible. A person reading the prospectus looks at it as a whole, he thinks the undertaking is a fine commercial speculation, he sees good names attached to it, he observes other points which he thinks favourable, and on the whole he forms his conclusion. You cannot weigh the elements by ounces. It was said, and I think justly, by Sir G Jessel in *Smith v Chadwick* that if the Court sees on the face of the statement that it is of such a nature as would induce a person to enter into the contract, or would tend to induce him to do so, or that it would be part of the inducement to enter into the contract, the inference is, if he entered into the contract, that he acted on the inducement so held out, unless it is shown that he knew the facts, or that he avowedly did not rely on the statement whether he knew the facts or not.

[65] That passage addressed the distinct issue of the nature of reliance that must be made out to establish liability at common law for misstatements in a prospectus. I am not persuaded that Lord Halsbury's observations in that context justify reading the definition of untrue statements more widely than the natural and ordinary meaning of the statutory definition requires.

[66] The defendants opposed the plaintiff's approach, and argued that any allegedly misleading content or omissions had to be measured specifically in the context of the statement alleged to be misleading or, in the case of an omission, by reference to a particular statement in the prospectus that was alleged to be rendered misleading by the omission of some additional information.

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[24] *Arnison v Smith* (1889) 41 Ch D 348 at 369.

[67] The defendants' analysis relied on the wording of s 55 of the SA. "Untruth" in the statutory sense is to be made out in respect of a statement included in a prospectus if that statement is misleading in the form and context in which it is included. The defendants argued that this required a plaintiff to identify a particular statement and establish that it is misleading in the form and context of its inclusion in the prospectus.

[68] In my view, the terms of the section contemplate that the assessment is to be undertaken on a statement by statement basis. However, if the context that renders any one or more statements misleading is reflected in numerous other passages in the prospectus, then a determination of whether the statement complained of is indeed misleading would require an assessment of the sense reasonably conveyed by the impugned statement, in whatever breadth of context is relevant to its understanding.

[69] It follows that a statement that is criticised as being misleading cannot necessarily be confined to a single sentence or paragraph. The focus should be on the subject that is alleged to be misleading in the context in which that subject is addressed in the prospectus. I accept Mr Forbes' point on this, to the extent that the description of a particular topic in the prospectus (that is, the "context") may be set out at some length, and may not all be addressed at the same point in the document.

[70] However, I treat the statutory test as requiring a plaintiff to identify the passages from the prospectus that are alleged to address a material point in misleading terms. That is what the definition contemplates. In this case the plaintiff appended to the fourth amended statement of claim (4ASC) 21 extracts from the prospectus with passages highlighted as those which contained misleading statements. Some of the 21 extracts quoted passages from more than one page.[25]

[71] Given a relatively dense document of 148 pages, it would be extremely difficult to determine criticisms of misleading content or omissions without the claimant citing the particular passages that rendered the prospectus misleading on a

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[25] The largest number of extracts relative to a single criticism came from six pages of the prospectus.

given topic. The classic misleading content complained of tends to be relatively fact-specific such as:

- "the company does not and will not undertake related party lending";
- "the company has unconditional contracts to purchase all the properties involved in the proposed development"; or
- "the vessel to be used in the venture is in survey and has all requisite certificates for the work involved in the venture".

[72] Certainly, misleading content may occur in less specific contexts than these examples, but there must still be adequate definition of the misleading content to enable argument and analysis of whether there is an "untrue statement".

[73] Where allegations relate to omissions from a prospectus, the terms of s 55(a)(ii) require the identification of a particular statement within the prospectus that is rendered misleading by the omission of additional information which would be material to an understanding of that particular statement in the form and context in which the statement is included. This straightforward application of the terms of the section has been applied, for example, by Venning J in *R v Petricevic*:[26]

> Whilst s 55 extends liability to cases of omission, the omission is linked back to the statement: s 55(a)(ii). The omission relates to the statement, but it does not replace the requirement for a statement in the first place. It is not an offence to omit something from the prospectus unless that omission makes a statement in the prospectus untrue.

[74] The consequence of this structure is that a plaintiff cannot plead omissions in an abstract sense that the overall impression given by the prospectus is misleading because additional information ought to have been given. Rather, the plaintiff has to identify particular content, the sense of which is rendered misleading because of the absence of other relevant information, where the inclusion of that additional information would enable the reader to avoid being misled in respect of the point being addressed in the statement at issue.

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[26] *R v Petricevic* [2012] NZHC 665, [2012] NZCCLR 7 at [212].

[75] These provisions in the SA reflect a policy that the preparers of offer documents are to be held to account on a relatively specific basis, not at a level of abstraction that prejudices their ability to consider the criticism and respond to it. For instance, one of the more general criticisms here was that the prospectus overall gave an unjustifiably positive impression of Feltex's business and its prospects. Unless related to a specific statement or omission from an identified statement, such generalised criticisms are difficult to evaluate objectively.

[76] To the extent that the approach of Heath J in *R v Moses* suggested a more liberal evaluation of the impression given by a prospectus than that of Venning J in *R v Petricevic*, it may well be that Heath J considered it appropriate in the context of that prospectus to reflect the overall impression conveyed by the offer document as part of the context, whereas Venning J was focusing on the statement or omission that was the subject of complaint. Certainly, Heath J assessed a number of particular passages that were found to be misleading and, after doing so, it was appropriate to reflect on their combined impact.

[77] The second and third defendants emphasised that for content or omissions to be misleading, they must do more than cause a reader to be confused or uncertain. In applying the definition in s 55 of the SA, the impugned content or omissions have to be such as to lead the appropriate reader into error in understanding the topic that is being addressed.

The "prudent but non expert person"/"notional investor"

[78] When the SA was amended in 1996 to provide for investment statements as less complex offer documents, the first of two purposes of an investment statement was expressed in s 38D(a) as being to:

> Provide certain key information that is likely to assist a prudent but non-expert person to decide whether or not to subscribe for securities; …

That captured the essence of various concepts used at common law as the test for assessing whether the content of a prospectus was misleading.

[79] Proof that a particular claimant was in fact misled cannot be a sufficient basis for attributing civil liability to directors and promoters of a prospectus. Given the complexity of such documents, there are numerous circumstances in which a particular investor might be misled for idiosyncratic reasons that could not have been foreseen by those drafting the prospectus as reasonably likely to mislead.

[80] Therefore, even in the circumstances of a single claimant, the liability regime is to be applied by requiring that it was reasonable for the claimant to be misled in the respects complained of. Whether the individual claimant was materially misled by any particular misleading content or omissions will be relevant, but cannot be determinative.

[81] It follows that an objective standard is to be applied as to whether statements or omissions are misleading, namely by reference to the so-called notional investor. What attributes should that person have in the present context? This question has been considered in recent years mostly in the context of criminal prosecutions of directors of failed finance companies. Those cases involved prospectuses for debt securities. A thorough analysis was undertaken by Heath J in 2011 in *R v Moses*.[27]

[82] In a subsequent criminal trial of the same type in 2012, I adopted Heath J's interpretation with one qualification:[28]

> The Act contemplates that the audience for an investment statement is a "prudent but non-expert person". Heath J held that the target audience contemplated by the notion of a "prudent but non-expert person" is also the audience in respect of which an issuer is deemed to prepare a prospectus. Heath J described the attributes he contemplated for a "prudent but non-expert person" (he used the term "notional investor", which I will similarly adopt) as including:
>
> - The notional investor falls somewhere between one who is completely risk averse and someone who is prepared to take a high level of risk. They are expected to know that the higher the interest rate offered the greater the risk of loss.
>
> - The notional investor understands the language employed in the narrative sections of both an investment statement and a prospectus. This extends to a general understanding of technical words such as "debenture" and financial jargon, such as "rollover". As non-

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27 *R v Moses*, above n 21, at [65]–[70].

28 *R v Graham* [2012] NZHC 265, [2012] NZCCLR 6 at [25]–[26].

> experts, notional investors are expected to focus more on the narrative of offer documents than on financial statements.
>
> • Such notional investors seek assistance from financial advisers. While not expected to be financially literate, such persons are likely to have sufficient ability to comprehend competent advice about investment decisions.
>
> The only one of these characteristics attributed to a notional investor which I have reservations about is the third. Whilst Heath J pointed out that the regime permitting use of investment statements was introduced at the same time as the Investment Advisers (Disclosure) Act 1996, I would not confine the characteristics of the notional investor to those who would be guided in their consideration of investment statements by advice from investment advisers. Certainly, that may be a predictable pattern of conduct and the terms of offer documents complying with the statutory requirements urge investors to seek advice before making investment decisions. However, I would include within the range of those treated as the "notional investor" some who may not seek investment advice, despite realising that they are non-experts when it comes to weighing up investment decisions. Notwithstanding that the statutory provisions contemplate investors taking advice, I attribute to Parliament the practical recognition that a portion will not do so.

[83] Both Mr Forbes and Ms Mills in their contributions to the plaintiff's closing argument submitted that there was no material difference in the attributes of the audience for which a prospectus for shares in the IPO of a manufacturing company ought to be prepared, and the characteristics to be attributed to the audience for a finance company debt issue prospectus. They urged that there was no justification to vary the approach I had adopted in *R v Graham* contemplating a notional investor who was a non-expert but who nonetheless might not take advice before making an investment decision.[29]

[84] They submitted that the statutory purpose of the SA would not be achieved if it did not impose liability on those responsible for issuing prospectuses for content that could mislead the non-expert reader, where the risk of being misled would be eliminated by such readers obtaining assistance from an expert to understand more accurately the description of the issuing company's business. That would effectively make the test whether the prospectus was misleading to an expert reader.

[85] The attributes of the prudent but non-expert person are important in this case because the majority of the allegedly misleading content or omissions would

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[29] *R v Graham*, above n 28, at [26].

inarguably not have misled an expert reader of the prospectus. What higher standard of clarity of explanation than would be needed for expert readers was therefore required? The analysis is inevitably different from cases of classic misleading content such as the examples suggested in [71] above. Where there are such straightforward misstatements as to current facts, then readers will be misled, irrespective of the level of expertise they bring to reading the prospectus.

[86] For the first defendants, Mr Galbraith QC drew a distinction between the investment decision involved in placing money with a finance company to acquire debt securities for defined terms, and the potentially more complex evaluation of the prospects for an equity investment in an IPO of shares in a manufacturing company.

[87] For the most part, finance companies separately issued and relied predominantly on investment statements, the content of which would draw the readers' attention to the availability of a registered prospectus that the issuer had to make available upon demand. In contrast, Feltex issued a combined prospectus and investment statement, so that all readers of its offer document had the more detailed information available to them.

[88] The investment decision in relation to Feltex shares was relatively more complex than that confronting potential investors in debt securities issued by finance companies. The assessment is not simply whether the issuer is sufficiently well run to be able to pay the interest on money invested, and be able to repay the principal on a set date, mostly between 12 and 24 months later. Instead, the assessment is whether the short, medium and long-term prospects of the issuer are sufficiently promising for it to pay the anticipated level of return to owners reflected in dividend projections, and to maintain the market's perception of its value so that its share price is maintained, and hopefully enhanced. Numerous considerations and risks are likely to arise in a thorough evaluation of those prospects.

[89] Given the nature of the evaluation, the defendants attributed to the notional investor an appreciation of the extent to which he or she did not understand either the narrative or the financial tables in a prospectus, and that such persons would be

sufficiently concerned to make a good decision that they would seek advice to clarify those parts of the document that they did not understand.

[90] I am satisfied that there is a material difference between the evaluations respectively of a defined term debt investment in a finance company, and an open-ended equity investment in an IPO for a manufacturing company. An equity investment involves many more considerations bearing on the risk of not recovering the investor's capital because the realisable value of the shares at any point in the future will depend on a wide range of factors, many of them independent of the quality of the governance and management of the company in question. So, too, with the prospects of earning income, given that the level of income on a debt instrument is a matter of contractual commitment and whether investors will receive it is confined to an assessment of the adequacy of the finance company's solvency. In contrast, investors in shares are assuming a wider range of risks that could affect the timing and quantum of returns of income.

[91] Investments in the debt securities offered by the finance companies in issue in the cases of *Moses*, *Graham* and *Petricevic* would routinely be made by investors completing the application form accompanying an investment statement or prospectus, and posting it off to the issuer. In contrast, those investing in shares issued in an IPO are likely to do so as part of investing in equities for which there is an on-going market, access to which is via brokers. That difference suggests another reason why it is less likely that investors in the Feltex IPO would have decided to subscribe for the shares without the benefit of any advice. It appears that those subscribing directly for shares in the IPO may have been as small as 1.7 per cent.[30]

[92] The first of the attributes of the prudent but non-expert person identified by Heath J in *R v Moses*, as paraphrased at [82] above, illustrates the differences that need to be recognised. That attribute reflected on the interest rate offered by the issuer as a measure of the level of risk that the investor would be assuming. That contemplates, for example, that the prudent but non-expert reader of a finance company prospectus will compare the interest rate offered on the debt securities to, say, government stock or bank bonds, or rates offered by other finance companies.

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[30] See allocation schedule, CB16 011519.

Potential investors in shares in a manufacturing company IPO would not be in a position to make such relatively simple comparisons.

[93] I adhere to the view that Parliament did recognise the prospect that some prudent but non-expert investors would make decisions after considering a prospectus without taking advice. However, the more complex any prudent evaluation of an investment decision would need to be, the less scope exists to measure misleading content for prudent non-expert readers on the assumption that they do not get any advice. If an assessment of the prospects for an issuer is inevitably complex and technical, then it may well be *im*prudent for a non-expert to decide to invest on an incomplete understanding of matters material to the investment decision.

[94] Mr Rob Cameron, a Wellington investment banker, called to give expert evidence on behalf of the directors, suggested during his cross-examination that retail investors do not understand the detail of prospectuses.[31] Mr Cameron was reflecting his work as chairman of the government-appointed Task Force on New Zealand Capital Markets, which reported in December 2009. He suggested that, 10 years after the Feltex prospectus, regulators and government are still striving for the most appropriate format to be required of promoters that is sufficiently informative to enable adequately informed decisions, but in a form that is understandable to retail investors who do not have the skills of sophisticated investors or financial analysts.

[95] I accept that there is a category of potential investors who are intelligent and careful readers of a prospectus, but who lack the skills to understand financial detail, and to analyse for themselves the range of relevant signals arising from the financial data provided.

[96] I also accept that there are some retail investors who decide to invest on relatively cursory or impressionistic assessments of offer documents. Others invest without looking at the prospectus, for instance because they rely on a recommendation from a friend who is a retail investor whose judgement they

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[31] NoE at 2419–2424.

respect. In addition, a significant portion will invest in reliance on a broker's recommendation. That was the case with Mr Houghton. It is to be hoped that brokers' recommendations are only made after a competent analysis of all the detail in the prospectus, so that a commentary on it is provided with any recommendation.

[97] It is not appropriate to test the content of a prospectus as it would appear to cursory or careless readers. To do so would impose on those responsible for the prospectus an obligation to make disclosure on an extensive range of complex business matters, and to explain their relevance, to an unrealistic level of simplicity. Nor can it be expected that the content will be "dumbed down" to avoid the risk of more complicated content being misunderstood by less sophisticated readers. The prospectus also has to be addressed to sophisticated readers who expect the more complicated content to aid their analysis of the issuer's prospects.

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

[99] This notional investor will, for the most part, recognise the content of the prospectus that he or she does not understand. To the extent that passages not understood are perceived as material to his or her decision, then prudently he or she will not invest in the company before seeking clarification on the meaning of such passages.[32]

[100] I have to allow for exceptions where a prudent, non-expert investor reasonably does not appreciate that he or she does not understand particular misleading content, and proceeds in reliance on that misunderstanding. Such

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[32] Compare with *R v Petricevic*, above n 26, at [226] to the same effect.

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

[101] I am satisfied that applying these attributes to the notional investor does not protect those responsible for issuing prospectuses in a manner that undermines the statutory purpose of requiring adequate and accurate disclosure. The approach is positioned where the terms of the SA, in light of previous decisions about its application, draw the line. It involves a balance between, on the one hand, holding the issuer of a prospectus to account for content that would materially mislead prudent, non-expert readers of the prospectus, and, on the other hand, transforming the civil liability regime under the SA into a warranty enabling recovery of losses for investors who could subsequently claim they were misled, irrespective of the idiosyncrasies or inadequacies in their understanding of the document.

Level of reliance required to trigger liability

[102] The statutory liability as provided in the SA at the time of the Feltex prospectus was in the following terms:

> **56 Civil liability for misstatements in advertisement or registered prospectus**
>
> (1) Subject to the provisions of this section, the following persons shall be liable to pay compensation to all persons who subscribe for any securities on the faith of an advertisement or registered prospectus which contains any untrue statement for the loss or damage they may have sustained by reason of such untrue statement, that is to say:
>
> …
>
> (c) In the case of a registered prospectus, every person who has signed the prospectus as a director of the issuer or on whose behalf the prospectus has been so signed, or who has authorised himself or herself to be named and is named in the prospectus as a director of the issuer or has agreed to

become a director either immediately or after an interval of time:

(d) Every promoter of the securities.

…

[103] The plaintiff argued that a claimant did not have to establish reliance on the specific content of the prospectus that was found to be misleading. Rather, subscribing for securities "on the faith of" a prospectus contemplated no more than investing in the knowledge that a prospectus existed. This has been referred to as indirect reliance, or per se reliance on the existence of the prospectus. Alternatively, the plaintiff argued that it would be sufficient for a claimant to establish that they relied on the prospectus as a whole.

[104] In an early interlocutory appeal, the Court of Appeal recognised the prospect that "… on the faith of a prospectus" may refer to reliance generally on the prospectus, rather than on specific passages.[33] The test was not before the Court, and the point was not fully argued. Mr Forbes also invoked the practical observations of Lord Halsbury from the decision in *Arnison* that I have set out at [64] above, to argue how unrealistic it would be to require individual claimants to reconstruct the features of a prospectus on which they relied, in the subsequent context of a claim for losses flowing from reliance on a misleading prospectus.

[105] The plaintiff also cited the commentary in *Company and Securities Law in New Zealand*, to the effect that the requirement for investment "on the faith of" a prospectus is broader than requiring reliance on the very statement, which was characterised as being consistent with the investor protection purpose of the SA.[34] That commentary also observes that the investor must have relied on the prospectus, rather than on the system of prospectuses.

[106] The defendants' argument that the elements of the cause of action require a claimant to make out specific reliance on particular misleading content or omissions started with the terms of s 56(1). Liability depends on the claimant having

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33 *Saunders v Houghton* [2010] 3 NZLR 331 (CA) at [85].

34 John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Brookers, Wellington 2013) at [34.6(1)(d)].

subscribed for securities "*on the faith of* … [a] registered prospectus which contains any untrue statement for the loss or damage they may have sustained *by reason of such untrue statement* …". The defendants treated "on the faith of" as a synonym for "in reliance on", and argued that the reliance had to be specifically upon the untrue statement because the section requires a claimant to establish that the loss claimed is by reason of that misleading content or omission.

[107] The defendants relied on the Court of Appeal decision in *Boyd Knight v Purdue*.[35] That was a representative action by investors in a failed finance company against the auditors responsible for an allegedly negligent audit report in the company's prospectus. The investors did not read or rely on the financial statements to which the report related. They argued that reliance on the existence of the report was sufficient. The Court held that:[36]

> … it would be exceeding the statutory scheme if the Court were to find auditors responsible for inaccuracies in information which was not utilised by an investor.

[108] The Court said further that:[37]

> … a plaintiff investor must … show reliance on a particular item or items in the financial statements which were inaccurate. … For, if the inaccurate material was not an influence on the investor, how can it be alleged that the investor would not have gone ahead with the investment.

[109] Although the auditors' impugned conduct arose in discharging a duty imposed under the SA, the context for assessing reliance as an element of the cause of action was the tortious one of negligent misstatement. That classically requires specific reliance as an element of the cause of action. Further, the confined responsibility of an auditor in certifying financial statements as one component of a prospectus cannot be likened to the responsibility imposed on directors and promoters for the adequacy and accuracy of the whole prospectus. The Court of Appeal also rejected the analogy with auditors' possible liability in an interlocutory appeal in this case.[38]

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35 *Boyd Knight v Purdue* [1999] 2 NZLR 278 (CA).
36 At [55].
37 At [56].
38 *Saunders v Houghton*, above n 33, at [87].

[110] The defendants also cited a number of statements in law reform work on this aspect of securities law, that tended to suggest civil liability under s 56 did require the claimant to establish reliance on a prospectus, and within it on any untrue statement, when subscribing for the securities.[39] In terms of most recent parliamentary consideration of this point, the defendants cited the explanatory note to the Financial Markets Conduct Bill 2011, which introduced a different notion in terms of reliance on defective disclosure. The explanatory note observed that under the SA it was difficult for an investor to obtain compensation due to "the need for each investor to prove actual reliance on the misstatement that caused the loss".[40]

[111] The defendants also cited three Australian decisions for the proposition that liability for a misstatement in a prospectus or equivalent document should only arise if the claimant is able to establish reliance on the impugned content.[41] The factual circumstances in each of those proceedings were relatively complex, and the statutory provisions creating liability are not on the same terms as s 56. The debate in those cases centred on whether indirect reliance was sufficient. That was because the evidence was that the respective plaintiffs either did not read or barely read the information that they alleged was misleading. Therefore whether or not the content was misleading would not have made a difference to their investment decision.

[112] In *Woodcroft-Brown* the plaintiff met with his financial adviser for an hour and a quarter to discuss three different investment schemes. There were several hundred pages of material. In a second meeting he considered five different schemes over the course of two hours. The Judge found that the review of the documents was no more than a perfunctory glance, if that. Further, the evidence showed that the plaintiff was primarily motivated by the desire to obtain a tax deduction so the content of the prospectus did not induce the decision to invest.

[113] In *Digi-Tech* the investors did not rely on the conduct alleged to be misleading in their decision to invest. The plaintiff argued that this conduct caused

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39 These included Investment Product and Advisor (Disclosure) Bill 1995 (138-2) (Select Committee Report) at vi.

40 Financial Markets Conduct Bill 2011 (342-1) (explanatory note) at 6.

41 *Digi-Tech (Australia) Pty Ltd v Brand* [2004] NSWCA 58; *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* [2008] NSWCA 206, (2008) 73 NSWLR 653 and *Woodcroft-Brown v Timbercorp Securities Ltd* (2011) 253 FLR 240.

another person to act in a way that caused the investors loss. In *Ingot Investments* it was unsuccessfully argued that reliance on the existence of the product disclosure statements alone was sufficient.

[114] Accordingly, the debate was whether the plaintiff needed to show reliance at all on the misleading conduct or misleading prospectus (and the information it contained). The primary concern of the Court in *Digi-Tech* and *Ingot Investments* was thus that the plaintiff's approach would enable an investor to succeed even though he or she knew the truth of the misrepresentation or was indifferent to the subject matter.

[115] I am not satisfied that the Australian decisions cited by the defendants are authority for the proposition that a plaintiff must make out specific reliance on particular content or an omission where the statute contemplates investment "on the faith of" a prospectus with misleading content. I do not consider that to be the equivalent of "reliance on" the impugned content of a prospectus.

[116] Although the expression "on the faith of" may be seen as imprecise, I consider that it was used to connote a less direct connection than reliance on specific aspects of misleading content or omission. It is a long-standing expression used in cases and statutes to reflect the link between the content of a prospectus, and potentially misled readers of the document.[42] In imposing a form of civil liability as part of the statutory regime regulating the issuance of securities, the legislative purpose was to impose liability on those accepting responsibility for a prospectus, in respect of losses suffered by those who invested in the offer, on the faith of the prospectus. There also has to be a nexus between the loss sustained and the untrue statement, but not to an extent that requires the claimant to prove reliance directly on the untrue statement.

[117] Despite the focus on specific reliance in parliamentary materials, I do not treat the requirement that an investment had been made "on the faith of" a registered prospectus as requiring the same reliance on particular passages as arises, for

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[42] Companies Act 1867, s 38; *Shepheard v Broome* [1904] AC 342 (HL); *Macleay v Tait* [1906] AC 24 (HL); *Arnison v Smith*, above n 24, Promoters' and Directors' Liability Act 1891, s 3; Companies Act 1955, s 53.

example, in a tortious claim for reliance on a negligent misstatement. Had the legislature intended that closeness of connection, then the link between the prospectus and the investor's decision to invest would instead have been expressed in terms of reliance on the content found to be misleading.

[118] I consider that the legislative intention was to create liability in respect of misleading content or omissions where that content materially contributed to a claimant's decision to invest. The untrue statement or statements must be sufficiently material that, if corrected, it would then have been more likely than not that the investment would not have been made. That proposition assumes that the claimant makes out reliance on the prospectus in general, and that his or her assessment of the risks of investment would more likely than not have been reversed if the untrue statement or statements were corrected. It also involves rejection of the plaintiff's broader claim that indirect reliance, merely on the existence of a prospectus, would be sufficient.

[119] In arguing for a more direct level of reliance being required of claimants, the defendants urged the benefits of consistency with jurisprudence under the FTA and in the tort of negligent misstatement. Liability under the FTA requires that a plaintiff prove that he or she was actually misled or deceived by the impugned conduct.[43] In negligent misstatement, a claimant has to make out actual reliance on the misstatement complained of as an element of the cause of action.[44] The rationale for those causes of action involves a specific link between misleading or negligent conduct, and the loss suffered by a claimant.

[120] I am mindful that the test for "on the faith of" that I have proposed could attribute liability under the SA on a lesser standard of reliance than would be required under these other causes of action. I am satisfied that the statutory context justifies any practical difference that arises. The standard ought to reflect the reality of how investment decisions are likely to be made by potential investors. Since at least the observations of Lord Halsbury in *Arnison*, the courts have acknowledged

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43 *Red Eagle Corp Ltd v Ellis*[2010] NZSC 20, [2010] 2 NZLR 492 at [27]–[29].

44 *Body Corporate No 207624 v North Shore City Council* [2012] NZSC 83, [2013] 2 NZLR 297 at [199].

that evaluative processes by investors are likely to involve a range of factors so that particular reliance on one component as being determinative is unrealistic.

Expressions of opinion, including prospective financial information

[121] Statements of existing fact in a prospectus can readily be tested for their accuracy. If the state of affairs existing at the time of a representation is consistent with the statement, then it was true. Conversely, if a statement of existing fact is materially at odds with the relevant state of affairs, then it will be untrue. Different considerations are required if the statement in issue addresses an expectation of what is to occur in the future, and can therefore only be a matter of opinion.

[122] The plaintiff's closing submissions cited academic commentary which describes the inclusion of forecast financial information in a prospectus as "perplexing", recognising that such information is inherently speculative and potentially easily manipulated.[45]

[123] The defendants argued that in assessing all expressions of opinion in the prospectus, including prospective financial information, the Court should test whether the makers of the statement believed that it was accurate at the time, and had reasonable grounds for such belief. If they did, then the opinion as to future events could not be "untrue", however differently the matter subsequently played out.

[124] The defendants invited analogy with the approach adopted under the FTA, such as where the vendor of a business had made representations as to sustainable prospects for the business, as was considered by the Court of Appeal in *David v TFAC Ltd*.[46] In that context, the Court observed:[47]

> … the expression of an opinion that subsequently turns out to be incorrect does not, of itself, give rise to liability for misleading or deceptive conduct under s 9. However, the expression of an opinion involves at least one and perhaps two representations of fact. The first is that the person expressing the opinion honestly holds it, and the second is (in some cases at least) that he or she has a reasonable basis for the opinion.

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45 *Company and Securities Law in New Zealand*, above n 34, at [34.4.3].

46 *David v TFAC Ltd* [2009] NZCA 44, [2009] 3 NZLR 239.

47 At [43], citing the Court of Appeal's own earlier decision in *Premium Real Estate Ltd v Stevens* [2008] NZCA 82, [2009] 1 NZLR 148.

[125] To similar effect were the observations of Thorp J in *Jagwar Holdings Ltd v Julian*:[48]

> It has frequently been held that liability for representations about future events should only be imposed if they were not made in good faith, or if it is shown that there were no grounds on which they could reasonably have been made … The principles established by those authorities must in my view apply to any assessment of the obligation of the directors in respect of forecasts, either of earnings or future asset positions. Their effect must be to cast upon the plaintiffs the obligation of establishing not just that the forecasts were inaccurate or inadequately prepared, but that they were made either in bad faith or without any reasonable grounds.

[126] In the present context, the test for impugned statements that comprised opinions as to what was to occur in the future is whether the directors had reasonable grounds for forming the opinions they did. Although Mr Forbes did not abandon the additional requirement that the directors establish that they honestly believed the expressions of opinion they provided, in reality the directors' bona fides on the opinions expressed was never challenged.

Plaintiff's evidence

[127] I found Mr Houghton to be an intelligent lay person. He did not acknowledge any qualifications in relation to accounting or financial markets. He had been a client of ForBar for some time in May 2004, and had made a number of investment decisions subject to recommendations from ForBar in the past. Mr Houghton received a copy of the prospectus, and read at least parts of it. He and his family had had a recent positive experience as buyers of Feltex carpet, and that was one factor triggering his interest in the IPO.

[128] Unsurprisingly, Mr Houghton was not able to be precise in his recollection of the pages of the prospectus he had read 10 years after it was issued.

[129] In a pre-trial judgment on 19 July 2013, I declined the plaintiff's application to expand the issues for determination at this first stage of the trial to include the claim of an additional plaintiff, Hunter Hall.[49] Hunter Hall is a fund manager based in England and Australia that was the largest institutional subscriber for shares in the

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[48] *Jagwar Holdings Ltd v Julian* (1992) 6 NZCLC 68,040 (HC) at 68,077 (citations omitted).
[49] *Houghton v Saunders* [2013] NZHC 1824 at [131]–[148].

IPO. Given the extent to which a determination of their claim would have altered the scope of the present hearing, I upheld objections to it being included at the late stage it was sought.

[130] However, I allowed the plaintiff to call evidence from Mr Peter Hall, the relevant director of Hunter Hall.[50] His experience as an expert institutional investor in assessing the prospectus was potentially relevant at least in providing a contrast when determining Mr Houghton's claim as a presumptively prudent but non-expert investor, in dealing with the parts of the prospectus that were alleged to contain misleading content or omissions.

[131] Mr Hall gave evidence via audio-visual link from London. His rationale for investing in the IPO included relevant understandings he gleaned during a presentation from Mr Magill, who accompanied a ForBar representative on a visit to London to promote the institutional book build aspect of the IPO. Mr Hall certainly read the prospectus, but did not claim to have relied solely on it. His evidence demonstrated an expertise in analysing the content of such documents that clearly distinguished him from a non-expert reader of the prospectus.

[132] Some of the plaintiff's criticisms related to statements in the prospectus to the effect that Feltex had strong relationships with its customers. In support of these criticisms, the plaintiff called two experienced carpet retailers who described unsatisfactory experiences with the relative unreliability of Feltex's invoicing for carpet supplied to their companies and, at least in one case, adverse comparisons on other aspects of the service Feltex provided to large-scale carpet retailers. This evidence included that of a practice by Feltex of forward dating invoices to the extent that goods dispatched by Feltex in the last days of a month would be charged to the customer by way of an invoice dated the first day of the following month. Such invoices were then included in the statement of account with Feltex for the existing month (for example, the statement to 30 November included invoices dated 1 December). Feltex only required payment of such forward dated invoices as if they were issued in the month they were dated, despite their being included in the statement of account for the previous month.

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[50] *Houghton v Saunders* [2014] NZHC 423.

[133] The first of these two witnesses was Mr Terrence Harrison of Auckland, who is a director of Carpet One New Zealand Limited and also Harrisons at Home Limited. Both companies are, or were at times relevant to these proceedings, in business as retailers of carpet. Carpet One operated via franchisees throughout New Zealand. The New Zealand Carpet One company was also a shareholder in Carpet One Australia Pty Limited, which is a significant carpet retailing group in Australia. Mr Harrison expressed a range of opinions drawing on his own experience as a director of a carpet reselling business that bought from a range of manufacturers including Feltex and its competitors, as well as drawing on general carpet industry knowledge acquired by him over a long period in the industry.

[134] I upheld a number of objections to opinions Mr Harrison intended to proffer that were beyond his areas of expertise, such as the relative efficiency of carpet manufacturing machines. Mr Harrison's brief had him opining on that in reliance on occasional observations as a visitor to plants operated by Feltex and competitors. I also upheld objections to evidence that would have relied on hearsay sources.[51]

[135] Addressing topics on which Mr Harrison was qualified to express opinions, he rated Feltex as much worse, or materially worse, than its competitors in terms of product availability, the promptness of response to orders and the reliability of Feltex's invoicing for products sold to Mr Harrison's companies. His companies did not ask for forward dated invoices, and were apparently required to undertake extra work in reconciling the statements received.

[136] Mr Harrison purported to speak of the experience of Australian customers of Feltex as well, on the basis of his New Zealand company's shareholding in the Australian Carpet One entity. Mr Harrison's knowledge of the experience of Australian customers of Feltex was at a level removed from those able to make a first-hand assessment of the nature of Feltex's dealings with its major Australian customers.

[137] The second such witness was Mr Stephen Pearce, who gave evidence from his perspective as the financial controller of Hills Floorings Limited. Hills Floorings

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[51] *Houghton v Saunders*, above n 50, at [31] to [39] and Ruling No 3, 1 April 2014.

operated in commercial and residential arms, each having different terms of trade with Feltex at the relevant time. Mr Pearce was critical of Feltex's practice of forward dating invoices, and Feltex was perceived by Mr Pearce to be difficult to deal with in relation to queries over carpet deliveries or invoices. He rated Feltex worse in these respects than their competitors, Cavalier and Godfrey Hirst.

[138] Mr Pearce observed the practice of forward dating invoices to be used more frequently and for larger amounts during 2004. Feltex's practice of forward dating invoices caused extra work for his company's accounting staff.

[139] Another criticism of the prospectus was that it misleadingly failed to acknowledge the true nature and extent of the risk posed for Feltex's Australian business by the prospect of increased competition from imported carpets, and reductions in certain Australian Government incentives under a Strategic Investment Program (SIP grants), which subsidised capital expenditure on innovations, inter alia, for carpet manufacture. The on-going level of tariffs imposed on imported carpet, and the nature and extent of government financial support for local manufacture, were the subject of an inquiry by the Australian Productivity Commission (APC) in 2003. The plaintiff's criticisms relied on an alleged disparity between the supposedly dire consequences of such changes claimed on behalf of Feltex in submissions to the APC, and the relatively muted recognition in the prospectus of the risk of increased imports caused by reduced tariffs and reduced financial support from the Australian Government.

[140] On this aspect of the case, the plaintiff called Mr Alan Coleman to offer both fact and opinion evidence from his perspective as a senior Australian civil servant who provided input into the work of the APC, and monitored submissions made to it, including those by the Australian carpet industry body and Feltex Australia.

[141] A further criticism of the prospectus related to what the plaintiff characterised as misleading claims that Feltex had adopted "lean manufacturing" techniques. From 1999 or 2000 until 2003, Shaw and (once Shaw had been acquired by Feltex) Feltex, consulted Dr John Blakemore, a scientist with expertise in the efficiency of the manufacture and marketing of processed goods. Dr Blakemore had

recommended a range of innovations, mostly for Feltex's Australian manufacturing operations. Dr Blakemore described these innovations as lean manufacturing techniques.

[142] Dr Blakemore was called on behalf of the plaintiff to give a mixture of fact and opinion evidence. He acknowledged a testy relationship with senior management, in particular Mr Magill, and his consultancy at Feltex ended some time between February and mid 2003, in circumstances where Dr Blakemore considered there was still further work to do in implementing improvements in efficiency. Dr Blakemore considered that Feltex desisted from the lean manufacturing innovations after his consultancy came to an end.

[143] There was a substantial volume of evidence about Feltex accounting data that had been retrieved on behalf of the plaintiff. In 2012, the plaintiff's advisers negotiated with Godfrey Hirst, the company that had bought the assets of Feltex, to gain access to accounting data stored in electronic form and physically located in Melbourne. The data was stored in a form of software called Global System Manager (GSM) that was no longer being used. The plaintiff's advisers retained a Melbourne information technology (IT) expert, Mr Andrew Harper, because of his familiarity with GSM software. The integrity of the process by which Mr Harper retrieved the accounting data, and the accuracy of the accounting reports he produced for analysis by other experts retained by the plaintiff, was challenged by the defendants. Mr Harper gave evidence of the processes he followed, and how he rationalised discrepancies that were identified when an IT specialist retained for the defendants could not replicate the reports as Mr Harper had produced them.

[144] Briefs were also served on behalf of the plaintiff from two other potential witnesses, Messrs Mark Walter and Michael Davies, that described the chain of custody of the GSM data, from its original retrieval in GSM form, to its physical delivery to Mr Harper. Mr Walter is with Melbourne lawyers, Slater & Gordon, who attended to discovery issues on behalf of the plaintiff that arose in Australia. He had dealt with Mr Davies who was then employed in an IT role at Feltex, under the company's then ownership by Godfrey Hirst. Neither of those witnesses was

required for cross-examination, and their briefs were admitted on the basis that they were to be taken as read.

[145] In addition, the plaintiff called five expert witnesses. Three were accounting experts. The first, Professor Susan Newberry, is a New Zealander who is currently a professor of accounting at the University of Sydney. The second, Professor Alan Robb, is also a New Zealander who provides consultancy services in New Zealand, having formerly been a professor of accounting at Canterbury University. He is currently a professor at the University of Nova Scotia. Both those professors gave expert accounting evidence in relation to the adequacy and accuracy of how various aspects of Feltex's financial data were represented in the prospectus.

[146] The third accounting witness was Mr Greg Meredith, a partner in the Melbourne office of chartered accountants, Ferrier Hodgson. Mr Meredith also commented critically on what he saw as misleading content of the accounting data provided in the prospectus.

[147] The plaintiff also called Mr Brian Russell, a senior sharebroker who also had experience as an investment analyst. Mr Russell has many years' experience as a sharebroker, currently in a small sharebroking firm in Sydney. He provided opinion evidence as to certain aspects of the prospectus which, in his view, provided less than adequate disclosure, or were misleading for non-expert investors considering it.

[148] The plaintiff also called evidence from Mr Arthur Lim, an investment analyst and former sharebroker. Mr Lim was involved in a relatively senior role at Macquarie Equities New Zealand Limited (Macquarie) at the time of the IPO, but I upheld defendant objections to his providing evidence of Macquarie's involvement in the IPO because of the late service of his brief and the absence of any disclosure of Macquarie documents. Mr Lim gave opinion evidence as to the aspects of the prospectus which he considered to be misleading.

[149] The defendants mounted robust challenges to the reliability, and in some cases the admissibility, of the opinion evidence offered by a number of the plaintiff's expert witnesses. Professor Newberry was challenged in relation to the views

expressed in an article that she wrote, which appeared in a publication called Foreign Control Watchdog in 2007. That publication was issued by the Campaign Against Foreign Control of Aotearoa, and Professor Newberry acknowledged being a periodic contributor to it. Her article made trenchant criticisms of the conduct of many of those involved in the collapse of Feltex, including in terms comparing it to the collapse of the United States company, Enron, which involved convictions of senior executives and directors for breaches of securities trading laws and insider trading.

[150] That expression of strong personal views was made many years before Professor Newberry was retained on behalf of the plaintiff. She was taken to the article and did not resile from any of the views expressed in it. The defendants suggested that the commitment of strongly expressed personal views in these circumstances raised a question over the ability of Professor Newberry to be sufficiently objective to provide substantial help to the Court on the matters on which she was qualified to express opinions.

[151] Despite the polemical tone of her earlier expression of views, and a marked reluctance to make concessions when objective application of her expertise might have been expected to produce a moderating of her views, I was not persuaded to discount the opinions that Professor Newberry expressed on matters within her area of expertise.

[152] There was also a thorough challenge to Mr Lim. This raised the circumstances in which he left Macquarie, involving disciplinary proceedings brought against Mr Lim by the NZX. He was also challenged on the basis that his subsequent experience was more in the area of fringe financial services rather than sharebroking or investment banking work. In addition, Mr Lim was challenged on the basis of his having been briefed only very late, after witnesses' briefs were already due, in circumstances where he depended on others to have prepared very substantial parts of the brief for him.

[153] It was unnecessary to rule on the admissibility of all of Mr Lim's evidence, but in certain respects, the points elicited in cross-examination on these criticisms do adversely affect the weight that could be given to the opinions he expressed.

[154] There were also criticisms made of Mr Russell, in terms of the inadequacy of information assessed by him when he had not considered any of the evidence for the defendants but advanced criticisms that ought to have taken their explanations into account.

Defendants' evidence

[155] Each of the directors gave evidence as to his or her involvement in the preparation of the prospectus. Mr Thomas had been Credit Suisse's representative on the Board, and his evidence reflected that perspective. He and Mr Saunders, the Chairman, were directors on the DDC, together with Mr Magill, the only executive director.

[156] The directors also called extensive evidence from Mr Des Tolan, who was Feltex's CFO at the time of the IPO, and from Mr Andrew Tootell, who had responsibilities for reviewing the manner of Feltex's manufacturing processes.

[157] Decisions on matters relevant to the sale by Credit Suisse were primarily made by Mr Ron Millard, who subsequently resigned from Credit Suisse and who gave evidence by way of audio visual link from Houston, Texas. Evidence was also called for the second and third defendants from Mr Rob Stewart, who was the managing director and CEO of Credit Suisse Australia. He contributed to Mr Millard's decision-making on behalf of the vendor. Credit Suisse also called an IT expert, Mr Richard Farley, who was retained to analyse the GSM data and who raised concerns with Mr Harper as to the integrity of that data.

[158] The first to third defendants called Professor Tony van Zijl of Victoria University to respond to the opinions expressed by Professors Newberry and Robb as to whether the financial data reproduced in the prospectus complied with relevant accounting standards. Professor van Zijl also expressed opinions on the adequacy of disclosure of various accounting details on the prospectus.

[159] The first to third defendants also called a Wellington investment banker, Mr Rob Cameron, who provided opinion evidence as to the adequacy of the process adopted for vetting the content of the prospectus, and the standard generally evident in prospectuses of this type. The first to third defendants also jointly called Professor Bradford Cornell, a visiting professor at California Institute of Technology. He opined on the extent, if any, to which recoverable loss had been suffered by the plaintiff. Mr Cameron endorsed, from his New Zealand experience, the analysis undertaken by Professor Cornell.

[160] FNZC called Mr Martin Stearne, a director of investment banking, who was the person from FNZC principally involved in contributing to the terms of the prospectus, and in the marketing of shares by FNZC as one of the JLMs. FNZC also called its managing director, Mr Rob Hamilton, who had overall responsibility for his firm's involvement in the IPO.

[161] ForBar called Mr Ross Mear who was, at the time, its head of investment banking. Mr Mear had extensive experience as a lead manager and adviser in relation to IPOs for both debt and equity raising. He was the person principally involved on behalf of ForBar in settling the terms of the prospectus and other aspects of the IPO process. ForBar also called its managing director, Mr Neil Paviour-Smith, who had overall responsibility for ForBar's involvement as a JLM.

[162] ForBar also called Mr Darren Manning, who manages ForBar's institutional equities and fixed interest practice. It was Mr Manning who escorted Feltex representatives on a so-called "road show", making presentations to potential institutional investors in Australia and in London. Mr Manning was the representative of the JLMs at the meeting in London with Mr Peter Hall of Hunter Hall.

Analysis of the criticisms

[163] I now turn to analyse the various criticisms under the groupings foreshadowed at [49] above.

A Undisclosed adverse trends in current trading

Adverse trend in gross sales revenue, and volume of sales

[164] For management purposes, Feltex had created a budget before or near the beginning of the 2004 financial year that included predictions of the amounts for sales revenue, volumes of carpet sold, and the major components of its operating expenses. That budget was set ambitiously, in part to incentivise greater productivity.

[165] Feltex's financial year ran from 1 July to 30 June in each year. When the forecast for FY2004 was settled in late April 2004, the directors and the DDC had available to them a form of management accounts showing the results of trading to the end of March 2004. At a Board meeting on 27 April 2004, the directors were also warned that April would be a difficult month, but that the shortfall was expected to be picked up in May and June.[52]

[166] In preparing the financial data for inclusion in the prospectus, a forecast for sales revenue was adopted that was modestly less than the earlier budget for the remaining months of FY2004. The prospectus stated that the forecast relied on actual results for the first nine months, and that it was prepared as at 5 May 2004. The amount included in the FY2004 forecast for total operating revenue was $335,498,000. The operating revenue subsequently achieved was $7,743,000 less than that.

[167] By the time of the "bring down due diligence" consideration when the offer closed on 2 June 2004, the DDC and the Board were on notice that revenue for the full year was likely to be short of the forecast that had been adopted by between $7.5 and $9 million. The plaintiff argued that because the prospect of a material deficiency in operating revenue was present by the end of April, and also because of the high importance of achieving the forecast revenue, the directors ought to have been alert to the need to obtain and take into account data that was entirely up to

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[52] BP5 003828.

date. It was argued that Messrs Magill and Tolan would have had daily flash reports available to them, and that the other directors could have called for such data.[53]

[168] The directors responded to this criticism on the basis of the data that had been provided to them. They deflected criticism that they ought to have demanded more up to date data before it was prepared for them in the usual cycle of management reports by disputing the importance that the plaintiff attributed to the level of operating revenue.

[169] The plaintiff argued that the extent by which sales revenue was predicted to fall short of the forecast amount, as apprehended when the prospectus was settled, should have been disclosed in the prospectus. An alternative formulation of this criticism is that the directors should have revised the forecast sales revenue to reflect their most accurate prediction when the prospectus was settled. The plaintiff advanced his criticisms of the variances on sales revenue, and volumes of carpet sold, separately. The argument attributed importance to both variances as signalling deteriorating trends in Feltex's trading position. Having assessed their impact separately, I am able to address the two criticisms together.

[170] One of the assumptions relative to the revenue included in the FY2004 forecast was in the following terms:[54]

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

[171] Both Professors Robb and Newberry disputed that Feltex's recent trading history afforded the directors any reasonable basis for assuming the level of revenue required in the fourth quarter to achieve the forecast for FY2004. By deducting the actual results for the first nine months, Professor Robb calculated that sales revenue of some $91,618,000 was required in the fourth quarter, and that that would amount to a 12.75 per cent increase on the sales revenue for the fourth quarter of the 2003

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53 Mr Tolan acknowledged having daily sales reports (NoE at 1564). The passage in the evidence cited in the plaintiff's closing submissions for Mr Magill accepting he got daily sales reports (NoE at 1940) did not confirm that point.

54 Prospectus at 89.

financial year (FY2003). He opined that such a level of increase was not justified when a comparison of the sales revenues for the first nine months in FY2003 as against FY2004 showed that there had only been an increase of 2.39 per cent for the first three quarters of that year.[55]

[172] Professor Newberry calculated that the level of forecast sales for the final three months of FY2004 would require an increase of 14.7 per cent over the average monthly sales reported in the first nine months of the year.[56]

[173] It was common ground that there was a pattern of fluctuations in Feltex's revenue generation throughout the year, with the second quarter (September-December) and then the fourth quarter (March-June) generally being recognised as the most successful.[57]

[174] Mr Forbes cited observations by Mr Tolan in his due diligence interview on 2 April 2004 as drawing to the attention of the DDC the unsatisfactory performance on the volume of sales and level of sales revenue. Mr Tolan is noted as observing:[58]

> - Volume is the biggest driver - generally will achieve budget if have sufficient volume.
>
> - However, recent volumes have been static or slightly down and growth in revenue has been from changes in product mix as Feltex seeks to move customers up the value chain.
>
> ...
>
> - … actual revenues for financial year 2004 are A$17.9 million below budgeted revenues, but A$4.1 million ahead of the comparable number for financial year 2003. A slow January/February contributed to this shortfall in revenue. However, March was a very good month.

[175] The plaintiff argued that performance relative to the forecast in terms of volume of sales and the level of sales revenue were sufficiently important to require separate consideration and to be accurately disclosed in the prospectus. In terms of management reporting, the volume of sales and sales revenue were the first and

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55 Robb BoE at [35].
56 Newberry BoE at [72].
57 For example, Tolan NoE 1649/8–11.
58 DD1 000222.

implicitly important items routinely reported on. Achieving anticipated levels of sales would always be critical in achieving projected financial outcomes. Mr Forbes relied on the first of the comments from Mr Tolan quoted in [174] above.

[176] Mr Forbes argued that an anticipated failure to meet the forecast sales revenue to 30 June 2004 would have been important to readers of the prospectus for a number of reasons. First, it would signal that the forecast performance for FY2004 may not be achieved. Secondly, it would cast doubt on the reliability of the assumptions used, or the method for producing the forecast, given that those preparing it had actual figures for the first nine months of the 12 month period. Thirdly, readers were likely to treat the projection for FY2005 as being based on, or at least influenced by, the forecast for FY2004 and a doubt about the reliability of the forecast would also send a cautionary signal as to the reliability of the projection for the following year. Fourthly, it would enable readers of the prospectus to assess the reliability of positive claims about Feltex that were made in the prospectus, from a better informed perspective.

[177] In addition, Mr Forbes argued that the way the analysis of Feltex's prospects was structured in the prospectus both explicitly and implicitly rated the extent of sales revenue as an important criterion. Mr Forbes argued that that importance was further heightened by Feltex's sensitivity to high break-even costs. He cited an acknowledgement by Mr Magill in cross-examination to the effect that if Feltex did not achieve sufficient sales revenue, then because of the high break-even costs it would obviously go into losses. Mr Magill acknowledged that he had explained this point to brokers and in institutional presentations prior to the IPO.[59] The point can therefore be seen as having some importance, at least to analysts.

[178] The defendants criticised the plaintiff for "cherry picking" parts of only one feature of the management reports. They argued that, when assessed overall, the data available to the directors at the time the prospectus was being drafted did not create any cause for concern that the forecast revenue should be qualified or changed.

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[59] NoE at 1905/30–1906/4.

[179] The directors denied that the sales revenue and sales volume figures relied on by the plaintiff demonstrated any trend of deteriorating performance for Feltex in the period leading up to the IPO. They compared the sales data relied on by the plaintiff (criticising it as being selectively chosen) against the data from Board papers on margins on sales, EBITDA[60] and net profit for the five months from December 2003 to April 2004.[61] On those three criteria, the figures showed a positive improvement over Feltex's performance in the comparable period for the prior financial year. Further, when measured against the aggressively set budget, the result for each month showed a positive variance to budget on each of the three measures except for relatively minor negative variances on margins on sales achieved in February, March and April 2004. The directors accepted the opinions of Messrs Magill and Tolan that the discrepancy was not a cause for concern in light of the improved margins being achieved. Management also cited one-off operational issues that had unexpectedly constrained the company's production capacity, and anticipated that June would be a strong month.

[180] The directors argued that sales revenue and volumes figures were less relevant as a basis for comparison with Feltex's performance in the prior period than they might ordinarily have been, when there had been a deliberate policy of changing the mix of Feltex's products towards higher margin sales. This strategy was referred to in a number of places in the prospectus.[62]

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

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60 Earnings before interest, tax, depreciation, amortisation and write-offs.

61 Collated at [20.38] of first defendants' closing submissions from various reports in BP4.

62 Prospectus at 15, 41, 81, 82 and 83.

variance on the opening item in a forecast is lessened by countervailing variances in subsequent items, which mean that the final outcome more or less accords with what was forecast.

[182] The defendants also argued that, in any event, the difference between projected gross operating revenue used for the forecast in the prospectus, and the lower revenue that was recognised when the prospectus was finally settled and immediately prior to allotment of the shares, was not material in extent. The difference was projected in early June to be approximately 2.5 per cent and was eventually 2.3 per cent. Any grounds for concern were lessened when Feltex was achieving an improvement in the margins on net returns on sales. On this approach, the gross operating revenue achieved was less important than the margin achieved. On the latter measurement, the directors and the DDC reasonably treated Feltex as being on target to achieve the net surplus from operations, consistent with the net surplus that was forecast in the prospectus.

[183] Mr Forbes' rejoinder was that the trend in gross operating revenues and volume of sales would always be material indications of the company's prospects, and should have been accurately and fully disclosed so that prospective investors could take the discernible trend into account when considering other content of the prospectus that portrayed Feltex as enjoying an improving financial position. Mr Forbes repeatedly made the point that for a manufacturing company, the volume of its sales is so basic to success that anyone monitoring the company's performance could not overlook an adverse trend in sales as a material consideration in evaluating the company's prospects. In its most basic form, this proposition is a matter of common sense. Mr Russell opined that a mature company with decreasing sales is a concern to anyone.[63] Mr Russell did balance that concern with an observation (in light of the FY2004 result as announced in August 2004) that the comparison of the forecast to actual result showed "… not a bad set of numbers for a mature company".[64]

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[63] NoE at 1090/11.
[64] NoE at 1097/13.

[184] The directors' decision that the failure to meet the forecast revenue figure was not a material circumstance was supported by the experts called on behalf of the defendants. Mr Cameron, calling on his experience as an investment banker, described a framework that he would apply to assess materiality in terms of the content of a prospectus. He concluded that the anticipated sales shortfall was not a material adverse circumstance.[65] Professor van Zijl applied his expertise in relation to accounting standards to opine that the anticipated shortfall in sales was not material when the profit was not expected to be affected.[66]

[185] Professor Cornell considered materiality by reference to the market response at the time of the announcement of the full year result on 24 August 2004. The annual report specified that sales in April and May 2004 had been lower than forecast, but that the shortfall was to some extent made up by stronger than forecast sales during June 2004. It stated that sales were below forecast in the fourth quarter, however Feltex had achieved a superior product mix yielding higher than forecast margins. The annual result included a specific contrast with the numbers from the forecast in the prospectus. Overall, the financial outcome was in accordance with the forecast.[67] The lack of adverse response to the market learning of the shortfall meant, on Professor Cornell's analysis, that that was not a material circumstance.[68]

[186] The concerted responses in evidence from and on behalf of the defendants, denying the importance of Feltex's failure to meet gross revenue and volume of sales targets to 30 June 2004, involved an element of overstatement. The contemporaneous documents do support the directors' focus on other measures of performance, but that cannot entirely eliminate the relevance of the trend in sales for a manufacturing company. I note, for instance, that Mr Hunter focused on significant declines in volume of sales in March 2005 as a relevant indication of tougher trading conditions.[69]

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65 Cameron BoE at [58], NoE at 2445–2447.
66 van Zijl BoE at [143]–[145].
67 2004 result announcement, CB17 012269–012270.
68 Cornell BoE at [88].
69 SB2 000548 at 000550.

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

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

[189] Mr Forbes also challenged the reasonableness of the revenue assumption in light of the deteriorating relationship with Carpet Call Pty Limited (Carpet Call), a major retailer in which Feltex had a 50 per cent stake . I address that in considering the plaintiff's criticism of the statement in the prospectus as to the quality of Feltex's relationship with major customers.[70] In terms of the assumption about the level of trade with existing customers cited at [170] above, it was argued for the plaintiff that Carpet Call had to be seen as a sufficiently important exception to any assumption about the behaviour of other customers. Mr Forbes submitted that Feltex's adverse relationship with Carpet Call required a qualification to the assumption made more generally about the level of trade with Feltex customers.

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[70] At [255] to [275] below.

[190] I am not persuaded that the relationship with Carpet Call was so important an exception to the positive reports that were provided to the DDC about the status of relationships with major customers, that it required this assumption to be cast in more negative terms.

[191] An additional aspect of the plaintiff's argument on the discrepancy in gross revenue was that the extent by which revenue was going to fall short of the forecast was more clearly identified at the date of bringing down of due diligence on 2 June 2004. By that time, the Board and the DDC were aware that Feltex would not achieve the forecast revenue figure, and Mr Magill had reported that there would most likely be a shortfall of between $7.5 and $9 million in operating revenue for FY2004. The DDC and the directors were also advised that Feltex would not achieve the volume of sales (measured in linear metres of carpet) that was forecast for FY2004. The plaintiff argued that the directors had a clear responsibility to acknowledge an adverse event that constituted a change in the circumstances since the prospectus had been issued.

[192] Had the directors considered such a course, the terms of a communication for the Board would, in all likelihood, have taken one of the forms of advice I suggested in [188] above. That tends to demonstrate the lack of materiality in the variances on sales revenue and volumes.

Unacknowledged adverse trend in result for six months to 30 June 2004

[193] The plaintiff also alleged that it was misleading for the prospectus not to state explicitly that Feltex's trading for the six months to 30 June 2004 was going to involve a net deficit of some $1.3 million. The most recent financial data presented in the prospectus on an historical basis was a consolidated summary of audited financial information for the six months to 31 December 2003.[71] That showed a net surplus attributable to Feltex's shareholders of $11,414,000. The forecast of prospective financial information for the 12 months to 30 June 2004 included a net surplus attributable to shareholders of $10,113,000. Because that forecast net surplus for the 12 months was less than the reported outcome for the first six months

[71] Prospectus at 93.

of the financial year, the plaintiff argued that the alleged deterioration in the financial position that was reflected in the lower net surplus for the whole of FY2004 should have been drawn explicitly to the attention of readers of the prospectus.

[194] The point was not pressed in closing. The criticism overlooked the inclusion in the full year results of significant one-off costs that were incurred during the second half year in relation to the IPO. If those items were excluded to achieve a like-for-like comparison between the first and second halves of the year to 30 June 2004, then the trading activity would have shown a material improvement, rather than any deterioration. [72]

Removal of provision for management incentive plan

[195] A further criticism of the presentation of the financial performance anticipated for FY2004 that was tested during the evidence related to the treatment of a provision for the cost of a management incentive plan (MIP). This was without the point being the subject of a specific pleading. Feltex had an arrangement with management that a certain level of bonuses would be paid if ambitious financial targets were achieved. Management accounts earlier in FY2004 had made provision for MIP payments, but in May 2004 the provision was removed. The plaintiff sought to criticise the removal of the contingency, contending that it was done to avoid a deficit in the management accounts when compared with the forecast, because the removal of the provision for MIP transformed a deficit into a surplus. The point was not pressed in the plaintiff's closing, other than by way of footnote.

[196] The defendants' explanation for removing the MIP provision was that it had become apparent by May 2004 that it would not become payable, so that the preferable treatment was to remove it. I accept that that was a reasonable approach to adopt. Accordingly, the removal of the MIP provision does not raise the spectre of the forecast for FY2004 being misleading.

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[72] The one-off, IPO-related expenses are most of those excluded in arriving at the "second bottom line" (see [352] below). If amortisation of goodwill was not included, the remaining IPO-related expenses would involve an add back of some $10.26 million.

B Misstatements or statements omitted as to risks confronting Feltex

Risks arising from reduced tariffs and increased imports of carpet into Australia

[197] The plaintiff claimed that it was misleading for the prospectus not to state that there would likely be increased import competition in the synthetic carpet sector in Australia, with an acknowledgement of the significance of that having regard to the substantial portion of Feltex's sales in Australia that comprised sales of synthetic carpet.[73] The claims were that the prospectus inadequately disclosed the likely impact of a pending reduction of five per cent in the tariff on carpet imported into Australia, and failed to recognise the risk of adverse impact on Feltex of expansion of carpet manufacturing in China. In closing, the plaintiff's submissions expanded to criticise the absence of warning about an additional threat of imports from Thailand, that arose because of a Free Trade Agreement between Australia and Thailand. This criticism was not pleaded.

[198] The "What Are My Risks?" section at pages 126 and 127 of the prospectus addressed the topic in five paragraphs under the heading "Imports". The essence of that section was that:

- Feltex was subject to competition from imports;
- the level of imports into Australia was dependent on a number of factors including movement in the level of tariffs and exchange rates;
- tariffs were scheduled to decrease from 15 per cent to 10 per cent on 1 January 2005 and then from 10 per cent to five per cent on 1 January 2010; and
- the import of significant carpet volumes into the Australasian market could have a material adverse effect on Feltex's results or financial position.

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[73] Primarily pleaded in 4ASC at 39.21, 39.22, 46.3, 56, 57, 64.6.3, 71.2 and 72.2. Tangentially relied on elsewhere, including at 35.2, 39.16 and 46.

[199] The commentary to those paragraphs acknowledged that it was not possible to predict with certainty the future movements in the strength of the Australian or New Zealand exchange rates, or that the scheduled tariff reductions would occur at the rate and on the dates then expected.[74] This statement was criticised as wrongly suggesting that there was uncertainty about the likely levels of decrease in the rate of tariffs when, in Australia, a legislative commitment had been made to them.

[200] In addition, the commentary expressed a belief that there were a number of factors acting as effective barriers to a significant increase in imports at the then current exchange rates. Those barriers included the requirement for carpet importers to have an effective distribution system and timely availability of product and after-sales service. The plaintiff complained that these mitigating factors were set out in terms that suggested there was no substantial risk at all.

[201] In pursuing these allegations, the plaintiff relied primarily on statements that had been made on behalf of Feltex to the inquiry conducted by the APC during 2003. In the explanation Mr Saunders provided at the 2005 AGM, the fourth of five particular impacts identified as affecting the change in Feltex's trading fortunes was expressed as follows:[75]

> The fourth impact came from increasing import competition in the synthetic sector in Australia … As the Australian dollar rose, the cost of imported synthetic carpets denominated in US dollars fell, and imports into Australia increased. This increased competition in a weakening Australian market resulted in some manufacturers driving down prices to maintain production levels.

Nothing was made of this in closing.

[202] A reduction in tariffs by five per cent from the beginning of 2005 had been proposed in 1997 and provided for in legislation in 1999. Therefore the focus for the APC in its 2003 inquiry related to the situation applying after that change came into effect. That point was made explicitly when the inquiry was announced in November 2002.[76]

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74 The uncertainty referred implicitly to changes described in both Australia and New Zealand.
75 CB20 014405.
76 CB4 003052.

[203] A former senior executive of Feltex, Mr Ray Bennetts, together with Mr John Kokic who was the CFO at the time, were authorised to make submissions on behalf of Feltex in a context where the Australian carpet industry was motivated to resist any acceleration in the then proposed rate of reduction in tariffs on imported carpet. Mr Bennetts was highly regarded and had over 40 years' experience in the carpet industry.

[204] Feltex was a member of the Carpet Institute of Australia Limited and the submissions made on behalf of Feltex to the APC were intended both to support the position of the Carpet Institute, and to advance particular interests of Feltex. The extent and timing of reductions proposed when the inquiry was undertaken were as stated in the prospectus. There was an allied concern to retain the SIP grants that were intended to incentivise textile industries to modernise so as to be better able to compete with imported products. Feltex was a recipient of SIP grants that were paid as cash rebates in the year after qualifying capital expenditure had been incurred. The way SIP grants were treated in the prospectus was a separate criticism advanced for the plaintiff.[77]

[205] A first submission to the APC, prepared by Mr Bennetts in March 2003, painted a dire picture of the threat posed to Feltex's business by increased imports, which the submission anticipated could follow from any further reduction in the level of tariffs. That initial submission stated that greater reductions in tariff levels than those that had then been provided for would threaten the viability of Feltex's business, likely leading to plant closures and redundancies. The Australian carpet market was described as very cyclical and relatively small. The production of man-made fibre carpets was seen as being the most vulnerable to competition from cheaper imports.

[206] The plaintiff relied on Mr Bennetts' first submission as if it claimed that the same level of serious adverse consequences would follow from the level of reductions that were to take effect from January 2005, as would occur if there were

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[77] See [391] to [408] below.

further reductions beyond that. That submission was somewhat imprecise on the point, but provided:[78]

> [Feltex] believes that [the man-made fibre] sector of the carpet industry will face the greatest threat from the tariff reduction scheduled for 2005, and would be further adversely impacted by any additional tariff reduction after 2005.

[207] A little later in the executive summary to the first submission, commenting on the reduction as it was then understood to occur, the submission stated:[79]

> … there will likely be some adverse impact on [Feltex's] Australian business when tariffs reduce from 2005. If further tariff reductions occur this adverse impact will likely be more significant.

[208] The APC issued a position paper in April 2003 responding to a first round of submissions. The position paper proposed that the programme for reduction of tariffs over time would remain as had been contemplated when the initial submissions were made to it. This involved a further five per cent reduction in tariffs from January 2010. The holding of the line at that point was consistent with Feltex's aspirations.

[209] A second submission filed on behalf of Feltex in May 2003 focused more specifically on the extension of SIP grants to businesses in metropolitan centres, whereas components of the government grants programme had previously been reserved for businesses in regional areas. In its second submission, Feltex argued for the tariffs to be maintained at their 2005 level, at least until 2010.[80] After that was submitted to the APC, Messrs Bennetts and Kokic made an oral presentation to the APC in June 2003, the transcript of which was in evidence. It continued the theme that any greater reduction in the level of tariffs on carpets would constitute a significant threat to Feltex's Australian business, but the 2005 reduction in tariffs was accepted.[81]

[210] There was no evidence called for the plaintiff that addressed the relative severity of the threat to Feltex from imports, except for those who commented on the

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78 CB4 003266.
79 CB4 003268.
80 CB5 004204.
81 CB6 004347, 004348.

Feltex documents, and in particular Mr Bennetts' submissions. Without expertise in the area, Mr Meredith inferred from the terms of Mr Bennetts' submissions that the decrease in tariffs would be a serious threat to Feltex's on-going business.

[211] The plaintiff also called evidence from Mr Coleman about the APC's process, but he did not opine on how Feltex ought to have perceived the threat in the second quarter of 2004.

[212] The directors of Feltex did not, with one exception, see Mr Bennetts' first submission. They received reports that he was making submissions and had a Board report about the effect of the second submission. That submission was attached to Board papers for a meeting around the time it was made. A number of the directors assumed that they would have read it because of its inclusion in the Board papers. None of those directors had any distinct recollection as to its content. Without in any way denigrating Mr Bennetts, and without conceding that he would have knowingly misrepresented the nature of the threat to Feltex, their consistent responses were that the submissions, and in particular the first one, contained an element of hyperbole for the sake of advocating for a particular outcome.

[213] It is clear that Mr Bennetts' submissions were part of a lobbying campaign to achieve the best possible outcome. An indication of that is the inclusion in both submissions of a related theme in the area of industrial relations. Mr Bennetts characterised Feltex's Australian workforce as heavily unionised, and resistant to change. A recurring theme was the perceived need to have the workforce receptive to changes in working conditions that were required to make innovations in the manufacturing processes.

[214] Predictably, the APC did not take claims of adverse consequences at face value. For example, in its report issued on 31 July 2003:[82]

> … the likely declines in [textile carpet and footwear sectors] output and employment from post 2005 tariff reductions and a phasing out of transitional budgetary support have been exaggerated by some parties.

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[82] CB6 004687.

[215] In a part of the report on the approach to post-2005 assistance, the report recognised the stimulus for more competitive operations, observing:[83]

> … managerial effort that, in parts of the sector, has been devoted to preserving high assistance and looking for ways to garner and 'game' government support, could be directed to improving international competitiveness.

[216] I note also that in the exchanges between the Commissioners and Mr Bennetts at the conclusion of his oral submissions, the presiding Commissioner put Feltex's position to Mr Bennetts in relatively moderate terms, and certainly did not acknowledge any strident claims of likely harm:[84]

> … we've got the drift of your arguments about more time for the tariff to come down and for SIP to be a bit more generous. We'll take those into account. …

[217] Mr Forbes challenged the credibility of the directors' reliance on the mitigating circumstances that were cited as lessening the extent of the risk from imports and circumstances of reduced tariffs, when those factors had not been acknowledged in Mr Bennetts' submissions. He urged the view that because of Mr Bennetts' positive reputation, the submissions he lodged with the APC should be treated as complete, and as having absolute integrity. It would follow that if the mitigating factors cited in 2004 did have validity, then they would have been acknowledged in his 2003 submissions.

[218] Without impugning Mr Bennetts' integrity at all, I am satisfied that the converse of Mr Forbes' proposition is the more likely construction on this point. Whether consciously or otherwise, factors lessening the risks that Mr Bennetts wished to emphasise would realistically be left out. In any event, the Commissioners were obviously aware of countervailing advantages that Australian based manufacturers would have. Towards the end of his oral submissions, Mr Bennetts was questioned on lower freight costs where, at the lower end of the carpet market, freight costs would be a larger component of the overall selling price. In relation to the upper end of the market, it was put to him that local manufacturers had the ability

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83 CB6 004805.
84 AF1 000560.

to offer customised or special Australian colours and designs to pander to Australian fashion.[85]

[219] In this context, the defendants made the point that the submissions were hearsay as to the truth of their contents. No attempt had been made to call Mr Bennetts, and whilst there was no dispute that the submissions were what they were represented to be, it was speculative to consider what information Mr Bennetts might have relied on, or what his motives were for casting what were inarguably advocacy documents in the terms he did.

[220] In short, the APC was expecting industry participants to lobby for outcomes that best advanced the submitter's own interests, and in the case of Feltex, that is what Mr Bennetts gave them.

[221] Many of the directors disagreed with Mr Bennetts on the relative importance of the level of tariffs to the competitiveness of carpet imports. Mr Bennetts' submissions suggested that the level of tariffs was very important to the competitiveness of imports. However, the directors consistently expressed the view that the United States/Australian dollar exchange rate was a far more important influence on the extent of competition that Australian carpet manufacturers faced from imported carpets.[86] The defendants cited numerous references in the APC's report that tended to recognise that exchange rates were of equal or greater importance in terms of the extent of competition from imports than a five per cent drop in the level of tariffs.[87]

[222] The one director who saw Mr Bennetts' first submission was Mr Feeney, but his recollection of having seen it was imprecise. Mr Feeney was Feltex's nominee on the board of Carpet Call and he suggested it was likely he saw the submission by virtue of that directorship. Mr Feeney did not agree with the level of threat articulated in it, but did not recall being sufficiently concerned to make a point of it at the time.

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85 Question from Mr Weickhardt, AF1 000560.

86 For example, Thomas BoE at [176] and NoE 1233/8–29, Magill NoE at 1849/1–23.

87 For example, CB6 004743 – firms sensitive to exchange rate changes; CB6 004756 – external shocks such as appreciation of the exchange rate can trigger a lumpy and therefore more costly adjustment episode.

[223] The DDC addressed the threat from imported carpet as a discrete topic in the course of preparing the prospectus. The view arrived at, which is reflected in the description of the risk as it appeared in the prospectus, was also reviewed by the directors. The views of senior managers, tested by the directors and shared by them, were to the effect that:

- There were barriers to the importation of broadloom carpet because of the difficulties of competing without a local distribution network, on-going availability of product and after-sales service. The analysis distinguished between broadloom carpet, which was the core of Feltex's business, and rugs. It was noted that there was a trend in Australia towards hard floors that were more likely to generate sales of rugs which could more readily be imported.

- Feltex's import agreement with Shaw enabled it to import carpet into Australia at favourable rates so that Feltex would have a competitive advantage over its Australian competitors in sourcing imports, if exchange rate movements made that viable.

- The updating of technology in the manufacture of carpets better enabled Feltex (and indeed its Australian competitors) to compete with overseas manufacturers.

- The poor quality of cheaper imports from Asia, and particularly China, were likely to lessen the threat that they might otherwise represent.

[224] Among the senior managers interviewed by the DDC was Mr John Shackleton whose position at the time was General Manager, Distribution and Customer Services. The notes of his interview by the DDC, when addressing the level of tariffs and the Free Trade Agreement with the United States, included the note:[88]

> There were no major surprises from the Australia/US Free Trade Agreement and generally it was a satisfactory outcome for the carpet industry.

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[88] DD1 000604.

[225] Mr Magill's evidence was that he believed the outcome of the company's interaction with the APC was as good as Feltex could have hoped for.[89]

[226] When the directors and witnesses called on their behalf were cross-examined about the relatively dire predictions that Mr Bennetts had made to the APC, the consistent tenor of the responses was to dismiss the seriousness of the claimed consequences as lobbying or overstatement. None were prepared to characterise Mr Bennetts as having intentionally misled the APC as to Feltex's position, but nor were any of the defendants' witnesses prepared to accept that the level of threat described by Mr Bennetts in the first half of 2003 represented the way in which they saw such risks at the time the prospectus was settled in April 2004.

[227] The plaintiff's criticism required an advocacy document more than 12 months old to be treated as if it was current and adhered to the complete truth without any exaggeration. On the basis of all the information available at the time, I am satisfied that the nature and extent of the threat posed by imports in a reduced tariff environment were reasonably described in the risks section of the prospectus. Certainly, the risk might have been expressed in a range of different ways, but as a prediction of future trading conditions, the terms chosen in the prospectus were certainly within the spectrum of comments that fully informed directors could reasonably have arrived at when the prospectus was settled.

[228] My conclusion would be the same if I included the unpleaded criticism in respect of the threat posed by the completion of a Free Trade Agreement between Australia and Thailand. The plaintiff adduced no evidence of the nature of the threat that tariff-free imports of carpet from Thailand might represent. Mr Forbes cited comments from June, July and August 2003 that suggested a concern about competition from carpet made in Thailand should a Free Trade Agreement be concluded, but there was no analysis of the form such competition would take and nothing cited nearer to the time the prospectus was being prepared.[90] I consider Mr Magill was qualified to express the opinion he did on this topic, namely that

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89 Magill BoE at [201].

90 For example, Magill email, CB6 004396, and Mr Saunders' response, CB6 004637.

imports from Thailand were a very modest component of the total Australian market and did not target sectors that were of concern to Feltex.[91]

Adverse impact of a strengthening in the New Zealand dollar

[229] The plaintiff alleged that an identifiable form of exchange rate risk existed for Feltex because of its requirement to remit Australian dollars into New Zealand dollars. It was pleaded that the prospectus should have disclosed that each one cent rise in the cross-rate between the New Zealand and Australian dollars would affect the profitability of Feltex by approximately NZ$550,000.[92]

[230] That allegation relied on an acknowledgement provided by Mr Saunders in his address to the 2005 AGM. Mr Saunders stated at that time that the company result for FY2005 had been adversely affected by the strengthening of the New Zealand dollar, saying that each one cent rise in the cross-rate in favour of the New Zealand dollar had affected EBITDA by approximately $NZ550,000 per annum.

[231] The plaintiff contended that the impact described by Mr Saunders in December 2005 ought reasonably to have been projected by the directors and included as material information in the prospectus.

[232] Under the heading "What Are My Risks?", the prospectus included a section on exchange rate fluctuations. The risk was described in the following terms:[93]

> Feltex's principal sales market is Australia. Any appreciation in the New Zealand dollar against the Australian dollar adversely impacts the margin of Feltex's New Zealand manufactured woollen product sold in the Australian market. Feltex's major competitors have manufacturing plants in New Zealand and are subject to similar exchange rate risks. As Feltex also remits funds from its Australian business to New Zealand, Feltex is also exposed to movements in the Australian dollar/New Zealand dollar exchange rate.

[233] The relevant section also included reference to Feltex addressing exchange rate exposures by hedging the risks to an extent. The section also recognised risks

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91 NoE at 1874/11.
92 4ASC at 58.
93 Prospectus at 126.

created by having to acquire raw materials priced in United States dollars. The section concluded with the following observation:

> There can be no assurance that changes in exchange rates will not have a material adverse effect on Feltex's results or financial position.

[234] The plaintiff criticised the description of exchange rate risks as being placed in the prospectus too far away from the earlier sections promoting the relative strength of Feltex's business, and without any indication of its relative importance when addressed in a section describing a range of different risks. The addition of a comment about the company's ability to hedge exchange rate exposures was also criticised as implicitly assuring readers that the risk was not a material one that ought to trouble potential investors. It was submitted that to adequately convey the risk "quite strong language" was required. In contrast, the concluding observation quoted at [233] above was criticised as "fairly anodyne".

[235] There was no evidence that any readers of the prospectus had in fact been misled by any inadequacy in this disclosure of the exchange rate risks. Nor did any of the experts called for the plaintiff opine that the extent of disclosure was misleading. Mr Meredith considered that a sensitivity analysis demonstrating the impact of movements in the cross-rate between the Australian and New Zealand dollars was a matter that readers of the prospectus would be interested in, and that they might find it helpful.

[236] The pleading did not criticise the disclosure on exchange rates as misleading, but rather alleged the omission of specific statements to the effect described in [229] above. The second and third defendants took the point that the plaintiff was required to identify a particular statement in the prospectus that was rendered misleading by the omission of this further detail. Because the plaintiff had not advanced the criticism on that basis, it was argued that the allegation could not, in any event, be made out.

[237] The defendants contended that the description of exchange rate risks included in the prospectus was adequate, and that a more specific illustration of the effect of movements in the New Zealand/Australian dollar exchange rate, such as the plaintiff

claimed should have been included, would either be misleading or rendered meaningless by the need for multiple qualifications to it.

[238] Professor van Zijl recognised difficulties in giving any quantified effect of one exchange rate movement on a prospective basis when there were a number of factors at play. He considered that the disclosure about exchange rate risk was as helpful as the company could have provided. He was not challenged on that assessment.

[239] I accept the defendants' explanation on this point. It was possible for Mr Saunders to provide a specific illustration of the impact of strengthening in the New Zealand dollar, when focusing retrospectively on the impact of one cross-rate over a defined period of time. A simple calculation of the same type could not be done prospectively because numerous variables would have to be taken into account. For instance, Feltex's results in any period would be affected by movements in the Australian/United States dollar exchange rate, and the extent to which Feltex's New Zealand operation provided product to Australia, relative to the extent of earnings that Feltex's Australian operations were to be accounted for in New Zealand dollars. Addressing only the impact of a strengthening of the New Zealand dollar against the Australian dollar at a given point in time or for a given volume of money would not assist readers of the prospectus when such a consequence would never occur in isolation for Feltex's operation.[94] Certainly, readers would take more or less from the warning about exchange rate exposures, depending on their level of understanding. The notional investor would appreciate that an additional risk arose because Feltex was doing business in Australia, and exchange rates do move with positive and negative impacts.

[240] The nature of the risk was adequately described. Readers were warned that the risk could occur to the extent that it would "have a material adverse effect" on Feltex's results. The absence of a warning in more specific terms, such as by giving

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[94] Mr Forbes referred to a June 2003 Board paper as illustrating the company's awareness of the impact of changes in exchange rates. However, that paper demonstrates the multiple computations that arise, given positive and negative impacts of changes between all of United States, Australian and New Zealand exchange rates: BP3 002244.

one or more examples of the dollar impact of exchange rate movements of a given extent, could not be misleading in the relevant sense.

[241] Nor do I accept that the context in which the risk was described, or the extent to which its relative seriousness might appear to have been ameliorated by the company's ability to hedge exchange rate exposures, altered the natural meaning of the warnings to an extent that rendered them misleading.

The adoption of lean manufacturing techniques

[242] The investment features on page 15 of the prospectus included a heading:

> …WITH A NUMBER OF SUBSTANTIAL OPERATIONAL STRATEGIES NOW SUCCESSFULLY IMPLEMENTED…

[243] As a second paragraph under that heading, the prospectus stated:

> In addition, management has implemented lean manufacturing techniques, streamlined distribution, rationalised product stock keeping units and improved supply chain management to further increase cost efficiency and customer service and to reduce working capital.

[244] The plaintiff alleged that these descriptions of Feltex's business failed to disclose, and thereby concealed, that Feltex in fact operated rigid systems that prevented it from being responsive to changing market conditions.[95] This criticism appeared to proceed from the premise that Feltex had ceased adopting lean manufacturing techniques, or at least stalled any further adoption of them. That proposition depended on the pre-trial opinion of Dr Blakemore on the extent to which Feltex had adopted lean manufacturing techniques as recommended by him during the course of his consultancy at Feltex up to mid 2003. As to the position thereafter, Dr Blakemore inferred from the headings in a PowerPoint presentation, which he understood was presented by Mr Tootell in November 2005, that Feltex had stalled the pursuit of further lean manufacturing initiatives.

[245] The concept of lean manufacturing was not defined in the prospectus. The term was possibly initiated, and was certainly widely used, by Dr Blakemore. It included the notion of streamlining manufacturing processes so as to be able to

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[95] 4ASC at 60.

produce carpet in response to orders from buyers, and thereby substantially reduce the stock of carpet manufactured without a specific sale commitment. Dr Blakemore considered that he had encountered resistance to the adoption of such ideas at Feltex from sales managers and those sympathetic to their perspective that opportunities for sales of carpet would be harmed if the company did not have manufactured products already available when orders were received.

[246] I found Dr Blakemore to be genuine in his enthusiasm for strategies to improve manufacturing and marketing efficiencies. There is, however, scope for the defendants' criticism that his enthusiasm for reforms as he perceived the need for them, and his antipathy to senior management at Feltex, closed his mind to the prospects that improvements otherwise coming within a reasonable definition of "lean manufacturing" could be and were pursued by Feltex in initiatives that continued after his departure.

[247] Mr Weston QC, who cross-examined Dr Blakemore on behalf of all defendants, submitted that there were sufficient unsatisfactory features of his evidence to justify disregarding it. Dr Blakemore acknowledged an on-going commitment to improving the efficiency of Australian manufacturing industries. He perceived himself as having considerable expertise to advance that cause, and that his initiatives to do so at Feltex were thwarted by senior managers, in particular Mr Magill, who did not share his vision. Despite such criticisms, Dr Blakemore had subsequently described the success of some of his lean manufacturing initiatives at Feltex as "spectacular".[96] Further, what he perceived as antipathy towards him whilst at Feltex had led to Dr Blakemore still harbouring a level of resentment towards Feltex executives. Mr Weston criticised the generally extravagant content of Dr Blakemore's evidence, which he suggested was exemplified by the extent to which Dr Blakemore retracted strident criticisms that he had made in his briefs, once he was in the witness box. In summary, Mr Weston submitted that cumulatively these features tainted Dr Blakemore's evidence sufficiently to require his evidence to be discarded as insufficiently independent.

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[96] NoE at 802/15.

[248] It is unnecessary to reject the totality of Dr Blakemore's opinions on this ground. However, there is merit to the criticisms Mr Weston advanced and they do influence the weight that it is appropriate to give to his opinion evidence.

[249] By the end of his evidence, Dr Blakemore had certainly moderated the extent of his criticisms of lean manufacturing practices at Feltex since his consultancy there ended, as well as his criticisms of Mr Magill and other senior managers at Feltex. He had sought to corroborate his own criticisms on these matters by referring to his recollection of discussions he had with Messrs Saunders and Horrocks during 2005. It is unnecessary to analyse the differences in recollection as to the content of those conversations. To the extent that Messrs Saunders and Horrocks have different recollections of the matters covered, and the context in which comments were made, I prefer their versions, rather than the relatively strident criticisms of others that Dr Blakemore attributed to them in his evidence.

[250] The plaintiff's criticism of the way lean manufacturing was addressed in the prospectus was also modified during the hearing. In closing, the pleading that it was misleading for the prospectus to claim that management had implemented lean manufacturing techniques was treated as an allegation that the relevant statements in the prospectus overstated the position. Predictably, that change was criticised on behalf of the defendants, arguing that this change rendered it an unpleaded allegation. However, I am satisfied that the core of the criticism in this particular context is sufficiently similar to that pleaded, to deal with the merits of the criticism on the basis on which the plaintiff closed his case.

[251] The defendants called relatively extensive evidence from Mr Tootell. He had worked at Feltex from March 1996 until June 2006, and had been appointed the lean manufacturing co-ordinator in early 2000. Mr Tootell's job title changed over time thereafter but he remained responsible for Feltex's lean manufacturing strategies until he left the company. He gave evidence of the continuation and evolution of various lean manufacturing initiatives that were introduced throughout that period. Mr Tootell put the headings in his November 2005 PowerPoint presentation that Dr Blackmore had focused on into a materially different light, consistent with his evidence that lean manufacturing initiatives continued after Dr Blackmore ceased

assisting Feltex. Dr Blackmore's comments on the PowerPoint presentation were a superficial misconstruction. I am satisfied that Mr Tootell was careful and balanced in his evidence that addressed the timing and extent of such initiatives.

[252] Mr Tootell acknowledged that there were countervailing considerations limiting the extent to which such initiatives could be pursued. In essence, however efficient the manufacturing process, a business of Feltex's scale could not exist without substantial volumes of carpet in stock that was manufactured in anticipation of there being a buyer for it. Although it was not suggested as a routine and regular item on which progress was reported to the Board, I was referred to occasional Board reports about progress with "lean and demand", which reflected lean manufacturing initiatives.[97]

[253] During the due diligence process, references to lean manufacturing principles were tested with the appropriate responsible managers, Messrs Magill, Kokic and Shackleton.[98] I am satisfied on the basis of what was actually being done and the manner in which the accuracy of the relevant content was tested during the due diligence process that it was appropriate for the references to lean manufacturing to appear in the prospectus in the terms they did.

[254] The second aspect of this allegation arose out of Mr Saunders' acknowledgement at the 2005 AGM that Feltex had rigid systems. From late August 2005, Mr Thomas assumed responsibilities as an executive director at Feltex. Faced with seriously deteriorating financial conditions, he pursued a number of initiatives that included structural reviews of the company's operations. In giving his evidence, Mr Saunders was not certain as to the origins of his observation about systems being too rigid. However, he thought it most likely that it reflected a finding of the management groups Mr Thomas had directed to review Feltex's operations after he assumed executive responsibilities and that it reflected the conditions in which the company was then trading. This reconstruction of the reference to rigid systems was not seriously challenged, and there was no evidence to the contrary. It accordingly does not provide a basis for attributing to the directors an appreciation in April 2004

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97 For example, BP4 002852 at 002946.

98 DD1 000130, 000215 and 000601.

that Feltex could not justify a claim to having implemented lean manufacturing techniques, or that there should have been an acknowledgement in May 2004 that management of Feltex was rigid and unresponsive to changing market conditions.

The quality of Feltex's relationship with major customers

[255] At page 41 of the prospectus, in the introduction to a "Business description" section, a list of "successful operating strategies [that] have been successfully implemented over recent years …" included the following:

> • expanding its relationships with key customers and increasing customer service levels.

[256] Then in a section described as "Management discussion and analysis of financial results", the prospectus included at page 82 a comment implicitly intended to balance two neutral or potentially negative factors:[99]

> The impact of these two factors was offset partially by stronger relationships with key retailers, the strategy to use available capacity to service the high end of the market, a small increase in selling prices in March 2003 and improving market conditions.

[257] In the "What Are My Risks?" section at page 128 of the prospectus, customer relationships were addressed in the following terms:

> *Key relationships with customers and suppliers*
>
> Feltex's business and growth opportunities are dependent on key customer relationships (a small number of whom make up a large proportion of Feltex's revenues), and key supplier relationships. The ability to retain and develop these relationships in a competitive environment and the ability of key customers to pay for product ordered on a timely basis have a material effect on the conduct of Feltex's business. Consistent with industry practice, many of these relationships typically are not formalised through long-term legal arrangements. *Consequently, there is no certainty that current key customer and supplier relationships will continue to be successful or maintained on similar terms*, and/or that if such relationships did not continue they could be satisfactorily replaced. Feltex is not aware of any impending issue that may lead to the termination of, or adverse changes to, any of these relationships. (emphasis added)

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[99] The two factors were the strengthening of the New Zealand dollar against the Australian dollar, which had reduced the New Zealand dollar value of the FY2003 Australian sales by $12.8 million, and an inability to service demand for wool carpet while spinning equipment was relocated to New Zealand.

> Changes to these relationships could have a material adverse effect on Feltex's results or financial position.

[258] The plaintiff's allegations included a variety of criticisms on this topic based on the propositions that Feltex:[100]

- did not in fact enjoy the strength of relationships with major customers stated by these passages in the prospectus;

- had changed its terms of dealings with major customers that jeopardised those relationships; and

- that the italicised phrase quoted above from page 128 of the prospectus – "… will continue to be successful or maintained on similar terms …" – implied that customer relationships were successful at the time when the prospectus ought to have disclosed that they were not.

[259] The plaintiff advanced these various allegations in reliance on:

- acknowledgements by Mr Saunders at the 2005 AGM; and

- statements attributed to Mr Saunders in New Zealand Herald articles published in late 2006 to the effect that Feltex was not nearly as close to the market as it thought it was and that, apart from one or two retailers, it did not have the relationships that it believed it had with the market. Mr Saunders acknowledged as particularly poor the relationship between Feltex and Carpet Call.

[260] In closing, the plaintiff addressed the allegedly unsatisfactory state of Feltex's relationship with its major customers in a range of contexts. These included the reasonableness of the inputs into the forecast for FY2004 and the general criticism that Feltex was not a good investment, whereas the terms of the prospectus represented that it was. Less was made of the pleaded criticism that Feltex had altered its terms of dealing with major customers to an extent that jeopardised the

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[100] 4ASC at 42, 43, 46 and 48.

relationships with them, and more was made of documents that suggested a seriously deteriorating relationship with Carpet Call. That company routinely featured in the top 10 customers for Feltex. Mr Feeney was a director on the Carpet Call board.

[261] It is difficult to delineate the shareholder tensions that existed within Carpet Call at Board level, from the supplier/purchaser relationship that was more important to the amount of carpet that Feltex sold to Carpet Call. The shareholder relationship had been adversely affected by a decision of the Feltex Board in the second half of 2003 to withdraw a guarantee it had provided for Carpet Call's borrowings with its bank. That appears to have been a source of on-going irritation to the other 50 per cent shareholder, Mr Jim Smith, despite his shareholding not having provided a comparable guarantee to the company's bank. It also appears that the withdrawal of the guarantee did not materially hamper Carpet Call in its funding arrangements.

[262] The plaintiff invited the inference that the record of purchases by Carpet Call had consistently trended downwards over the 18 months or so before the IPO. This was based primarily on a statement by Mr Magill in October 2004 in a memorandum recommending sale of Feltex's shareholding in Carpet Call. That included: [101]

> … despite our best endeavours it appears that Jim Smith is determined to continue to move business from Feltex Carpets. I attach the details of his sales performance over the last two years which show a reduction in Carpet Call and Solomon's purchases of Feltex products.

Mr Magill's memorandum also commented on what he perceived to be a negative attitude within the Carpet Call business towards Feltex. Unfortunately, the numbers in the detailed schedule that appears to have been attached to Mr Magill's memorandum are illegible.

[263] The plaintiff relied on a group operating report for May 2004 that included the comment:[102]

> Carpet Call who had their worst month ever, was a major contributing factor. Jim Smith is not giving us any support whatsoever.

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[101] CB18 013105–013106. The reference to "Solomons" is to a subsidiary of Carpet Call.
[102] BP5 003820 at 003871.

However, that comment related to the marketing of one particular brand (Feltex Classic) in Australia. The report was produced for a Board meeting on 22 June 2004 which was after the IPO.

[264] The effect of the plaintiff's argument was that the Board ought to have cast the assumption about Feltex's relationship with its retailers in negative, rather than neutral, terms, to reflect that Carpet Call was reducing its business with Feltex.

[265] The directors rejected that notion. Acknowledging that there were cyclical effects of the relationship with Mr Smith, the Board was assured by management that none of the major customers were likely to dramatically change their pattern of purchases from Feltex in the forthcoming periods. In the case of Carpet Call, there was inarguably a rocky relationship with a series of negative signals in early 2004. Ultimately, however, Feltex was a 50 per cent shareholder, and Mr Smith was adhering to his policy of not buying from Godfrey Hirst, the principal competitor.

[266] It is difficult to avoid the impression of Mr Smith as flamboyant and inconsistent in his dealings with Feltex. In December 2003, Mr Thomas reported his view to Mr Millard that he thought Mr Smith was "a whacko". He suggested his view was shared by the Feltex Board. He described the relationship with Mr Smith as very "hot and cold". In November 2002, Mr Smith was moved to compliment Feltex on the standard of its service to Carpet Call as a customer in terms that "All our states have the very highest praise for your services and factory personnel", and described Feltex's service as "the best in the industry by a country mile".[103]

[267] Mr Feeney acknowledged that the relationship was a difficult one at Board level. Early in his dealings with Carpet Call, Mr Feeney commented that the relationship was not unusual for one in which a supplier was also a shareholder.[104] At the time of the IPO, he expected Carpet Call to remain a major customer.

[268] As pleaded, the plaintiff appeared to rely in part on criticisms of the consequences of Feltex having changed rebate and discount regimes with adverse

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[103] CB4 003051.
[104] CB2 001769.

impacts for major customers. That criticism was not pushed at trial. On the basis of the case as closed for the plaintiff, alleged unreasonableness in the assumption about customer relationships focused primarily on the deteriorating relationship with Mr Jim Smith of Carpet Call. The directors would need to have seen that relationship as sufficiently important on its own to justify a less than neutral assumption about the nature of Feltex's relationship with its major customers overall.

[269] The directors could have flagged a concern about the relationship with Carpet Call by acknowledging that there was one exception to good relationships with major customers, but that that relationship would not materially affect Feltex's performance overall. No doubt Feltex's competitors would be excited by any such disclosure, and the interests of adequate and accurate disclosure would need to be weighed against the risks to retention of commercially sensitive information.

[270] I am satisfied that a neutral assumption that, overall, relationships would remain unchanged and that there would be no adverse developments with material retailers was among the range of assumptions that was reasonably open to the directors. The implied characterisation of customer and supplier relationships as "successful" was in relative terms, in that it suggested that they would continue to be as they had been.

[271] The plaintiff also criticised the representation as to the strength of customer relationships, in light of an analysis of Feltex's sales performance in the six months to June 2004. In terms of both the volume of products sold and the revenue generated by sales in four out of the six of those months, Feltex had fallen short of its budget. I have addressed that separate criticism at [164] to [192] above. The analysis for the plaintiff was that the adverse variances ought to have caused the directors to question whether they could make any positive claims as to the strength of the company's relationship with customers.

[272] The defendants' response was that such criticisms were "cherry picking" individual points that suggested a basis for concern, when overall the picture was more positive. The monthly reports by management to the Board included commentary on major customer relationships and statistics that showed the level of

business with major customers. There was nothing in the nature of a worrying trend in those reports.

[273] More generally, the defendants relied on the data provided during the due diligence process. Senior managers at Feltex who were responsible for customer relations approved the terms in which they were described. Their contributions supported the positive statements that appeared in the prospectus. Management reports on the topic in the due diligence process tended to focus on quantitative measurements such as improving figures for on-time deliveries, which were up to 95 per cent for the top 20 retail groups, and the speed of response to customer enquiries.[105] The DDC was also told that there had been measureable improvement in production planning, stock availability and after-sales service.[106] Another manager, in the context of acknowledging that relationships had been harmed following a lengthy strike in 2001, advised that Feltex had regained relationships with customers since then and that a good level of satisfaction was being achieved.[107] Overall, Mr Magill confirmed to the DDC that Feltex had excellent relationships with customers and that there were no concerns. Given the size of Carpet Call as a significant customer of Feltex, and a pattern of evidence that the supplier/purchaser relationship with it was under stress, Mr Magill's lack of concern appears to involve an omission. However, there was statistical support for the proposition that, in general, customer relationships were sound and the directors could reasonably rely on that.

[274] One of the specific questions appropriate senior managers were required to answer in the confirmatory responses for due diligence was whether Feltex had major customers who provided business worth more than five per cent of Feltex's turnover and, if so, whether there was any risk to that business for FY2005. The responses were to the effect that there were such customers, but that there was no reason for Feltex to expect any of that business was at risk.[108]

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105 Mr Shackleton, DD1 000600–000601.
106 Mr Jovanovski, DD1 000510.
107 Mr Lyons, DD1 000535.
108 DD1 000120 (17.7) and 000122 (19.3).

[275] In light of the information the DDC considered during due diligence, I am not persuaded that notional investors were misled by the statements about Feltex's relationship with major customers.

Carpet manufacturers have high break-even cost structures

[276] The plaintiff alleged that the prospectus ought to have disclosed that the carpet industry, including Feltex, operated on a high break-even cost structure. The pleaded consequence was that it was only after Feltex passed through its break-even point that a margin on incremental production became very high and generated profit, whereas small reductions in overall sales volumes would dramatically reduce the company's profitability.[109]

[277] This allegation relied on Mr Saunders' explanation for the deterioration in Feltex's fortunes given to the 2005 AGM. The criticism was advanced on the basis that this feature of the business was known to, or recognisable by, the directors at the time of the prospectus, and that advising potential investors of it would enable readers of the prospectus to make a more fully informed decision.

[278] Although not among the criticisms expressly abandoned, this was not addressed as a material criticism in closing. It was implicit in the allegation that the notional investor would be unaware of this as a factor affecting the business environment in which carpet manufacturers operated. However, there was no argument on how much educating on the point would have been sufficient, nor was any particular statement in the prospectus identified as being allegedly misleading by virtue of the omission of a statement about high break-even cost structures.

[279] Relatively high break-even cost structures are a normal feature of many manufacturing businesses. That is generally known amongst business analysts. I could not be persuaded that it was within the generic observations that drafters of the prospectus ought reasonably to have been required to acknowledge. In essence, if readers of the prospectus did not possess the level of analytical skills that extended to recognition of that feature, then such readers were considering the material in the

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[109] 4ASC at 59.

prospectus at a less sophisticated level than one at which their analysis would be enhanced by being explicitly told of it.

C Misleading or unreasonable assumptions in predicting future performance

[280] The essential criticism of the prospective financial information was that the directors could not have had reasonable grounds for believing that such positive outcomes could be achieved. In many respects, the plaintiff argued that the extent to which prospective financial information was misleading was exacerbated by the misleading comments in, or omissions from, the qualitative narrative that I addressed in group B of the criticisms.[110] However, these criticisms also stand on their own.

[281] The prospective financial information included in the prospectus constituted a forecast for FY2004, and a projection for FY2005. The relevant Financial Reporting Standards (FRS) defined a forecast as prospective financial information prepared on the basis of assumptions that the directors reasonably expect to occur associated with the actions the directors reasonably expect to take as at the date that the information is prepared. A forecast is accordingly a best estimate assumption.[111] The prospectus specified that the forecast for FY2004 was prepared in accordance with that definition.

[282] In contrast, a projection is prepared on the basis of hypothetical but realistic assumptions (or "what if" scenarios) reflecting possible courses of action. It reflects an opinion that the projection falls within a range of possible outcomes.[112] The terms of the prospectus similarly related the FY2005 projection to this definition from FRS-29.

[283] When the content of the prospectus was being considered, the JLMs recommended that prospective financial information ought to be included as forecasts for both FY2004 and FY2005. The JLMs considered that a forecast would have more credibility than a projection given the awareness among the broking and

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110 At [197]–[279].
111 As defined in FRS-29 at [4.1].
112 As defined in FRS-29 at [4.2].

investment analyst communities, that were likely to lead the response to the prospectus, that less uncertainty attached to a forecast than a projection.[113]

[284] The directors debated the recommendation and decided that the prospective financial information for FY2005 should be a projection rather than a forecast. The distinction was stated explicitly at page 90 of the prospectus in the following terms:

> The prospective financial information for the year ending June 2005 presented on pages 85 to 87 of this Offer Document constitutes a projection as defined in New Zealand Financial Reporting Standard No. 29, 'Prospective Financial Information' and has been prepared on the basis of a number of hypothetical but realistic assumptions that reflect possible courses of action that the Directors reasonably expect to take as at the date the information was prepared. A projection is not a forecast. The projection was prepared as at 4 May 2004 for use in this Offer Document. The projection may not be suitable for any other purpose. There is no present intention to update this prospective financial information or to publish prospective financial information in the future. No actual results have been incorporated into the projection.

[285] That statement appeared just above an outline of the assumptions that were relied on as the framework for producing the projection. That outline extended to two and one third pages.

[286] The prospectus contained separate sets of assumptions that had been applied in constructing the forecast and the projection. There was a measure of overlap in their content. The assumptions for the forecast were at pages 88 to 90 of the prospectus, and those for the projection at pages 90 to 92 of the prospectus.

[287] A number of these assumptions were criticised as being unreasonable or misleading.[114] These included that:

- existing customers would continue to trade with Feltex at their then current level;

- there would be no material changes in the competitive markets in which Feltex operated;

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113 JLMs' memo, 23 March 2004, CB9 007102.

114 4ASC at 46 plus numerous cross-references.

- there would be no change to the level of importation of carpet;

- relationships between carpet manufacturers and floor covering retailers would remain unchanged and there would be no adverse developments with any material retailers; and

- Feltex would successfully implement strategies that were described elsewhere in the prospectus that would result in it increasing its market share by approximately one per cent in FY2005.

[288] The criticisms of these assumptions were relied on in the further or cumulative criticism that the performance projected for FY2005 was not reasonable, because the projected outcome was not reasonably achievable.

[289] Some aspects of the plaintiff's criticisms of the projection were, implicitly at least, on the basis that a particular assumption was not the most realistic, or the most accurate that could have been adopted. Such a stance relies on a premise either that those responsible for the assumptions had an obligation to identify the optimum terms for such assumptions, or alternatively that the way in which the projections were included in the prospectus carried an implication that the directors had worked on the assumptions to produce them to that optimum standard.

[290] I am not satisfied that that premise can apply in assessing whether any of the assumptions on which the FY2005 projection was based were misleading. The description of the character of assumptions relied on for the projection (as cited at [284] above) appeared just ahead of the assumptions and was expressed in terms that ought to have been readily understandable to anyone who went to, and was capable of understanding, the assumptions themselves.

[291] Readers of the prospectus could anticipate that the directors would apply their accumulated knowledge of the business and the environment in which it operated in crafting a set of assumptions for the purposes of projecting the prospective financial information. That cannot impose an obligation on directors to slavishly research and refine the assumptions to be adopted until they are satisfied that they are the most

likely assumptions in all circumstances as known at the time. The rationale for stating such assumptions is so that readers of the projection can measure the criteria that have been applied in constructing it. Given the range of uncertainties that is likely to affect business conditions for a company in the ensuing 12 months, it would generally be unrealistic to expect definitive research on the material conditions that will pertain. In short, the assumptions applied are to be realistic in light of all the experience and knowledge possessed by those responsible for them at the time, but that does not involve anything in the nature of a warranty that they are the assumptions that are most likely to be proven correct on any empirical basis.

[292] An assumption about exchange rates is a good example. There would always be a real prospect that any given assumption will be wrong, but those considering the projection need to know the terms of the assumption that was relied on. Many of the assumptions related to matters entirely beyond Feltex's control (for example that there would be no new entrants in the market) and were inherently likely to be wrong. That did not make them invalid, and certainly not misleading. Their purpose was to define the parameters of the exercise undertaken to produce the forecast and the projection.

[293] The assumptions for the forecast are to be assessed against a higher standard. In terms of the accounting standard, the directors had committed themselves in the prospectus to producing a best estimate assumption, and that had to reflect what the directors reasonably expected to occur, in light of the actions they reasonably expected to take. There was a measure of overlap between the terms of the assumptions cited for the forecast, and for the projection. Unsurprisingly, that was reflected in an overlap in the terms of the plaintiff's criticisms of them. It is appropriate to address the criticisms made of the assumptions on which the FY2004 forecast was based, and those cited in respect of the FY2005 projection, in the same analysis.

[294] The defendants relied on the disclaimers in various parts of the prospectus as adequately warning readers not to place reliance on forward looking statements. At the outset of the assumptions underlying the projection, readers were directed to read the assumptions in conjunction with the "What Are My Risks?" section of the

prospectus. The introductory part of the description of the assumptions then continued with the description of a projection that is set out at [284] above.

[295] In the "What Are My Risks?" section, under the heading "Other Risks", the following statement appeared:[115]

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

[296] These passages are sufficient to remove any basis for claiming that readers were entitled to rely on the assumptions as accurate or the most reliable projection of the particular condition affecting Feltex's business.

Existing customers will continue to trade with Feltex at their current level

[297] An assumption was made in these terms in relation to the FY2004 forecast. I have considered the point when dealing with the criticism of a failure to disclose a shortfall in sales revenue and volumes. The opposing views in that context were also applied to the plaintiff's criticism of this assumption. From the plaintiff's perspective, the "current level of trading" was to be measured by the volume and value of sales to existing customers. In that context, the results for recent months showing decreases in the volume of sales arguably precluded the directors from

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[115] Prospectus at 129, 130.

reasonably expecting that levels of trade with existing customers would indeed continue, because that was inconsistent with the downward trend as analysed for the plaintiff.

[298] From the directors' perspective, what mattered was the level of profitability of the current pattern of trading with existing customers. On that measure, arguably it was reasonable for the directors to expect that, in general terms, the level of trading with existing customers would continue.

[299] The directors' failure to address the discrepancy in the volume of sales and level of revenue likely to be achieved was a major plank of the plaintiff's broader criticism that there was no reasonable basis for the FY2004 forecast as included in the prospectus. The criticism was heightened by the fact that the directors knew the actual figures for the first nine months, so were only forecasting performance for the final quarter of the year.

[300] I am satisfied there was a reasonable basis for the directors to include the assumption on the level of trade with existing customers in the terms that they did. Certainly, the reliance on this assumption was not unreasonable on the basis of the information given to the DDC, and responses provided when it was tested. The assumption could not contribute to misleading readers of the prospectus on this topic.

No change in competitive markets and industry conditions

[301] These assumptions were made in relation to both the forecast and the projection. Analysis for the plaintiff of the detail of Board papers between February and April 2004 showed a number of comments in relatively specific contexts about the impact of competition on Feltex's business. Many of the references were to Godfrey Hirst's tactics in competing for sales. The plaintiff invited the inference from such comments that the directors ought to have appreciated that they could not make predictions for Feltex's future performance on the assumption that there would be no change in the competitive environment.

[302] It is reasonable to infer that Feltex was operating in a highly competitive business, and that new variants on competitive tactics were encountered with its major competitors on an on-going basis. However, the assumptions as expressed in the prospectus were at a more generalised level.

[303] I am not satisfied that new competitive initiatives by Feltex's competitors, as likely to recur in the competitive market in which they all operated, should have been acknowledged as a "material change" in the competitive markets in which Feltex operated. What the Board papers reflected were variations on what seems likely to have been a constant theme that Feltex's major competitors would be doing all they could to promote sales of their products, including to customers of Feltex. No doubt Feltex was doing the same thing. There is nothing in the specific references relied on by the plaintiff that suggests the competitors' conduct was different in kind, rather than variations on on-going competitive tactics. Continuation of the status quo in the nature of competition was an assumption that was realistically open to the directors, as an assumption for both the forecast and for the projection.

No change in the level of imported carpet

[304] The assumptions relied on for both the forecast and the projection included an assumption that there would be no change in the level of importation of carpets.[116] This was separately criticised as not realistic in view of Feltex's submissions to the APC in 2003, which had predicted significant harm to Feltex's business from increased imports that were claimed as likely to follow from a reduction in tariffs. I have already considered the discrete criticism over misleading and/or inadequate disclosure about the perceived likely impact of increased imports.[117]

[305] In scoping the competitive environment in which Feltex would be operating, it was relevant for the directors to make an assumption on some terms as to the on-going level of imported carpets. It may have been preferable (particularly with the benefit of hindsight) for the relevant assumption to be that there would be, say, a five or 10 per cent increase in the level of imported carpets. However, that

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116 Prospectus at 88, 91.
117 At [197]–[228] above.

alternative does not make the assumption that was made unreasonable, when a status quo assumption in relation to the level of competition from imports was among the range of options open to the directors.

[306] The extent and content of the work done to assess the threat from increases in imported carpet when the prospectus was being drafted also apply to satisfy me that the assumptions to the effect that there would not be an increase in the level of imported carpets was reasonably open to the directors for the forecast for FY2004. Inconsistently with Mr Bennetts' view, the preponderance of views available to the directors was that a material strengthening of the Australian dollar against the United States dollar was the most likely trigger for an increase in imports. The assumption on exchange rates was for a continuation of the status quo. A best estimate on imports for the last three months of the year could readily follow that factor, as remaining constant. Similarly, it was valid as a hypothetical but realistic assumption for the projection for FY2005.

Raw material costs, carpet selling prices

[307] There was also criticism of the following assumption in relation to the FY2005 projection:[118]

> It is assumed that to the extent that raw material costs increase during the projected period, there would be a corresponding increase in carpet selling prices (noting that the projection does not assume any carpet selling price increases), resulting in a neutral earnings effect.

[308] The plaintiff alleged that the Board knew raw material prices were going to increase and that carpet prices would increase correspondingly. It was argued that readers ought to have had this disclosure made to them because it might affect readers' perception of the company's assumption that it could grow its market share. The plaintiff also criticised this assumption as being cast in terms that implied that Feltex was not planning to increase its selling prices, and was not aware of any impending raw material price increases, when that was not the case. Given the function of assumptions, I am not persuaded there is anything in that point.

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[118] Prospectus at 91.

[309] The relevant point here was that the directors assumed, in relation to FY2005, that to the extent Feltex encountered increases in raw material costs, then it would be able to pass on such increases by increasing the prices charged for its carpet. As the assumption specified, the outcome was that any cost increases that were incurred would have a neutral effect on the company's earnings. That was clearly within the range of assumptions that was open to the directors in setting the parameters for the FY2005 projection.

[310] The defendants' rationale for adhering to the assumption of increased market share relied on changes in Feltex's business and its anticipation of having a market advantage derived from new technology in the tufting machines that were being acquired. The directors also cited specific reasons why Feltex had lost market share to its competitors in prior years, in particular a five week strike that had affected performance in 2001. All aspects of these assumptions were thoroughly tested with the senior managers who were close to the business, and appeared to be reasonable at the time.

Feltex's market share would grow by one per cent

[311] The assumptions underlying the FY2005 projection included the following:[119]

> The size of the carpet market in New Zealand and Australia, measured by volume of linear metres sold, will grow over the projected period by approximately 1%, which is below the average growth rate over the past 10 years. The relationships between carpet manufacturers and floor covering retailers will remain unchanged and there will be no adverse developments with any material retailers.
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> …
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> The projection assumes that the market will grow as described [in the above paragraph], that new products are introduced into the market in line with expectations, that Feltex will successfully implement the strategies outlined under the heading "Business description", resulting in Feltex's market share increasing by approximately 1% over the projected period.

[312] The plaintiff alleged that there was no reasonable basis on which to assume that Feltex would increase its market share. The 4ASC pleaded a range of "adverse

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[119] Prospectus at 91.

circumstances" that it was alleged the directors should have appreciated would preclude, or at least put at risk, any relative improvement in Feltex's performance.

[313] The plaintiff focused on the adverse variances from the previous year's performance and from budget on the volume of carpet sold, and the amount of revenue generated in the first half of calendar year 2004. By the time of the bring down due diligence meeting of the DDC on 2 June 2004, Mr Magill reported to the DDC and to the Board that the revenue generated for FY2004 would be between $7.5 and $9 million less than forecast. The plaintiff's criticisms focused on that variance and contended that, when taken with other adverse circumstances, that variance deprived the directors of any justification for producing a projection that assumed Feltex would increase its market share by one per cent.

[314] A bar graph available to the directors showing Feltex's share of the overall carpet market in the years from 1999 to 2003 reflected a steady decline from 30.7 per cent to 26.5 per cent, with a forecast 26.1 per cent for FY2004 and a projection for that share to grow to 27.1 per cent in FY2005.[120] The plaintiff argued that the history of Feltex's recent performance did not permit the directors to reasonably make an assumption that Feltex would increase its market share.

[315] The consolidated statement of prospective financial performance started with projected revenue for FY2005 of $348,147,000.[121] On the plaintiff's analysis, that would require a 4.7 per cent increase in sales above those forecast for FY2004, and indeed greater than that percentage when account was taken of the shortfall in FY2004 revenue. By early June 2004, that shortfall was likely to be between $7.5 and $9 million. That was an increase which the plaintiff alleged could not have been justified at the time the prospectus was issued.

[316] It was argued for the plaintiff that the directors did not have reasonable grounds for believing the revenue component of the projection because of the extent of problems known to them at the time. First, the inability to achieve the forecast revenue and sales volume for FY2004, an implied awareness of the extent to which

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120 CB10 007624. The percentages have been rounded to one decimal point.

121 Set out at [342] below.

the revenue was being bolstered by forward dating of invoices,[122] and production difficulties encountered with new tufting machines that were perceived as critical to transforming Feltex's product mix. On this last perceived problem, the plaintiff cited documents from late June 2004 to November 2005 that contained reservations by Board members about the adequacy of planning for such tufting machines, and teething problems with getting them to work to projected capacity.

[317] Mr Meredith opined that Feltex's assumption that it would grow market share was not reasonable as a matter of common sense.

[318] When the content of the prospectus was settled, the DDC and the directors had the results of Feltex's trading for January to March 2004, together with the management accounts reporting a result for April 2004. All of those months except March 2004 had shown a substantial shortfall in sales revenues and volumes of carpet sold, by comparison with the budget for those months. Indications from management were that some of the shortfall would be recovered in more positive months' trading before the end of the financial year. The budget was treated as aggressive and comparison with sales figures from prior periods were not strictly relevant because concerted attempts were being made to transform the mix of products sold by Feltex to higher margin products.

[319] The process for preparing the prospective financial information involved Feltex employees working under the direction of Mr Tolan, the CFO, to develop a model of the expected revenue, first for the remaining three months from 1 April to 30 June 2004, and then for the following 12 months to 30 June 2005. The model also projected the level of various categories of expense that would be incurred in operating Feltex's business, and in producing the volumes of carpet implicit in the revenue assumptions.

[320] It was put to Mr Tolan in cross-examination that the projection was the product of computer modelling for which he was not personally responsible. However, Mr Tolan emphasised that the modelling exercise was by no means dictated by the software used to create it. Rather, all of the assumptions involved in

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[122] See [409]–[444] below.

the modelling were reality tested in light of the state of relevant knowledge of those in the appropriate departments within Feltex responsible for the respective components of the model. I accept that the numbers eventually adopted in the projection did reflect the views of managers who were close to the respective aspects of revenue and costs being projected.

[321] Whilst the numbers for gross sales and volume of linear metres of carpet sold were materially below the levels forecast, on the other measurements of performance that were considered by the Board to be more important Feltex was meeting or exceeding the forecasted figures. Accordingly, the margins on product sold were improving, and Feltex was meeting its EBITA, EBITDA and NPAT forecasts.

[322] The trend for these figures as known to the directors at the time of the prospectus and the bring down due diligence meeting on 2 June 2004 was subsequently borne out by the financial statements for FY2004, as released to the market on 24 August 2004.

[323] In addressing an anticipated shortfall in gross sales revenue of between $7.5 and $9 million in early June 2004, Mr Magill advised the other directors that that shortfall was compensated for by improved margins. In evidence, Mr Magill adhered to the positive view he had adopted in reporting to the Board in early June 2004 to the effect that "the company is in the best shape it has ever been in".[123] In all these circumstances, the assumption of a one per cent increase in market share was reasonably open to the directors.

The FY2005 projection was not reasonably achievable

[324] At various points in the 4ASC, the plaintiff made a range of allegations that various components of the numbers used in the FY2005 projection were not reasonably achievable, or were not likely to be achieved, or were not capable of

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[123] NoE at 1803/22, 1890/16-27.

being attained. The criticism was made in respect of the value of sales projected, the NPAT figure and other assumptions built into that projection.[124] The plaintiffs' argument built on the criticisms of the assumption of a one per cent increase in Feltex's market share, that I have just considered.

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

[326] The plaintiff's criticisms focused on a summary table of "FY2005 Projected Implied Multiples and Yield" set out at page 11 of the prospectus.[125] The projected outcomes for FY2005, in terms of EBITDA, EBITA and NPAT applied roundings from the projected financial performance for FY2005 that was set out at page 85.[126] Those numbers were then applied to calculate enterprise value to EBITDA and EBITA multiples, a price/earnings multiple, and dividend yields in the second part of the table. Because the EBITDA, EBITA and NPAT numbers were all alleged to be unreasonably inflated by the overstated revenue projection, it followed that the projected price/earnings ratio and the gross dividend yield for FY2005 were also alleged to be misleading.

[327] The projected revenue translated into a net surplus attributable to shareholders of some $23,889,000 which was more than Feltex had ever achieved. The plaintiff alleged that was not an assumption reasonably open to the directors. The criticism was advanced in light of Feltex's trading history, current trends and adverse circumstances, which the plaintiff argued should have been taken into account.

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124 The pleadings appeared in (at least) 4ASC at 37.1, 44.1, 46.1–46.5 and 64.1–64.6. Paragraph 46.1 appeared to criticise "General Assumptions" in the prospectus as if made in respect of both the FY2004 forecast and the FY2005 projection when different assumptions were cited for each exercise.

125 The table is reproduced at [379] below.

126 The table from p 85 of the prospectus is reproduced at [342] below.

[328] The plaintiff's criticism relied on Mr Meredith's opinion that it was unreasonable for the directors to form the view that the company would perform in accordance with the FY2005 projection. That view relied upon the adverse trend in the volume of sales, together with a view as to other risks which Mr Meredith considered ought to have been given greater weight by the directors in toning down the optimistic approach to the FY2005 projection.

[329] From the defendants' perspective, the anticipated shortfall in revenue for FY2004 was not material, and therefore did not trigger a need to re-assess the reasonableness of the FY2005 projection. Instead, from the directors' perspective, the FY2005 revenue projection had its own integrity, having been built up from thorough work undertaken by management, in light of their reasonable anticipation for Feltex's trading in the ensuing financial year. The work done included taking expert external advice on the market conditions likely to be encountered in FY2005. That advice comprised reports presented at a meeting on 1 April 2004 by BIS Shrapnel, economic forecasters on the Australasian building sector, the Melbourne Institute of Applied Economics on Australian consumer sentiment and from McDermott Miller on consumer confidence in New Zealand.[127]

[330] The plaintiff's case was that these considerations were speculative. The reality was that Feltex was not selling the volumes of carpet or generating the levels of revenue that had been contemplated so that the current trading experience did not justify optimism that the deficiency could be made up, as well as adding additional sales to achieve the projected revenue figure.

[331] The plaintiff's criticisms that the FY2005 projection was unreasonable relied in part on the circumstances surrounding profit downgrades for Feltex that were announced on 1 April and 20 June 2005.[128] These announcements came relatively soon after a positive announcement of the results for the half year to the end of December 2004, released to the NZX on 23 February 2005. That reported a net surplus that was up 7.1 per cent on the previous corresponding period and an interim

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127 CB10 007703, 007740 and 007648.
128 CB18 013418, CB19 013804.

dividend for the year of six cents per share which was 15.4 per cent above the interim dividend that had been projected in the prospectus.

[332] One example of the changed business environment from early 2005 is the assessment the Board undertook of consumer sentiment in Australia. Independent experts consulted at the time of the prospectus suggested positive levels of consumer sentiment whereas one of them, the Westpac Melbourne Institute of Consumer Sentiment survey, reported on 9 March 2005 the biggest ever fall in consumer confidence recorded during the life of the survey, between February and March 2005.[129]

[333] There was a natural inclination for the plaintiff to focus on issues referred to in Board papers and minutes and other documents to which directors were a party, in the second and third quarters of FY2005 that identified sources of concern as Feltex encountered deteriorating trading conditions. The inference I was invited to draw was that these adverse changes must have been readily predictable in May 2004, and ought therefore to have required the directors to adopt a more cautious approach in their projection for FY2005.

[334] That is classic hindsight thinking. Reflecting on the totality of evidence as to the position as assessed by the directors at the time of the prospectus, I am not persuaded by the plaintiff's arguments that the approach the directors adopted in light of all the information available to them at the time was unreasonable.

[335] As noted, Mr Meredith opined that Feltex's assumption that it would grow market share was not reasonable as a matter of common sense. In cross-examination, Mr Meredith accepted that he had not considered the reasons advanced by defendant witnesses for assuming Feltex would increase its market share in FY2005 and he had not undertaken any analysis of the effect of new tufting equipment that Feltex had acquired, the productivity of which was relied on by those making the assumptions of increased market share. Nor had he considered the 8 April 2004 presentation on the assumptions then being developed for the FY2005

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[129] CB18 013533.

projection, so he was unable to analyse the matters that were taken into account by those who formulated the assumptions.

[336] Mr Meredith's opinion could not stand against the thorough defence of the basis on which the projection was formulated in evidence from various defendant witnesses who were subjected to cross-examination about it. In cross-examination, Mr Meredith conceded a lack of appropriate expertise, and that those involved were in a better position to make assessments on the relevant factors.[130]

[337] Having regard to all of the information available to the directors at the time the prospectus issued, and in light of the relative thoroughness of the process undertaken to arrive at those projections, I am satisfied that the assumptions relied on, and the projected numbers in the FY2005 projection, were reasonably open to the directors. It follows that they were not misleading.

[338] The plaintiff's case also evolved on other aspects of the criticisms of the prospectus. That led to challenges on behalf of the defendants to criticisms being pursued when they related to unpleaded allegations. I have considered the essence of the plaintiff's criticism in relation to the FY2005 projection and the assumptions on which it relied. I am satisfied that, to the extent they need to be considered, the defendants were sufficiently on notice of these criticisms for them to be treated as coming within the criticisms that were pleaded.

D Misleading presentation of historical and prospective financial data

[339] The plaintiff made a range of criticisms of the way in which accounting data was presented in the prospectus. These relate to quantitative representations. There was no allegation that the figures in the prospectus reflecting Feltex's performance up to the date of the prospectus were wrong. Rather, a range of criticisms was advanced to the effect that both historical and prospective figures were presented in a misleading way.

[340] The plaintiff accepted that this concern was for unsophisticated investors who would not sufficiently understand the context in which financial data was presented

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130 NoE at 671, 672.

to be able to make accurate assessments in relation to it. The defendants disputed that any accounting or financial data was presented in a misleading way.

[341] In addition, the defendants denied that any presentation that was misleading to unsophisticated readers could in any event have caused any loss. This was because the market price for Feltex shares was arguably dictated by the views of sophisticated investors, who it was accepted would not be misled by the manner of presentation of the data. The unchallenged evidence for the defendants was to the effect that, once listed, the market price of Feltex shares efficiently assimilated all analyses of share value, and the market's on-going assessment was reflected in the share price. It would follow that, to the extent any misleading content was made out, unsophisticated investors who were potentially misled by it could not, in any event, make out any loss because sophisticated investors who set the price for Feltex shares would not have been misled.

The "second bottom line"

[342] In the section of the prospectus addressing prospective financial information, it included, at page 85, a table in the following terms:

CONSOLIDATED STATEMENT OF PROSPECTIVE FINANCIAL PERFORMANCE

FOR THE YEAR ENDING	**FORECAST JUNE 2004 $000**	**PROJECTION JUNE 2005 $000**
Total operating revenue	**335,498**	**348,147**
Earnings before interest, tax, depreciation, amortisation and write-offs – EBITDA	**41,641**	**51,683**
Depreciation	(8,076)	(8,427)
Earnings before interest, tax, amortisation and write-offs – EBITA	**33,565**	**43,256**
Amortisation of goodwill	(1,958)	(1,984)
Write-off of bank facility fee	(341)	-
Write-off of Bond issue costs	(4,881)	-
Earnings before interest and income tax	**26,385**	**41,272**
Interest expense	(13,307)	(7,526)
Early Redemption Amount	(5,014)	-
Operating surplus before income tax	**8,064**	**33,746**
Income tax benefit / (expense)	649	(11,335)
Net surplus after income tax	**8,713**	**22,411**
Share of retained surplus of associate companies after income tax	1,400	1,478
Net surplus attributable to Shareholders	**10,113**	**23,889**
Net surplus attributable to Shareholders (before amortisation, write-offs and Early Redemption Amount)	**22,307**	**25,875**

[343] The plaintiff alleged that the inclusion of the last line in this table was misleading. The penultimate line reflected the calculation of the net surplus attributable to shareholders in each of the forecast FY2004 period and the projected FY2005 period. The sequence of items listed above that point in the table started with operating revenue and then listed categories of costs that had to be deducted before arriving at the net surplus attributable to shareholders. Having done that, the drafters of the prospectus then included a further line that adjusted the net surplus attributable to shareholders by adding back in a specified list of costs that had been deducted at earlier stages in the table. On the plaintiff's case, this last line in the table was described as "the second bottom line".

[344] The inclusion of the calculations reflected in the second bottom line had been suggested by one of the JLMs. An email dated 7 April 2004 from Carolyn Steele, one of the team at ForBar, commented on the prospective financial information in the draft prospectus as follows:[131]

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

[345] In defending the inclusion of the second bottom line, the defendants called evidence to the effect that the table on page 85 would have been misleading without it because the penultimate line showing the forecast FY2004 net surplus attributable to shareholders in unadjusted form would suggest that Feltex was thereafter on a path of very substantial growth when compared with the comparable projected figure for FY2005. Such an implication would not be justified. It was argued that readers of the prospective financial information might well be confused or question the much more significant increase in net surplus attributable to shareholders from $10.113 million in FY2004 to $23.889 million in FY2005 as shown in the first bottom line. The defendants took the view that the extent of one off costs incurred because of the IPO should be isolated so that a reader of the financial data could compare the core operating revenues and expenses likely to be generated by Feltex's business on a year-on-year basis.

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131 CB10 007818.

[346] The rationale for isolating one-off costs cannot apply to the amortisation of goodwill. In calculating the second bottom line, there was an adding back of $1.958 million for amortisation of goodwill that was noted at page 89 of the prospectus as reflecting an historical amortisation of goodwill associated with the acquisition of Shaw. It was projected to be written off over a 20 year period, consistently with accounting standards, so that the equivalent figure in the projection for FY2005 was for amortisation of a further $1.984 million. The separate justification for adding back this amortisation was that it was a non-cash item that did not affect Feltex's on-going capacity to generate income. It was included to recognise the reduction in value of the intangible asset comprising goodwill that had been recognised on the purchase of Shaw.

[347] There was no commentary accompanying the table which might have explained a rationale for the inclusion of the second bottom line. Mr Thomas thought that there would have been little point in a footnote explaining the rationale because any readers of the prospectus who needed an explanation about inclusion of the second bottom line would be unlikely to go to a footnote. I do not accept that as an adequate justification for omitting what would have been a helpful clarification of what was presented in the table on page 85.

[348] The plaintiff alleged that the inclusion of the second bottom line was contrary to accounting standard FRS-29, gave the impression of greater profitability than was the case, and diverted attention from the first bottom line, which was required by FRS-2, para 6.1, and FRS-29, para 5.1. An allied criticism was that the adjusted larger amount in the FY2004 forecast lent credibility to the increased profitability projected for FY2005. If readers were left with the unadjusted figures in the first bottom line, they would arguably be more likely to question the achievability of the FY2005 projection.

[349] Mr Houghton's evidence on the second bottom line reflected confusion about the description of what it represented, and he was not quite sure how to read the difference between the first and second bottom lines.[132] His evidence cannot be taken to reflect how he responded to the second bottom line when considering an

[132] NoE at 54/16, 21.

investment in Feltex, as he was unsure whether he actually read page 85 at the time.[133]

[350] After the relevance of the criticism of the second bottom line had been focused upon to a greater degree, Mr Houghton deflected a question in cross-examination on the ability to understand how the difference between the first and second bottom lines had been calculated, by observing:[134]

> When I am looking at this page, the only thing that is mattering to me is what the total is at the bottom.

[351] I am satisfied that had the confusion Mr Houghton described as to the way the first and second bottom lines were presented on page 85 in fact been material to him at the time, a reasonably careful consideration of the items on page 85 would have led him to understand how the different numbers had been calculated.

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

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

[353] Professor Newberry was critical of the inclusion of the second bottom line on a number of counts. By the end of her evidence, I took her to be criticising its

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133 NoE at 78/6.
134 NoE at 80/1.

inclusion by reference to relevant accounting standards on the basis that it was contrary to the spirit, if not the letter, of relevant requirements. She resisted a second bottom line labelled as net surplus attributable to shareholders, when it did not in fact reflect the financial surplus that was attributable to shareholders.

[354] Professor van Zijl is a former chair of the Financial Standards Review Board, and has also been a member of the Accounting Standards Review Board. Those bodies were, at relevant times, responsible for setting standards as to how financial information ought to be presented. I accept that Professor van Zijl's views on presentation of accounting information are entitled to considerable respect. He was not materially challenged on his analysis of the implications of Feltex having included the second bottom line. He addressed it in the following terms:[135]

> To assess the usefulness of the second bottom line it is appropriate to consider the objectives of providing prospective financial information. According to FRS-29 para 1.4, the objectives include assisting users of the information to make decisions about providing resources to the entity (from para 1.4(c)). Potential investors in Feltex could be expected to have been interested to know the company's assessment of its future performance. Given the May 2004 date of issue of the Prospectus, potential investors were most likely to be interested in the company's projected performance for FY05, with the forecast performance for FY04 as a useful check on the credibility of the projected performance for FY05.
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> ... in order to properly assess the credibility of projected performance for FY05, it was appropriate to have regard to the forecast net surplus after adjusting for all these [one-off and non-cash] expense items. This adjusted net surplus would indicate the level of net surplus for a normal period. This is not an esoteric technical matter. Rather, it makes sense that if the record of the current situation or near past is to be used as a guide to the future then it is necessary to remove from that record all items that are specific to the current situation or near past. That is, the record should be adjusted to one that would have applied in a normal period.

[355] Professor van Zijl considered that there was no constraint in any relevant accounting standard that precluded the preparers of financial statements from adding an adjusted figure to the net surplus attributable to shareholders, to reflect the outcome on some relevantly different basis. Professor van Zijl rejected the prospect that any readers of the prospectus who could learn anything by considering the table would ever be misled by the inclusion of the second bottom line.

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[135] van Zijl BoE at 27, 28.

[356] I am not satisfied that the presentation on page 85 breached any relevant accounting standard. Non-compliance would not have made out the test for an untrue statement under the SA, but would be likely to add materially to arguments that the presentation was misleading, if the breach contended for on behalf of the plaintiff had been made out.

[357] In other respects, Professor Newberry criticised the second bottom line as being so illogical as to inevitably mislead readers not familiar with the processes for including adjusted or "normalised" items in statements of financial performance. This opinion was shared by Mr Meredith, who emphasised that, for a non-professional reader, the second bottom line was misdescribed because it certainly was not a net surplus attributable to shareholders when it included substantial components that were not available to be attributed to shareholders.[136]

[358] It was very clear that none of the plaintiff's accounting experts were at any risk of being misled by the presentation on page 85. Like virtually all of the witnesses for various defendants who addressed the topic, they clearly understood what the second bottom line represented, and also understood a rationale for its having been included. For her part, Professor Newberry's concern was because her perception of the notional investor was someone who would "scan through" the items listed on page 85 and find the inclusion of two "bottom lines" confusing. She attributed to a retail investor the thought process that:[137]

> … I don't know which is which [ie among the two lines that suggest the company's earnings]. I'll go for the bottom line.

[359] Interestingly, such a reader is not misled by the presentation, but rather is confused, leading to the prospect of seeking clarification if the point was considered material.

[360] None of the witnesses who addressed this point went so far as to opine that any constituency of readers would treat the second bottom line as stating the normal or unadjusted measure of net surplus attributable to shareholders. The second and

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136 NoE at 591/3–14.
137 NoE at 337/28.

third defendants submitted that in a representative action of this type, it could reasonably be expected that the plaintiff would call evidence from unsophisticated shareholders who were actually misled as to the effect of the second bottom line, if indeed there had been any such misleading. They urged that it was significant that there was no such evidence.

[361] Mr Cameron also supported the inclusion of the second bottom line as appropriate. His focus was on a presentation that enabled the reader to consider Feltex's on-going ability to generate free cash flows, in the sense of earnings after "usual" outgoings. To do that, he endorsed the inclusion of calculations of "normalised" earnings. His evidence included a survey of nine other prospectuses issued in New Zealand since 2004 where various forms of adjusted or normalised financial results had been included. Mr Cameron treated the second bottom line as an appropriate statement of normalised earnings for Feltex.

[362] I accept the view of numerous defendant witnesses that the second bottom line was helpful to sophisticated readers of the prospectus because it reflected a calculation that they would be likely to undertake in analysing the prospective financial information. The plaintiff was inclined to argue that such readers did not need that assistance, but it was not denied that those readers who were aware of why an adjusted figure would be cited in these circumstances would be helped by having the calculation done. Professor Newberry accepted that opinions would be divided on whether the second bottom line was helpful or misleading and that readers like Mr Cameron would appreciate such information.[138]

[363] On this point, the second and third defendants submitted that it would be rare to find information misleading where there was no dispute over its accuracy and other readers would find it helpful. The point is context-specific, but here it highlights the attributes of the audience which those drafting the prospectus should have had in mind, and accordingly the characteristics I attribute to the notional investor.

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[138] NoE at 228/10–24.

[364] Allied to this is the point already noted, that omitting the second bottom line would risk misleading a constituency of readers because the stark contrast between the FY2004 forecast and the FY2005 projection suggested a substantial growth in earnings, the extent of which would appear overstated because the 2004 earnings were reduced so substantially by the one-off costs of the IPO. Arguably, if the second bottom line had a legitimate purpose in preventing the presentation being misleading in one sense, then its inclusion ought not to be found misleading, provided it was accurately expressed and had a genuine rationale.

[365] For non-accountants, the concept of "the bottom line" has ubiquitous, if somewhat imprecise, connotations of the final outcome, or the result that matters. A variant on that in the context of financial statements is that the number at the bottom of the statement is the important one, being the "profit" for the owner of the business. I agree that a certain constituency of unsophisticated readers would likely be confused by the inclusion of the second bottom line. However, that is not the test I have to apply. The constituency of readers potentially confused by the second bottom line could comprise three types:

(a) First, those who do not appreciate that they are confused by the presentation of two bottom lines. Any readers of that type are either so lacking in basic interpretative skills as to be outside the scope of the prudent non-expert investor, or have read the page so cursorily as to not give themselves a chance of understanding what was being conveyed.

(b) The second type are those who appreciate that they are confused by the presentation of two bottom lines, consider this detail is material to their deliberation, but elect to rely on a confused impression of what it conveyed, without seeking clarification from anyone with the skills to explain what was being conveyed. Again, that type of reader falls outside the prudent non-expert.

(c) The third type are those who appreciate that they are confused and, to the extent that the information conveyed is likely to be material, they

take advice from a more skilled reader able to explain the significance of both bottom lines to them. That type of (initially) confused reader would not be misled.

[366] Professor Newberry had a further presentational criticism of the prospective financial information on page 85 of the prospectus. Immediately below the table ending with the second bottom line as set out in [342] above was an accompanying consolidated statement of prospective movements in equity. Entirely conventionally, that set out the equity at the beginning of the financial year (1 July 2003) and then set out a sequence of lines for movements affecting the extent of equity, ending with the forecast equity amount as at 30 June 2004. The first of those figures below the opening balance was "net surplus for the year", which took the number of $10,113,000 from the first bottom line.

[367] Professor Newberry considered that would add to the confusion caused because unsophisticated readers would expect the figure carried down for inclusion in this item to be "the bottom line" from the preceding statement of financial performance (that is, the second bottom line).

[368] I do not consider that this discrete criticism raises a respect in which the prospectus was misleading. The constituency of readers who would have expected the bottom line in a conventional statement of prospective financial performance to be the number transposed as the net surplus for the year would be those with a sufficient level of familiarity with the presentation of financial statements to appreciate why an adjusted figure had been included as the second bottom line in this case.

[369] I accept the criticisms advanced by plaintiff's experts that the inclusion of the second bottom line created a risk of misleading cursory readers of that table in the prospectus. Certainly, the rationale for the inclusion of the second bottom line would have been made much clearer by a footnote describing what had been done in its presentation, and why. I do not accept Mr Thomas's reason for rejecting such an addition, and I am satisfied that the table would have had more utility for unsophisticated readers if a footnote explained that the second bottom line

constituted a form of adjusted or normalised earnings for Feltex, and that the items added back were either non-recurring, or a non-cash item.

[370] However, the standard by which the prospectus is to be judged is not that of the highest clarity or greatest understandability. I am not satisfied that the inclusion of the second bottom line would mislead the notional investor as I have characterised that audience for the prospectus. A majority of careful non-sophisticated investors would at least understand how the number had been arrived at, even if they did not appreciate (without taking advice) why it had been done. The category of those who could be misled is therefore confined to readers less careful than the notional investor.

[371] As to whether the second bottom line was misleading, Mr Galbraith submitted that all of the content of page 85 required a basic level of accounting skills for it to have any utility to a reader of the prospectus. He instanced the item of amortisation, which is a concept that any reader considering the statement of prospective financial performance would need to understand. A similar point could be made in relation to the listed items of expense for writing off bank facility fees and bond issue costs. I accept that as a further point supporting an assessment of this criticism by the standard of readers who either have sufficient understanding of the presentation of financial statements to understand the rationale for the second bottom line, or are sufficiently careful in their consideration of that page to seek advice as to what was conveyed by the second bottom line, to the extent that they did not understand it.

Presentation of NPAT in summary financials

[372] In opening, the plaintiff raised a related criticism that the presentation of NPAT in the summary financials was misleading. A table at page 19 of the prospectus was in the following terms:

CONSOLIDATED STATEMENT OF PROSPECTIVE FINANCIAL PERFORMANCE

12 MONTHS TO 30 JUNE	2002	2003	2004[1]	2005[1]
	ACTUAL $000	ACTUAL $000	FORECAST $000	PROJECTED $000
Total Operating Revenue	322,506	314,352	335,498	348,147
EBITDA	13,219	31,018	41,641	51,683
EBITA	3,894	23,175	33,565	43,256
NPAT (before amortisation, write-offs and Early Redemption Amount)			**22,307**	**25,873**

[1] For further information on the forecast 2004 and projected 2005 financial information including the assumptions underlying this summary, please see "Prospective Financial Information" on pages 85 to 92 of this Offer Document.

[373] The figures cited for NPAT in the FY2004 forecast and the FY2005 projection were derived from the prospective financial information at page 85.[139] There were two elements to the criticism. First, that describing those numbers as NPAT, despite the qualification to the character of the NPAT by the words in parentheses after it, was misleading to readers of that table. For those who did not cross-check with the table at page 85[140] to see how the NPAT amounts were arrived at, the conceptual inconsistency between a figure for net profit after tax, and an amount labelled as NPAT but adjusted by adding back in significant pre-tax expenses for amortisation, write-offs and early redemption amounts, would arguably mislead readers of the summary financials.

[374] The second element of the criticism was the omission of amounts for NPAT in the actual results for 2002 and 2003. Given the format in which the NPAT line was printed, there was no space to include a figure for the 2002 year, and there was no explanation as to why gaps were left for both 2002 and 2003. If included, 2002 would have shown a negative number of $18,283,000, and 2003 would have reported a net surplus of $6,841,000.[141] It was argued for the plaintiff that the inclusion of the profit outcome from those years was necessary to illustrate how dramatically the company's financial fortunes had changed, and that it was misleading to omit them.

[375] At no stage were these criticisms related to allegations in 4ASC. Nor did I discern them being among the matters the plaintiff acknowledged that it was abandoning. A passing reference was made to them in the plaintiff's closing

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139 Reproduced at [342] above.

140 Readers of page 19 were directed to go to page 85 and following for the assumptions underlying the summary.

141 Adopting the net surplus attributable to shareholders at page 93 of the prospectus as the equivalent of NPAT in this context. Mr Cameron accepted that as appropriate – NoE at 2456.

submissions,[142] but only as a component of a high-level commentary on the overall impression given by the prospectus.

[376] These criticisms might have relevance in relation to a notional investor reading page 19 in isolation from other relevant components of the prospectus. I accept that some less sophisticated readers who took an impression from the summary financials, without following the direction to check the greater detail on later pages, could risk being left with a misleading impression as to the level of NPAT forecast to be earned by Feltex in the year to 30 June 2004. The reality is that more than half of the $22.3 million is not NPAT at all, but rather an adding back of significant pre-tax expenses that were non-recurring, or non-cash items.

[377] However, this criticism cannot be evaluated in that isolated way. Those responsible for preparing the prospectus were entitled to assume that the understanding taken from the summary financials by readers of the prospectus would reflect their reading and appreciation of other content of the prospectus to which it was explicitly linked. If assessed in that way, the presentation of NPAT in the summary financials would not be misleading to the notional investor.

Inappropriate emphasis given to EBITDA

[378] The analysis of Feltex's financial performance used calculations of EBITDA implicitly as an appropriate measure. In the narrative on "Key Investment Features" at page 7, the prospectus stated:

> Feltex is projecting EBITDA of $52 million in FY2005, an increase of 13% on forecast EBITDA (on a pro-forma basis adjusted for one-off items) of $46 million in FY2004. The FY2004 forecast pro-forma EBITDA is, in turn, an increase of 48% on EBITDA of $31 million in FY2003.

[379] In a summary pricing table at page 11 of the prospectus, the statement of prospective financial performance from page 85 (as set out in [342] above) was relied on to calculate a table of projected implied multiples and yields. It was set out in the following terms:

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142 See [12.7] and [12.8].

FELTEX FY2005 PROJECTED IMPLIED MULTIPLES AND YIELD[1]

	FINAL PRICE PER SHARE[2]		
	$1.70	**-**	**$1.95**
Fully Paid Shares on Issue (million)[3]	149.4		145.6
Market Capitalisation ($ million)[4]	254.0		284.0
Enterprise Value ($ million)[5]	348.1		378.1
FY2005 Projected EBITDA ($ million)		51.7	
FY2005 Projected EBITA ($ million)		43.3	
FY2005 Projected NPAT (pre-goodwill amortisation) ($ million)		25.9	
FY2005 Projected Cash Dividend ($ million)[6]		19.5	
FY2005 Offer Multiples and Yield			
Enterprise Value / EBITDA	6.7x		7.3x
Enterprise Value / EBITA	8.0 x		8.7x
Price / Earnings (pre-goodwill amortisation)[7]	9.8x		11.0x
Cash Dividend Yield[8]	7.7%		6.9%
Gross Dividend Yield[9]	9.6%		8.6%

NOTE: EBITDA means earnings before interest, tax, depreciation and amortisation.
EBITA means earnings before interest, tax and amortisation.
NPAT (pre-goodwill amortisation) means net profit after tax before goodwill amortisation

1. Figures in this table are derived from the projections prepared by Feltex and set out under the heading 'Prospective Financial Information' on pages 85 to 92 of this Offer Document. The projected multiples and gross yield should be read in conjunction with the projected assumptions set out under the heading 'Principal assumptions underlying the projections' on pages 90 to 92 of this Offer Document.
2. Calculated using the bottom and top end of the Indicative Price Range.
3. Shares on issue at the conclusion of the Offer.
4. Calculated as Shares on issue at the conclusion of the Offer multiplied by the Final Price.
5. Calculated as market capitalisation plus forecast net debt of $94.1 million as at 30 June 2004 and following the redemption of the Bonds.
6. In respect of the year ending 30 June 2005, an interim dividend of S7.8 million is projected to be paid in March 2005 and a final dividend of $11.7 million is projected to be paid in October 2005. In addition, a cash dividend of $9.0 million is projected to be paid in October 2004 in respect of the year ending 30 June 2004.
7. Calculated as the Final Price divided by earnings per Share. Earnings per Share calculated as projected net profit after tax and before amortisation divided by Shares on issue at the completion of the Offer.
8. Calculated as projected cash dividend per Share divided by the Final Price. Cash dividend per Share calculated as projected cash dividend divided by Shares on issue.
9. Calculated as projected cash dividend per Share plus projected imputation credits attached per Share divided by the Final Price. The dividends in respect of the year ending 30 June 2005 are projected to be 52% imputed.

[380] The plaintiff criticised the reliance on EBITDA as misleading because its use in the prospectus arguably implied that EBITDA was a reliable measure of financial performance. In the view of experts called for the plaintiff, it did not provide such a reliable measure. The plaintiff criticised the use of EBITDA as a form of proxy for measuring the level of Feltex's earnings, when it did not constitute that and was misleading when relied on for that ostensible purpose. Further, it was pleaded that the use of EBITDA concealed Feltex's falling sales trajectory.

[381] The plaintiff relied on the opinion of Professor Robb who was critical of the reliance placed on EBITDA in financial statements generally, as well as being critical of what he considered to be misleading reliance on EBITDA as a measure of financial performance in the Feltex prospectus. Professor Robb considered it was no indication in relation to solvency, nor was it a measure of performance provided for in accounting standards.[143] Professor Robb accepted that EBITDA was widely used as a measure of performance, but that had not caused him to change his views about it. Rather:[144]

> … it takes a time for some analysts to accept that some of the measures they've used are not good.

[382] Mr Meredith was less critical of the use of EBITDA. He acknowledged that it was an important measure of financial performance but considered that it ought to be used together with other measures of financial performance such as NPAT and level of sales.[145]

[383] Mr Russell volunteered "Yes, I'm an EBITDA man …"[146], and qualified that by treating EBITDA as a primary focus for sophisticated investors because they could put it into context, whereas less sophisticated investors would be more concerned with NPAT.

[384] From the perspective of an analyst, Mr Cameron supported the use of EBITDA as a helpful measure of financial performance. He acknowledged Professor Robb's apparently well-known[147] different perspective as an accounting academic concerned to have financial statements that were as accurate as possible at a particular point in time. In that context, other measures of financial performance were likely to be more appropriate. However, analysts seeking to assess the relative strength of a company's performance over a period of time are interested in applying a relatively standardised measure as a proxy for operating cash flows, from one period to another and as between companies sought to be compared. Mr Cameron acknowledged that EBITDA is by no means perfect, but considered that it enjoyed

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143 NoE at 520.
144 NoE at 527/12.
145 Meredith BoE at [202].
146 NoE at 1089/32.
147 NoE at 2421/17.

widespread support in the financial analyst community because of its utility in this context. Mr Cameron did not accept that the contexts in which EBITDA were used in the Feltex prospectus were likely to mislead any readers of the document who understood the components of the calculation, and the reasons for reliance on it.

[385] Professor van Zijl also supported the use of EBITDA as an appropriate measure of financial performance. He would not accept that there was any risk that use of EBITDA might be confusing, essentially because references to EBITDA would be no use to any readers who did not understand the concept and why it was used. He pointed out that EBITDA was a defined term and the calculations as presented were derived from other figures that were also available in the financial statements.

[386] There was no evidence of any investor in the Feltex IPO being misled by the form in which EBITDA calculations were included in the prospectus. It is common ground that sophisticated investors and analysts would readily appreciate the nature of the calculation, and the purpose for citing it in the various places in which it appeared.

[387] The plaintiff's case was advanced on the basis of Professor Robb's inherent dislike for EBITDA as not having the reliability as a measure of financial performance that financial analysts treat it as having, together with conjecture that concerns of the type he described would be more likely than not to cause some readers of the prospectus to be misled.

[388] That analysis is a substantial distance away from what is contemplated by the definition of an untrue statement and I am not satisfied that the manner in which EBITDA was used in the prospectus was misleading.

[389] It is regrettable that the prospectus did not use strictly consistent ingredients for its EBITDA calculations at all points where the concept was used. As a defined term, the prospectus adopted a non-standard definition of the elements of EBITDA by including "write offs". However, at some points in the prospectus, write-offs were not included in an EBITDA calculation. This was not a pleaded criticism, but

was traversed in evidence and argument. I am satisfied that the defendant witnesses who were asked questions as to the inconsistencies in the types of expenditure deducted in calculating EBITDA at various points in the prospectus were well able to deal with them. That is not to say that the defendants might not have called other evidence on the point, and been in a position to advance additional arguments, had they been on notice prior to trial of a pleaded criticism on the point. Given the view I have come to, their interests are not prejudiced by including consideration of it.

[390] The inclusion of write-offs rendered the use of EBITDA likely to confuse a small constituent of potential readers of the prospectus. Analysts and sophisticated investors would readily appreciate that a non-standard measure for EBITDA had been used, by virtue of the list of items included. At the other end of the scale, inexperienced retail investors could not be expected to appreciate the reason for EBITDA calculations and would prudently have been wary of placing any reliance on them. Shortly before Mr Meredith gave evidence, I declined an application for his evidence to be expanded to address this criticism. I did so on the basis that it was not a pleaded criticism. Notwithstanding that, the topic was addressed for the plaintiff and I remain of the view that its inclusion would not have made any relevant difference.

Misleading inclusion of SIP grants in reported earnings

[391] The plaintiff alleged that the prospectus was misleading in treating certain grants from the Australian Government as income with the consequence that it was reflected in NPAT, and also that the prospectus failed to disclose the extent to which Feltex's profit was reliant on those grants continuing. It was allegedly misleading to use an NPAT figure that incorporated the grants received when calculating the capitalised value of Feltex's earnings in a valuation multiple set out in the summary at page 11 of the prospectus. Also, it was allegedly misleading for the grants not to be identified separately from "total operating revenue" in the table of prospective financial performance on page 85 (as set out at [342] above).[148]

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[148] 4ASC at 66. (The second and third defendants took the point that the complaint that the prospectus failed to disclose the extent to which Feltex was reliant on the grants continuing was not a pleaded allegation.)

[392] There was no question of Mr Houghton having been misled by the manner in which SIP grants were treated in the prospectus. Nor was there any evidence of other readers of the prospectus having been misled. Rather, it was approached as a matter of expert analysis, to the effect that the way in which these items had been treated was likely to mislead readers.

[393] This source of payments to Feltex was described at page 50 of the prospectus in the following terms:

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

[394] There was no dispute with the accuracy of that statement.

[395] Consistently with that description, the SIP grants received in FY2004 were included in the total operating revenue stated in the opening line in the prospective financial information at page 85 of the prospectus. The plaintiff's complaint was that the SIP grants ought to have been separately listed, to identify the extent of the receipts from that source, enabling a comparison of that number with the net surplus attributable to shareholders of $10.113 million.

[396] On the page after the consolidated statement of prospective financial performance on page 85, the prospectus had a consolidated statement of prospective cash flows. In relation to the FY2004 forecast, the first category of entries was for "cash flows from operating activities". That included a line item for "other income" of $4.737 million. I accept the defendants' construction that for any observant reader who had considered the description of SIP grants on page 50, the line item for "other income" in the cash flow statement would be treated as including the SIP grants that were quantified at $4.7 million for FY2004.

[397] At a later point (page 97) the prospectus included statements of historic cash flows for the 12 months to June 2002 and 2003, and the six months to December 2003. In that statement, the cash flows from operating activities included a separate line item for "Government grants and rebates" with the amounts for the stated periods set out respectively as $795,000, $815,000 and $1.406 million. Again, allowing for rounding, the items for the 2002 and 2003 financial years match the description of SIP payments from page 50 of the prospectus. In addition, it would be tolerably clear that the $1.406 million for the half year to December 2003 was a component of the $4.7 million described at page 50 as being received in FY2004.

[398] It was acknowledged during the hearing that the appropriate accounting standards at the time provided for, and arguably required the inclusion of the SIP grants in operating revenue. Further, it was suggested that that was a condition of the government scheme under which the grants were made.

[399] Professor Robb contended that the SIP grants should have been treated as a non-recurring item. However, to the extent that he maintained that view, I prefer the contrary analysis that they were appropriately treated as a recurring item because, at the time of the prospectus, the grant scheme was to continue until at least 2010. That view was put by Professor van Zijl[149] and Mr Tolan[150] in terms that better reflected the practical reality of the scheme. Mr Tolan described a strong view that expenditure on innovation would continue, so Feltex would continue to apply for grants with an expectation of their receipt.[151]

[400] For his part, Mr Meredith was unable to determine whether the SIP grants were taxable, and accordingly did an analysis of their relative materiality on a before tax basis. The grants were in fact taxable so in that respect their materiality was to be assessed as an addition to gross (taxable) revenues. Mr Meredith considered that the SIP grants constituted a very significant portion of the operating surplus before income tax, so that if they had not been received, the forecast for FY2004 would have been very much worse.

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149 van Zijl BoE at [84]–[87].
150 Tolan BoE at [90].
151 NoE at 1634/27.

[401] The plaintiff argued that irrespective of their tax status, Mr Meredith's analysis demonstrated that the extent of the SIP grants relative to the forecast surplus rendered them material. Closing submissions cited FRS-29, para 5.5(b) as directing disclosure because, in terms of that standard, they were of such:

> … incidence and size, or of such a nature, that their disclosure is necessary to explain the prospective financial performance of the entity.

[402] The plaintiff's argument also relied on Mr Lim's opinion to the effect that where those drafting the prospectus sought to illustrate the impact of non-recurring or non-cash items that transformed the bottom line from $10.113 million to $22.3 million, then for consistency readers could expect the impact of $4.7 million from non-operating revenue also to be shown.[152]

[403] The plaintiff's closing sought to make something of an acknowledgement by Professor van Zijl during his cross-examination to the effect that a separate disclosure of the SIP grants on page 85 was "debatable" as a concession that readers of page 85 would have been better informed, had that been the case. I agree with the rejoinder for the second and third defendants on this point. First, adding additional information on a particular page to give a higher level of understanding is a distinctly different notion from whether the page is misleading without such additional information. Secondly, in the context of the points being put to Professor van Zijl, whilst a possible addition was seen as "debatable", the witness's overall view was that there was no need for additional disclosure to prevent the prospectus being misleading on the point.

[404] The directors opposed an assessment of the materiality of SIP grants as a proportion of the forecast net surplus. This part of the plaintiff's argument was advanced on the basis that SIP grants were a receipt in FY2004 for which there had been no expenditure (on the basis that all relevant expenditure had been incurred in the previous year) so that the receipts "went straight to the bottom line". That overlooks, first, that Feltex had to account for tax on the grants received, and also that there would be costs incurred in relation to the prior year's qualifying expenditure. The directors submitted that the extent of the SIP grants had to be

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[152] NoE at 949/25–950/9.

measured against total revenue, where they were required to be accounted for. On that basis, they comprised some 1.4 per cent ($4.7 million of $335.5 million).

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

[406] I am satisfied that the terms for receipt of SIP grants were adequately and accurately described at page 50 of the prospectus. What a reader of the prospectus made of that information when considering the table on page 85 would depend on the level of sophistication of his or her analysis. Once again, there could be no suggestion that sophisticated readers of the prospectus would be misled by an omission from the table of a separate line item for the SIP grants.

[407] For unsophisticated readers, if the components of revenue at the top of the table were broken down (as indeed they were on the following page), it seems likely that many of them would not draw the inference about the relative impact of the SIP grants on the net surplus appearing near the bottom.

[408] I am accordingly not persuaded that the manner in which SIP grants were treated in the prospectus was misleading. The basis for the grants, and how they were to be accounted for, were adequately described in the prospectus. It is unrealistic to expect the drafters of the prospectus to make explicit reference[153] to the fact that of $10.113 million of net surplus attributable to shareholders in the FY2004 forecast, an amount of $4.7 million less the income tax payable on that amount was derived by way of government grants for capital expenditure incurred in the previous financial year.[154]

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153 Such as in the table at page 85.

154 The evidence did not include any analysis of the after-tax benefit derived from the SIP grants.

Failure to disclose forward dating of sales invoices – the allegation

[409] The plaintiff alleged that Feltex undertook a practice of forward dating invoices, both to encourage sales to meet the April 2003 prospectus forecast for the bond issue, and in May and June 2004 to meet the sales targets forecast in the prospectus. It was also alleged that this practice was used to prevent a materially greater under-achievement relative to the forecast sales figures for FY2004.

[410] The nature of these allegations evolved through the amended statements of claim, and was also refined during trial. Very little was made in closing of the resort to the practice in 2003. Earlier allegations that the accounting practice by which forward dating of invoices occurred was improper, and that earnings were accounted for in the incorrect period, were not pursued. Those elements of the criticism would have been difficult to sustain in light of the practice having been specifically vetted and approved by Ernst & Young as Feltex's auditors.

[411] As I discerned it, the plaintiff's final position was that the increased extent to which the practice of forward dating invoices was employed in the latter period of FY2004 ought to have been disclosed in the prospectus because:

- the extent of the practice concealed the true extent by which Feltex was going to miss its forecast revenue; and

- the practice would create additional difficulties for Feltex in achieving the level of sales projected for FY2005.

[412] The defendants admitted that the practice occurred. It involved issuing invoices in one month, but dating them the first of the following month. It was used as a means of giving extended credit to the customer by deferring the payment obligation from the end of the first month after the issue of the invoice (Feltex's "usual" credit terms) until the end of the second month after issue of the invoice. It was used as one of a range of incentives to encourage Feltex's customers to buy carpet.

[413] Mr Horrocks, the director who chaired the Audit and Risk Management Committee, accepted in evidence that the practice of forward dating invoices raised two issues. First, the appropriateness of revenue recognition, and secondly the impact on Feltex's requirements for working capital that might be put under pressure if the practice was used too widely. Mr Horrocks' recollection in relation to FY2004 was that he was comfortable on both considerations. He had urged management to maintain a dialogue with Ernst & Young about the practice and, after considering it, the auditors confirmed at the time that it was appropriate.[155]

[414] In commenting on the increased credit risk that might arise by granting the extended credit, Ernst & Young reported in August 2005 in relation to their work on the audit to June 2005 that Feltex's history of bad debts was "low", enabling the auditors to be comfortable that history demonstrated that accounts including forward dated invoices were recoverable.[156]

Forward dating of invoices - the GSM data

[415] The plaintiff's case on the extent of increase in forward dated sales in the second half of FY2004 depended substantially on an analysis of accounting data obtained from Godfrey Hirst that had been retrieved electronically from discontinued records stored on GSM software. Challenges to the admissibility of accounting records derived from GSM data absorbed quite extensive resources, both pre-trial and at trial. The plaintiff sought to rely on an analysis conducted by Professor Newberry of records derived from the GSM data that purported to show that there had been a 5.2 per cent increase in the extent of forward dated sales recorded in the second half of FY2004, when compared with the level of such sales in the first half of that financial year.[157]

[416] Measuring forward dated sales as a component of total sales for the months of April and May 2004 showed, on her calculations, that forward dated sales boosted the total sales for those months by 10.6 per cent, and sales for the whole of the three

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155 Towards the end of 2005, Ernst & Young recommended that the practice be discontinued because in subsequent accounting periods when Feltex adopted IFRS, the manner of documenting extended credit sales would not conform to the new accounting standards.

156 CB19 013865.

157 Newberry second reply BoE (24 March 2014) at [11].

months April to June 2004 by some 10.1 per cent.[158] Professor Newberry relied on this analysis to opine that Feltex's practice of forward dating invoices to this extent was a matter that ought to have been disclosed in the prospectus. Another perspective on these statistics is that, if the data is accurate, the percentages calculated reflect the part of Feltex's sales in those months that were documented on forward dated invoices, leaving for debate what portion of such sales may have occurred anyway if forward dating of the invoice was not provided by Feltex. Certainly as to New Zealand sales, there was evidence that Feltex provided the extended credit that was facilitated by forward dated invoices, without being asked.

[417] The defendants continued to oppose the admissibility of the GSM data, and analysis dependent on it. I deferred a ruling on the second and third defendants' application for exclusion of the GSM data, which was made at an early stage of the trial, pending receipt of all evidence that might go to its reliability.[159] There is no dispute that the data came from records maintained for Feltex at the relevant time. Mr Tolan, the defendant witness closest to the collection and recording of such accounting data, described it as a "data dump" in a form that he did not recognise having been used for reports produced by Feltex. Mr Tolan treated the data in that form as unreliable unless a reconciliation was able to be undertaken which had not been done, and could not now be undertaken. Mr Tolan considered the files that had been created by Mr Harper (the IT expert retained for the plaintiff) were materially inconsistent with the monthly accounts contained in the Board reports going to Feltex directors.[160]

[418] Professor Newberry acknowledged that she was working from incomplete records. When Mr Harper and Mr Farley, the IT expert retained for the defendants, eventually conferred about the integrity of the data, they agreed that in some details – perceived by the defendants to be potentially material – irreconcilable differences remained.

[419] The manner and timing of disclosure of the GSM data was most unsatisfactory. In June and December 2013, I relied on statements from Ms Mills to

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158 Newberry second reply BoE (24 March 2014) at [16].
159 *Houghton v Saunders* HC Wellington CIV-2008-409-348, 20 March 2014 (Ruling No 1) at [24].
160 Tolan reply BoE at [14], [21], [22].

the effect that all of Mr Harper's work in electronically interrogating the GSM raw data reflected analyses of that data that were undertaken in response to specific instructions he had been given by the plaintiff's advisers. That is, to extract components from a larger whole that would show some only of the records stored for the plaintiff's specific litigation purposes. Ms Mills relied on that description of the work being undertaken to assert that privilege could be maintained in respect of the output of all the work that Mr Harper had done. I was given to understand that all the product of Mr Harper's work resulted from his interrogating a larger field of data to produce analyses or reports that addressed specific topics he had been asked to research on behalf of the plaintiff.

[420] Throughout that period, the second and third defendants had pressed for disclosure of all the data that had been obtained via Godfrey Hirst, in some electronically useable form. It was provided at that time only in its original GSM format that was practicably unuseable for the defendants. I upheld the plaintiff's refusal to comply with those requests on the basis that the only electronically useable form of data that was available to the plaintiff reflected the product of analyses done in the preparation of their case. The second and third defendants continued to dispute that characterisation of the data in issue.

[421] Mr Harper's evidence at trial established that the product of the first task he undertook when instructed in October or November 2012 was to indiscriminately transform the whole of the data stored in GSM into a useable format (SQL). Mr Harper confirmed in response to questions from me that there was no technological reason why the electronically useable form of the data in SQL, as provided to the plaintiff's advisers, could not have also been provided to the solicitors for the defendants.[161] All the data in useable, SQL, format was eventually provided to defendants' solicitors in January 2014.

[422] Withholding the initial (indiscriminate) transformation of the data into SQL, and instead providing the defendants' solicitors only with the data in unuseable GSM form, is clearly contrary to the approach that should have applied. It is no answer that the plaintiff had to find an IT specialist with the skills to transform the data into

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[161] NoE at 173–174.

useable form, so the defendants should expect to have to do the same. Affording earlier access to the data in useable form may, in the end, not have made a material difference, but withholding the raw form of the data in useable form was unjustifiable. In those circumstances, the defendants ought not to have to justify the materiality of their complaint by establishing what more they could or would have done if granted timely access to the data.

[423] My concern at the conduct of the plaintiff's advisers in withholding a useable form of the data on which Professor Newberry's calculations rely cannot be determinative. However, in assessing the range of arguments advanced for defendants in disputing the reliability of the calculations, I have borne in mind that the quality and range of those arguments may have been adversely affected by the defendants not having access to the data in useable form until some 13 or 14 months after it was available to the plaintiff, and then only shortly prior to trial.

[424] The defendants also criticised the inadequacy of the opportunity that the plaintiff's advisers had given Professor Newberry to undertake any reliable analysis of the data. It transpired that she was not given the data until a few weeks before her witness statement was actually completed and already after the date set for service of the plaintiff's evidence. She acknowledged a number of times in evidence that she was under extreme time pressure and that she was working from incomplete data. After her first analysis had been criticised by Professor van Zijl for having treated credit notes as if they were invoices, she accepted that error and reflected further work on the GSM data in two reply briefs dated 7 and 24 March 2014.

[425] Professor Newberry also accepted that her final workings included within forward dated sales the amounts for sales from one Feltex company to another that were recorded in the GSM system but would not be transferred into Feltex's accounts.[162]

[426] For Professor Newberry's analysis relying on the GSM data to be admissible, I need to be satisfied that I am likely to obtain substantial help from her opinion in understanding other evidence in the proceeding, or in ascertaining any fact that is of

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[162] NoE at 258/31.

consequence to the determination of the proceeding.[163] The question is what is the issue on which I am likely to obtain such substantial help? The existence of the practice of forward dating invoices is admitted. There is other evidence from which I am prepared to infer that there was an increased level of resort to the practice in the last quarter of FY2004.[164] The next level of detail reflected in Professor Newberry's analysis was the precise extent of forward dated sales, and the percentage they comprised of total reported sales in relevant periods. Those were disputed as too unreliable to be given any weight.

[427] There are numerous reasons for doubting both the reliability of the data in its detail, and the accuracy of the manner in which it was presented to Professor Newberry and worked on by her. Accordingly, I would not be likely to obtain substantial help from her opinion on the percentages that forward dated sales represented as a component of total sales, nor from the statistics going to the extent of increase in resort to the practice.

[428] At a more general level, the GSM data and Professor Newberry's analysis of it is likely to be substantially helpful, at least in a corroborative way, in establishing in approximate terms how prevalent the practice of forward dating invoices was. However, the closer an analysis comes to quantifying the effect of the practice, or ranking its relative materiality compared with earlier periods in Feltex's trading, the less reliable its accuracy and therefore the less weight that could be given to it, to the extent it is treated as admissible.

Forward dating of invoices - analysis

[429] Were readers of the prospectus misled by the omission of any reference to the practice of forward dating invoices? The defendants insisted that the plaintiff had to mount such a criticism by identifying a statement in the prospectus which was rendered misleading because of the absence of a statement describing the practice of forward dating invoices. Their point was that such statement would have to reflect the potential relevance of the practice, or in some other way relate to the statement that was allegedly misleading without a reference to the practice.

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163 Evidence Act 2006, s 25(1).

164 See [443] below.

[430] The plaintiff resisted any obligation to relate the relevance of this omission to any identified statement in the prospectus. Rather, the criticism was advanced on the basis that readers of the prospectus were inadequately informed to make an assessment of the strength of Feltex's existing and projected business, because they were not informed of the extent to which the forecast figures for FY2004 were bolstered by sales transacted on forward dated invoices.

[431] As in other criticisms in respect of misleading omissions, I consider the plaintiff was required to identify a particular statement which was rendered misleading by the omission of a statement describing the practice of forward dating invoices, and the projected extent of it in FY2004. In the end, my conclusion on the criticism would be the same, if it is assessed at large, as the plaintiff contended.

[432] In closing submissions for the plaintiff, the materiality of this omission relied heavily on the proposition that there was a finite market for Feltex carpet. The plaintiff submitted that Feltex could not reasonably expect that a sale brought forward from July 2004 into June 2004 would be matched by a comparable sale in July 2005 that might have been transacted on a forward dated invoice in June 2005. If the criticism is considered without that proposition, its materiality falls away. There was, ultimately, no dispute that the revenue was correctly recorded in the month in which the invoice was issued. Assuming Feltex continued to grant extended credit to customers as a means of incentivising sales, whether it be recorded in forward dated invoices or by other means, and assuming all other trading conditions are more or less equal, then the volumes of sales reported in any period will not be materially affected by the portion of sales done on such an extended credit basis.

[433] Professor Newberry considered that the practice of issuing forward dated invoices as a means of providing extended credit to Feltex customers should have been disclosed in terms of the requirements of FRS-29. Paragraph 5.5(b) of that standard required disclosure of items included in operating revenue or operating expense if they are of such incidence and size, or of such a nature that their disclosure is necessary to explain the prospective financial performance of the entity. Professor Newberry invited an analogy between Feltex's practice in issuing forward

dated invoices, and a practice by the Sunbeam Corporation in the United States that was found objectionable by the United States Securities and Exchange Commission (SEC). As characterised by her, Sunbeam Corporation was filling orders with existing customers substantially beyond the customers' current requirements, to inflate the level of sales. On Professor Newberry's analysis, Feltex's practice of offering extended credit terms also constituted an acceleration of sales.[165]

[434] Professor Newberry accepted that her analysis depended on the assumption that all sales recorded in forward dated invoices would otherwise have been completed by Feltex in a subsequent period. Professor Newberry acknowledged that she had no expertise in selling carpet but was nonetheless disinclined to accept the flaws in this assumption. As was tested with her, it was entirely likely that some such sales may have been made by Feltex within the same month in any event, or the sale may have been lost to a competitor, or the sale may not have been made at all. Her assumption was therefore not reliable.

[435] In any event, Professor Newberry's assumption did not provide a foundation for the last argument advanced on this criticism by Ms Mills in closing. Ms Mills' contention was that the size of the market available to Feltex was finite, so that any sale brought forward from, say, July to June was a sale that could not be procured elsewhere in a later period. Despite Ms Mills urging this point on me a number of times as entirely obvious and a matter of common sense, the logic of it avoided me.

[436] There was evidence that the market for carpet in both Australia and New Zealand was in a mature state, and likely to grow only modestly. However, that is a far cry from treating the market as closed and static. The alternatives suggested for the defendants in answer to Professor Newberry's assumption demonstrate just some of the vagaries of sales opportunities available to Feltex. Accordingly, there is no justification for assessing the omission of any reference to the practice of forward dating invoices on the basis that each particular sale transacted on those terms cancels out a sale that Feltex would have made in a later period.

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[165] NoE at 276-30.

[437] I am not persuaded that the extent or significance of the practice warranted separate disclosure, as Professor Newberry opined. Allowing for the fact that Feltex used the practice to an increased extent in the later months of FY2004, I am not satisfied that it applied to a material component of the total sales achieved. Given that a manufacturing company in Feltex's position could legitimately resort to a variety of forms of offering extended credit to its customers as a means of promoting sales, the size and form of the process used to achieve that in the present case did not come within the categories requiring disclosure under FRS-29.

[438] As to Professor Newberry's analogy with the practice of the Sunbeam Corporation condemned by the SEC in the United States, the conduct in that case appears to have involved making forced or even artificial sales that the customers would not undertake in the normal course of their business. That feature cannot be attributed to the practice in Feltex's case.

[439] The defendants raised other considerations against the requirement to disclose the practice of forward dating invoices. As CEO, Mr Magill raised the need to protect the commercial sensitivity of Feltex's mode of operating, against the concern that competitors would get access to commercially sensitive matters relating to Feltex's business from the prospectus. Mr Magill cited an exchange he had after the prospectus was issued with a senior executive at Godfrey Hirst, to the effect that Godfrey Hirst had been grateful for a range of previously undisclosed sensitive information about Feltex that was able to be gleaned from the prospectus.

[440] Whether that anecdote is true or not, it illustrates a valid concern. The aim of providing the fullest disclosure of business strategies in a prospectus has to be balanced against the concern not to unduly diminish the value of business strategies by providing disclosure for competitors.

[441] Mr Cameron opined that concerns of this type are valid for those preparing prospectuses, and sophisticated readers of prospectuses reasonably anticipate a measure of discretion in the level of detail disclosed in relation to the operation of a company's business. Arguably, a specific disclosure in the prospectus about the policy Feltex adopted in offering extended credit would be of interest to its

competitors for competitive purposes so that a countervailing consideration to retain the confidentiality of such arrangements could influence a reasonable decision on the extent of disclosure on such an item.

[442] What remains of the plaintiff's criticism is the absence of reference to a particular accounting procedure used to offer selected customers of Feltex extended credit terms as a means of promoting sales with such customers. It seems more likely than not that the procedure was adopted because of limitations in the computer software used by Feltex in Australia for the issue of invoices and statements of account to customers. If the policy of extended credit was applied more or less consistently on an on-going basis, then it would not give rise to any issue as to the timing of revenue recognition.

[443] Without relying on Professor Newberry's analysis of the GSM-sourced data, there is scope for inferring that Feltex resorted to sales on extended credit terms to an increased extent in the last quarter of FY2004. The accounting method adopted was by forward dating invoices. In her last calculations as to the extent of forward dated sales, Professor Newberry identified an increase in forward dated sales over the level in the prior period of $5.84 million out of sales of $111.3 million for the second half of the 2004 financial year. That amounted to an increase of some 5.2 per cent in the proportion of sales that were dealt with in this way. On an annualised basis for the whole of FY2004, the extent of the increase over the prior period was some 2.6 per cent. On her figures, the total sales transacted on forward dated invoices in FY2004 amounted to some 3.7 per cent of the overall total.[166]

[444] I do not accept that the increase in a practice that influenced the level of sales generated by Feltex to that extent was material in terms of disclosures required in the prospectus. My attention was not drawn to any specific statements in the prospectus that are rendered untrue by virtue of the omission of a description of the nature and extent of forward dating of invoices.

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166 Newberry second reply BoE (24 March 2014) at [11].

Proposed dividend for FY2004 misleadingly presented

[445] Components of the plaintiff's criticism of the proposals for a post-IPO dividend for FY2004 appeared at a large number of points through the 4ASC.[167] The essence of the criticism was that the Feltex Board acceded to a recommendation from the JLMs to pay a larger dividend in respect of FY2004 than the company would otherwise have done to make the IPO more attractive, and that the increased cost of the dividend was funded by increasing the size of the IPO, when the prospectus represented that the proceeds of the IPO would only be used for repaying bondholders.[168] Many of the pleaded references to the proposed increase in the extent of a dividend for FY2004 related to the alleged nature of the involvement by the JLMs, in support of the plaintiff's claims that they should be recognised as promoters of the offer.[169] I review that conduct at this point, because it provides context for the present criticism.

[446] At page 11, the prospectus included a table headed "… FY2005 Projected Implied Multiples and Yield".[170] A note to that table set out the projected interim and final dividends for Feltex's 2005 financial year. That note added:

> In addition, a cash dividend of $9.0 million is projected to be paid in October 2004 in respect of the year ending 30 June 2004.

[447] That component of the projected dividends was not relied on in calculating the implied multiples and yield in the table.

[448] In the statement of prospective cash flows at page 86, the FY2004 forecast indicated that there would be no dividend paid to the shareholders before 30 June 2004 and the FY2005 projection indicated dividends of $16.806 million. The notes to prospective financial information including that prospective cash flow stated, at page 92:

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167 The plaintiff's closing submissions cited 11 paragraphs of 4ASC as relating to this criticism: 9.7.4, 40.5, 73.5, 73.14, 73.15, 74.17, 74.18, 85.14, 85.15, 85.34 and 85.35.

168 See 4ASC at 73.15 and 74.18, which alleged non-disclosure in the prospectus of the fact that the primary offer was increased from $40 million to $50 million to fund the dividend in circumstances where Feltex was not in a position to take on more debt.

169 See [558] to [596] below.

170 Reproduced at [379] above.

> A dividend of $9.0 million in respect of the period ending June 2004 is projected to be paid in October 2004. Thereafter dividends are assumed to be declared in line with the Feltex dividend policy as set out under the heading 'What returns will I get?' on pages 123 to 125 of this Offer Document. An interim dividend of $7.8 million in respect of the year ending June 2005 is projected to be paid in March 2005.

[449] The "Answers to Important Questions" section of the prospectus under the heading "Dividend Policy", specified:

> Feltex's dividend policy is to declare dividends after due consideration of the current and projected operating performance, financial position, cash flows and capital requirements of Feltex at the time of declaration of the dividend. Subject to these considerations, the Board intends to declare dividends in the order of 75% to 80% of the net surplus after income tax (before amortisation and equity earnings of associates) …
>
> The Board of Directors reserves the right to amend the dividend policy at any time.

[450] The statement in respect of dividend policy also acknowledged a constraint imposed by the ANZ Bank as Feltex's banker that the company would not pay a dividend without the bank's consent if the ratio of total debt to EBITDA exceeded 3.2 times at any time in or before June 2007, and that Feltex was also constrained from paying a dividend if it was in default of its banking facilities.

[451] From February 2004, the JLMs were recommending that provision be made for payment of a dividend in respect of the second half of 2004, seeing it as likely to substantially increase the level of demand for shares. By April 2004, the JLMs were pressing for such a dividend, suggesting it could increase the retail demand by between $25 and $50 million.[171]

[452] There was initially some resistance to the dividend proposal from Mr Thomas. In February 2004, he suggested that the first post-IPO dividend should be provided for in February 2005 in respect of the half year results to the end of December 2004.

[453] The issue progressed, and in April 2004 Feltex management was proposing to include provision for a dividend of $5.5 million in respect of FY2004. However, the

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171 CB13 009669–009671.

JLMs recommended that a dividend at that level would not be sufficient to make this aspect of the offer attractive to potential investors, and they recommended it be increased to $9 million.

[454] After a Board meeting on 27 April 2004, Mr Saunders, as the Feltex Chairman and Mr Ron Millard representing Credit Suisse, attended a meeting with the representatives of the JLMs, and senior Feltex management, Messrs Tolan and Kokic. The outcome of the meeting was recorded in an email sent by Mr Saunders to all other Board members the following day, including the following:[172]

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

[455] Mr Thomas had a different recollection as to the sequence and rationale for agreeing to a dividend of $9 million payable in respect of FY2004. Mr Thomas's recollection is that by late April 2004 he was comfortable with a dividend, and did not accept that the Board was pressured into that position by the JLMs. He was also comfortable that a dividend of $9 million was not outside the articulated dividend policy for Feltex. (In any event, the statement about dividend policy made in the prospectus was explicitly to apply only to periods after any dividend declared in respect of FY2004.) Mr Thomas also took the view that the extent of the increase in the IPO was not directly related to the decision to pay a larger dividend. He considered that the company would have had ample borrowing capacity to fund the larger dividend from borrowings. In any event, funding being fungible the proceeds

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172 CB13 009695.

of shares sold by Feltex in June could not be related to the funds used to pay a dividend three or four months later.[173]

[456] To the extent that there are differences in recollection, I prefer the version recorded in Mr Saunders' 30 April 2004 email on most of the points. The contemporaneous relevant documents suggest that the meeting with the JLMs on 27 April 2004 was critical to the decision that was made in respect of a dividend. Mr Saunders' email is a thorough explanation provided at the time to the rest of the Board as to how the issue was resolved in circumstances where time did not permit a debate by the full Board. Mr Thomas was not at the 27 April meeting with the JLMs and, although his different recollection 10 years after the events was credible, he did not have the same measure of support from contemporaneous documents.

[457] I do prefer Mr Thomas's version on one point. The prior proposal had been for a dividend of $5.5 million, so that the increase in dividend was $3.5 million. It was unnecessary to raise the size of the IPO by $10 million to facilitate funding an additional $3.5 million in dividends. Mr Thomas's recollection was that the size of the IPO was increased to enable further reduction in Feltex's debt, to strengthen its balance sheet.

[458] The relevant statements in the prospectus about the size of a dividend for FY2004 were accurate. I am not persuaded that the circumstances in which that dividend was arranged, or the extent of it, render any of the statements misleading.

[459] The second criticism was that there should have been disclosure of a material increase in the size of the IPO and that the increase was to fund the $9 million dividend. Perhaps because this was put in issue as an aspect of the extent of involvement by the JLMs, the issue was not confronted directly. Accordingly, it is unsurprising that the defendants did not mount any separate argument as to the lack of a requirement to disclose either that the size of the IPO had been increased, or that the increase was to enable Feltex to fund a dividend payment in October 2004.

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173 NoE at 1419–1423.

[460] Taken separately, I can see no justification for an expectation that the promoters of an IPO would acknowledge that they had increased the size of the offer at some point in the formulation of the plan. The investment proposition made in the prospectus has to be assessed on its terms, and it is irrelevant that the vendor/promoter might have offered an investment on different terms.

[461] As to the diversion of some part of the proceeds of the IPO to pay a dividend, I am not persuaded that that would be materially different for potential investors reading the prospectus, from the understanding they would otherwise get that all of the proceeds would be applied to reduce debt.

[462] I have preferred Mr Thomas' evidence on the extent to which Feltex might have had to increase the size of the IPO to fund the proposed dividend. The dividend of up to $5.5 million was proposed when the size of the IPO was $40 million, with no suggestion that any part of the IPO would be required to fund the then contemplated dividend of $5.5 million. The decision made on 27 April 2004 involved an increase in the size of the dividend of $3.5 million. Even if the originally proposed dividend of $5.5 million exhausted all of Feltex's available resources, then it would only need another $3.5 million in funding to pay for the increased dividend that was eventually agreed to.

[463] Had they considered the point, the Feltex Board would not be assessing the need to alter the statement in the prospectus to be more precise about the use intended for $10 million of the $50 million to be raised. Rather, the Board would be considering the need to qualify the statement that was made to the effect that the proceeds of the offer would be used to repay existing debt, in relation to an amount of, say, $3.5 million.

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

whether advised simply that the proceeds of the offer would be used to repay the bonds, or that the proceeds would be used for that purpose, and to reduce other debt, or for working capital purposes.

[465] I am satisfied that sophisticated investors would not be troubled by this point. Subject to any dividend not breaching the terms of Feltex's banking arrangements, they would likely appreciate that the directors had a discretion as to dividend levels. They would also likely anticipate that the proposal to pay a dividend in respect of FY2004, despite new shareholders not having had an interest in the business for 11/12ths of the period to which the dividend related, was an option open to the directors. That option might be chosen to give subscribers a return relatively promptly, rather than waiting for an interim dividend in relation to the first six months' trading of FY2005.

E Misstatements as to the nature and effect of the equity incentive plan

[466] Under a heading "Shareholdings following the offer" on page 30 of the prospectus, it stated that 113,523,100 shares were to be sold to members of the public. The prospectus then continued:

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

[467] Further details of these arrangements, including the number of shares each director (except Ms Withers) would hold after the IPO, were spelt out at pages 59 and 60 of the prospectus under the heading "Directors' shareholdings".

[468] The plaintiff alleged[174] that the prospectus failed to disclose the extent of benefits to be received by the participating directors and senior managers by way of consideration under this equity incentive plan (EIP). In closing, the plaintiff's concern was characterised in the following terms:[175]

> The disclosure in the prospectus was intended to portray that the participants were purchasing shares at the retail price from their own resources in order to represent confidence in the company's prospects and the achievability of the forecast and projection.

[469] The plaintiff also complained that the prospectus ought to have disclosed that Credit Suisse would be funding its payments to the participants out of the proceeds of Feltex shares sold to the public.

[470] The sums involved for existing directors ranged from $1.046 million for Mr Saunders to $538,000 for some of the other non-executive directors, and some $7 million for Mr Magill, $2.6 million for Mr Kokic and lesser amounts for other senior managers. The net effect of the arrangements between Credit Suisse and the participants was that closing out the options they had had under the pre-existing EIP more than funded the costs of the shares that they were subscribing for in the IPO.

[471] The plaintiff's complaint was that the disclosure in the prospectus gave an incorrect impression that the participants in the EIP were paying the same amount for their shares as all other subscribers. That was likely to be viewed positively by readers who saw it as a personal commitment by the participants, on equal terms with all other shareholders, thereby implying confidence in the future of the company.

[472] Mr Thomas's evidence was that the participants were paying the same price as the public for their shares acquired in the IPO. He also confirmed that Credit

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174 4ASC at 62.

175 Plaintiff's closing submissions at [30.25].

Suisse's pre-existing contractual obligations entitled the participants to access those funds to purchase the shares, and to take the balance in cash. In the case of most of the directors, their entitlement from the EIP substantially exceeded the amounts required to acquire the shares they were subscribing for. Mr Thomas was an exception in that he subscribed for all the shares to which he was entitled. His explanation of how the EIP worked, and the numbers involved, was not challenged on cross-examination.

[473] For his own part, Mr Houghton's concern was that he did not want Feltex spending the monies subscribed by new shareholders to make substantial payments to the directors and senior managers. Mr Houghton accepted that his concern was lessened, and that he would have to rethink the rationale for it once he understood (as he did in the course of cross-examination) that the consideration passing to the participants was not funded by Feltex, but rather by Credit Suisse, as the former shareholder, in terms of contractual arrangements it had made some years earlier.[176]

[474] In his evidence-in-chief, Mr Peter Hall also expressed concern that there had been inadequate disclosure in the prospectus of the arrangements for directors and senior managers to subscribe for shares. In cross-examination, Mr Hall accepted that the details set out in the prospectus were sufficient to inform him. A doubt remained that any misunderstanding he had about directors subscribing for shares may have arisen out of his discussion with Mr Magill, rather than from reading the prospectus. Ultimately he accepted that, in the course of that conversation, he may have been at cross purposes with Mr Magill.

[475] Mr Russell also opined that fuller disclosure of what he had been advised by the plaintiff was the financial effect of arrangements made with the participants would have been a negative influence on retail investors. However, his understanding was to the effect that the participants "… stood to gain as much as $20 million from the float and that their option exercise price was 17c to buy a share being sold to investors for $1.70 to $1.95 each …".[177] That characterisation of the

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[176] NoE at 127/9.
[177] Russell BoE at [36].

arrangement is materially different from the pre-existing contractual commitments between Credit Suisse and the participants.

[476] I found Mr Russell's criticisms of inadequacy in the disclosure, as he developed them in his evidence, were influenced by the effect of the plan as he had understood it from the pleading in 4ASC. Although Mr Russell attributed a negative influence to the terms of the arrangements as he understood them, I am not satisfied that that adverse view persisted, once Mr Russell understood the detail of the pre-IPO contractual arrangements between Credit Suisse and the participants.

[477] The plaintiff also cited a July 2006 newspaper item by respected securities market analyst and commentator, Brian Gaynor, as evidencing a difficulty that Mr Gaynor had had in understanding the disclosure in the prospectus on the terms for participants' subscription for shares.[178] The plaintiff's submissions suggested that, even two years after the IPO, Mr Gaynor had misconstrued the description of the relevant arrangements. Mr Gaynor certainly described Feltex's disclosure on this matter as "extremely poor", but that reflected an expectation that there be precise disclosure of exactly the amount each director received. In other respects his column suggested an adequate understanding of how the arrangements were to work, as derived from the disclosure that was made in the prospectus.

[478] Mr Cameron gave evidence that the terms of the EIP were conventional for private equity owners of a company such as Feltex, and that the plan was to be perceived as having no cost to incoming shareholders. He was satisfied that the aspects that might be material to readers of the prospectus were adequately and accurately described.[179]

[479] Arguably, if readers of the prospectus had been advised that the participants were not making a commitment equal to that required by all other shareholders, but instead were paying for shares with the proceeds of what could be considered an extremely generous EIP previously arranged with the vendor, then readers might take the view that the participants were not in fact making an equal contribution. It

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178 CB20 014748–014749 – the article was one of Mr Gaynor's regular contributions to the New Zealand Herald.

179 Cameron BoE at [78]–[85].

would follow that they were not providing a demonstration of their confidence in the company's future by a commitment equal to that made by other subscribers for shares.

[480] One component of the plaintiff's argument was that the directors were not, in reality, paying the same amount as other shareholders because their commitment was funded for them by Credit Suisse. Implicitly the proceeds of the EIP were "easy money" or "just a paper entry". Such suggestions are misconceived. The participants had earned entitlements, for which they previously contracted with Credit Suisse, that were realisable on an IPO occurring. These entitlements, at their option, could have been realised for cash. Certainly, that last detail was not specified in the section of the prospectus cited at [466] above, but it was set out in a further commentary on "existing option arrangements" on page 59 of the prospectus.

[481] The plaintiff's closing did not advance the related criticism that the prospectus ought to have disclosed that the vendor was funding its payments to the participants out of the proceeds of the IPO. Witnesses were taken to an Excel spreadsheet recording the various components of the money flows involved in the IPO, that certainly suggested that Credit Suisse applied part of the proceeds of the IPO to discharge its commitments to the participants under the pre-existing EIP. However, defendant witnesses resisted any notion that that necessarily meant the vendor was funding the acquisition of shares by the participants from the proceeds of sale of shares to members of the public. Credit Suisse entities were described as having more than sufficient assets to fund the pre-existing contractual commitments out of other resources. In those circumstances, as money is fungible, no connection could be drawn in terms that the vendor depended on receipt of proceeds of the sale of shares to the public in order to make the necessary payments to the participants.

[482] The main passage in the prospectus on the EIP (cited at [466] above) did not disclose the amounts payable to each of the participants by the vendor. It was not alleged that the omission of these details was misleading. The final sentence of the relevant passage did advise readers that, collectively, the participants would be acquiring shares to the value of approximately half the benefits they would receive from the EIP. Readers of the prospectus interested in the EIP could get a sense of the

scale of the benefits provided to the participants by the vendor. The prospectus disclosed that the participants were to acquire 6,476,900 shares at consideration equal to the retail price. The consideration was that number of shares times $1.70.[180] It also stated that such consideration amounted to approximately half the total benefits from the EIP, meaning:

6,476,900 x $1.70 x 2 = $22,021,460

[483] I reject the plaintiff's argument that the scale of the benefits available to the participants was not sufficiently clear. I consider that the notional investor would have been able to undertake the shorthand calculation I have just set out.

[484] On 29 April 2004, Mr Stearne from FNZC circulated an email on behalf of the JLMs inviting further consideration of the extent of disclosure that was appropriate in the prospectus in relation to management shareholdings, and cash settlement of the existing EIP. His email recommended a shorter and simpler formulation of words to provide the appropriate level of advice on this topic.[181] Mr Stearne was cross-examined about the email. He did not recall what, if anything, happened as a result of it.

[485] Mr Stearne's form of words conveyed substantially similar information, but there was no material difference in the extent of information that would have been conveyed. The description of the EIP was still addressed at a generic level, and did not disclose the position of individual directors or senior managers.

[486] Whilst Mr Stearne's email provides some evidence of a level of concern among institutional investors that the description of the EIP was not as clear as it could have been, that goes to how understandable it was, not a concern about misleading or inadequate disclosure.

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180 This simple approach might have overstated the benefits, depending on individual elections as to the proportions of pre-existing options that were converted into shares, and those cancelled for cash. The range of differences would not have been significant to an understanding of the scale of overall benefits.

181 CB13 009699.

[487] A further concern was that the manner in which the participants would be able to fund their acquisition of shares from the proceeds of their EIP participation was somehow disguised or confused by the suggested alternative resources that participants might apply to acquire shares. Although the third paragraph in the extract cited at [466] above does acknowledge that payment from the proceeds received from realisation of the plan was one alternative, Mr Forbes argued that the inclusion of other alternatives gave rise to the suggestion that the proceeds from realisation of the plan might not be sufficient. Although that impression may arise on a superficial reading, on a thorough reading of the description I do not accept that that is so.[182]

[488] The plaintiff's closing also referred to a spirited debate that had occurred between Credit Suisse as vendor of the shares, and those representing the participants as to the terms on which there would be an element of "lock up" of the shares acquired by the participants. The JLMs recommended that some short-term constraint on sale of shares by the participants was desirable in promoting the IPO. Consistently with that recommendation, Credit Suisse proposed that the participants not be able to sell the shares they were subscribing for in the IPO for a period of 12 months. That proposal was initially resisted, and robust negotiations occurred before agreement was reached for a partial lock up.

[489] Comments made in the course of the dialogue on that topic were cited on behalf of the plaintiff as instancing a lack of genuine commitment by the participants, inconsistently with the signal said to arise implicitly from the statements in the prospectus that they were subscribing for substantial numbers of shares.

[490] However, this point is a discrete one and is irrelevant to an assessment of whether any of the content of the prospectus in relation to the participants subscribing for shares in the IPO was misleading.

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[182] I note that Mr Stearne's suggested wording would have been more direct in this regard, stating that the participants would be subscribing for shares from the proceeds of the EIP.

[491] The defendants denied that any greater level of detail than was provided would be relevant to issues raised in assessing an investment in the shares. It was submitted that the level of financial incentives that the participants had previously contracted for with the vendor could not possibly be relevant to an assessment of the prospects and risks for a future investment in Feltex.

[492] Non-expert investors are relatively more likely to place reliance on qualitative, rather than quantitative, features of a potential investment. In contrast, sophisticated investors are likely to pay scant regard to the commentary, preferring to reach their own views on the prospects for future earnings of a company by an analysis of the quantitative information provided. Among qualitative features likely to be seen as material are the calibre of directors and senior managers, and the extent of alignment of interests between them and all other shareholders. Therefore a commitment in a prospectus that directors are subscribing for shares is likely to be treated as a positive indication by unsophisticated readers.

[493] If such readers were subsequently to discover that the nature of the commitment made by directors was materially different, then it would likely lead, in at least some such investors, to a feeling of unease that they had relied on the alignment between the directors' and other shareholders' aspirations for Feltex, on a misconceived basis.

[494] It would have been preferable for the prospectus to spell out explicitly the financial ramifications of the EIP and how the directors were intending to apply the consideration available to them from the vendor to meet the costs of subscribing for shares. Despite that, a thorough reading of all references on the point would have dispelled any notion that the directors were committing to shares on different terms from all other subscribers. Given that the participants were free to take the proceeds of the pre-existing EIP in cash, the size of their entitlements is not relevant to the extent of commitment they were making, in subscribing for shares. There is therefore no scope for finding that the notional investor would be materially misled as to the relative strength of the directors' commitment, by the description of their proposed share purchases.

F Misstatement as to the book build process/content of the 24 May announcement

[495] The prospectus was issued on the basis that shares in Feltex would be offered in a range between $1.70 and $1.95. The prospectus stipulated at page 28 that the final price would be set on or before 24 May 2004, following a book build process that was described in the following terms:

> Between Wednesday, 19 May 2004 and Friday, 21 May 2004 the Joint Lead Managers will undertake a book build process inviting NZX Firms and institutional investors in New Zealand, Australia and potentially elsewhere, to submit bids indicating the number of Shares they wish to apply for at a range of prices. This book build process, in conjunction with demand from other investor classes at the close of the book build process, will be used to assist the Vendor and Feltex, in consultation with the Joint Lead Managers, to determine the Final Price.
>
> The Final Price will be set prior to 10.00am on Monday, 24 May 2004 taking into account various factors, including the following:
>
> - the overall demand profile for Shares at various prices;
> - pricing indications from institutional investors and NZX Firms under the book build process:
> - the level of demand for Shares from applicants under the Enhanced Priority Offer, the Priority Offer and the Public Offer:
> - the desire of the Vendor and Feltex to have an orderly and successful aftermarket for the Shares: and
> - any other factors the Vendor, Feltex, and the Joint Lead Managers consider relevant.
>
> The Vendor and Feltex reserve the right to set the Final Price outside the Indicative Price Range. However, the Retail Price will not be greater than $1.95 per Share.

[496] The essence of this information was repeated at pages 121 and 135 of the prospectus.

[497] The plaintiff alleged[183] that this statement represented that the final price would follow the factors it said would be taken into account, when in fact those factors either did not dictate the outcome, or were not applied reasonably. It was alleged that the defendants had no proper or reasonable basis on which to imply that

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[183] 4ASC at 40, 40.1–40.11.2.5.

the final price would be set in accordance with the stated factors. The plaintiff alleged that there was a low level of institutional support for the offer, that responses from some institutions suggested Feltex was over-valued, and that ForBar as one of the JLMs had had to undertake extraordinary measures in order to ensure that the offer could close fully subscribed. Despite those efforts, the plaintiff alleged that both JLMs were required to take up shares themselves, which then had to be sold in the secondary market because of insufficient demand for the IPO.

[498] These criticisms of the descriptions in the prospectus as to how the final price would be set were linked to criticisms of the content of the 24 May announcement. In closing submissions the criticisms appeared to be rolled together. It is appropriate to assess them together. The 24 May announcement was prepared in Mr Saunders' name, although it was not drafted by him. Some parts of the announcement were attributed to Mr Magill, and both of them were comfortable that the terms of the announcement reflected their understanding at the time. The content of the announcement criticised by the plaintiff included the following points:[184]

- the IPO had been well received in the market;
- the level of retail investor interest in the offer had been excellent;
- the book build had attracted good support from a range of domestic and international institutions and primary market institutions; and
- there would be a very attractive gross dividend yield of 9.6 per cent for FY2005.

[499] The plaintiff alleged that the 24 May announcement was misleading in these and other respects.[185]

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184 CB15 011308.

185 4ASC at 53 and 54. Unless the plaintiff made out at least a prima facie case on one or more of these criticisms, then, on my analysis, the remaining criticisms pleaded in these paragraphs fell away.

[500] As to the book build process, the JLMs projected the likely level of demand, and then monitored where it came from. Assessing the level of demand had to take into account a projection of the extent to which holders of the bonds issued under Feltex's debt security prospectus the previous year would agree to convert their securities into shares. Holders of the bonds were incentivised by a five per cent discount on the subscription price for shares. The JLMs agreed to underwrite the conversion by committing to up to a maximum of $30 million of shares in relation to bondholders who elected to take cash instead of converting.[186]

[501] A relatively small portion of the institutions to whom the JLMs and representatives of Feltex made presentations indicated that they would subscribe. By far the largest institutional response was from Hunter Hall that had received a presentation in London, as part of the JLMs' road show.

[502] In planning the IPO, the JLMs had predicted indicative demand in a paper produced on about 19 April 2004.[187] The plaintiff contrasted the prediction that had been made at that time with the firmer indications of commitments used in the book build process by 21 May 2004. It was argued for the plaintiff that the IPO was in fact not well received when, for instance, the New Zealand institutional demand, predicted to be between $40 and $60 million, produced a little less than $8 million. The public pool (treated in the plaintiff's analysis as including small New Zealand sharebrokers), predicted at $20 million, had produced only $1.13 million in indicative commitments by 21 May 2004.

[503] In addition, the plaintiff submitted that the offer would not have closed without the unexpectedly large commitment signalled on behalf of Hunter Hall, at some $39 million. Reliance was also placed on aggressive marketing claims made by Messrs Paviour-Smith and Mear on behalf of ForBar to Messrs Millard, Thomas and Saunders, describing how hard ForBar personnel had had to work to achieve success for the IPO.[188] The submission was made on 28 May 2004, seeking a greater than half share of the incentive success fee payable to the JLMs.

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186 That maximum commitment in the mandate letter, CB14 010167, was eventually taken up to the extent of approximately $6 million by each of the JLMs.

187 CB10 007548.

188 CB16 011448–011454.

[504] There was relatively extensive evidence as to how the book build process worked. Inconsistencies between the early predictions of where demand would come from, and where it was subsequently realised, were not a significant concern to those involved. For the purposes of presenting the alternatives to Feltex and Credit Suisse, the JLMs prepared a graph reflecting the level of demand that had been conveyed to them during the book build process, at various price points between $1.70 and $1.95. One form of the analysis of the book build, in Excel spreadsheet form, calculated the demand at prices between $1.60 and $1.80.[189] At the lowest end of those price alternatives, the demand was covered by 194 per cent, at $1.70 it was 126 per cent and at $1.80 it was 64 per cent. At $1.70, the demand exceeded the number of shares available sufficiently to require scaling back of a small number of New Zealand institutional bidders, who were allocated between 80 and 90 per cent of the shares they had bid for.[190] Mr Stewart of Credit Suisse Australia, who was involved in the final decision on setting the price, described it as a relatively easy decision to make, given the assessment of demand undertaken by the JLMs.

[505] I am satisfied that sophisticated investors would readily understand the parameters of the considerations that would dictate the setting of price under a book build process, and would not have been surprised at all by the course that was followed.

[506] The plaintiff's criticism about misleading content in the 24 May announcement included the point that not all shares were sold in the IPO because at least one of the JLMs and Macquarie, that had also taken a firm allocation of $20 million worth of shares, were unable to place those shares as a component of the primary offer, and instead had to quit shares on the secondary market after the shares were quoted on the NZX.

[507] That circumstance does not make a representation to the effect that the offer was fully subscribed a misleading one. What it indicates is that the JLMs and Macquarie over-estimated the demand from within their own client bases. Commitments in dollar terms had been made before the book build process was

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189 CB15 011304.
190 CB1 000572.

complete, and thereafter the vendor was entitled to treat itself as having firm commitments to sell the total numbers of shares represented by the commitments that had been made. I infer that the JLMs and Macquarie would have been confident, at the time of the 24 May announcement, that they could generate sufficient demand to sell all the shares they had committed to take in the initial offer. If that did not occur, then they became sellers in their own right once Feltex's shares were listed on the NZX.

[508] Professor Cornell treated the price-setting process that was used as effectively determined by sophisticated investors. That category of investor readily understood the dynamic of a book build process, and participants would arrive at a consensus on an appropriate price by relatively detailed quantitative analysis of the prospects of Feltex's future cash flows. Once a decision to set the price at $1.70 was underpinned by a sufficient level of support from such investors, then (although Professor Cornell did not put it so cynically) the remainder of those subscribing would do so as price takers.

[509] From Professor Cornell's perspective, the integrity of the price setting process in the book build was validated by virtue of the fact that Feltex shares then traded in the secondary market at or around the initial offer price. In reliance on the efficient market theory, Professor Cornell treated the relatively lengthy period in which the shares traded on the secondary market at or around the original issue price as confirming the validity of the perception of value reflected in the price at $1.70 per share.

[510] I do not consider that the process by which the final price was settled differed from the description in the prospectus materially so as to characterise that description as misleading to the notional investor. Further, whilst the projections made at early stages of the IPO process might suggest that the extent and source of demand for shares were insufficient to justify the positive description of the demand in the 24 May announcement, nor would I be persuaded that its terms were misleading. Certainly from the perspective of Messrs Saunders and Magill who were cited in the announcement, I accept their evidence that they had reasonable grounds for believing that the demand demonstrated in the book build process

reasonably enabled them to make the statements that were attributed to them in the 24 May announcement.

[511] As to reliance on the 24 May announcement, Mr Houghton said in his evidence-in-chief that he learnt of the final share price being set from reading the Dominion Post newspaper. When the relevant article from the day after the announcement, 25 May 2004, was put to him in cross-examination, he was less certain that he had read that article at the time.[191] Given that the features about the IPO that Mr Houghton recalled learning at that time were in the Dominion Post article, I am satisfied on the balance of probabilities that he learnt of the final price being set at $1.70 from the article that was put to him. He did not see the content of Feltex's statement as conveyed to NZX at the time.

[512] The content of the Dominion Post article is materially different from the 24 May announcement. The newspaper article was substantially less enthusiastic than the entirely positive tone of the company's announcement. The heading was "Soft market dents Feltex share issue hopes" and the article started by noting that the $1.70 price was at the bottom of the indicative price range. The article quoted an equity analyst as saying:

> The fact it was priced at the low end probably indicates demand wasn't as strong as they thought it would be, …

[513] The article also cited another portfolio manager as saying that his fund had opted out of the IPO:

> … as it regarded the offer as fully priced even at the low end of the range. … we thought it had a good strategy and good management. But the valuation wasn't there for us.

[514] The gross dividend yield of 9.6 per cent was specified at page 11 of the prospectus, so those assessing a potential investment in Feltex did not need to rely on the 24 May announcement for that indication of value. Further, once a consideration of the nature of reliance is abstracted to the level of considering the market reaction to the announcement, consideration would also have to be given to the negative media comments, as a matter of balance.

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[191] NoE at 21/23, compared with 66/18–68/15, CB15 011388.

[515] The plaintiff's closing submissions did not include argument that the price had been set other than by reference to the factors described in the prospectus as influencing its determination. There was an acknowledgement that Feltex and Credit Suisse were not precluded by the factors set out in the prospectus from setting the price at $1.70 per share.[192] What remained was a more generalised criticism that the positive factors described in the 24 May announcement as the context in which the price had been set were misleading.

[516] Because Mr Houghton did not see the terms of the 24 May announcement, its content cannot have contributed to any material misleading of Mr Houghton.

[517] More generally, the impact of the terms of the 24 May announcement is to be assessed in light of what all potential investors, including sophisticated market participants, would have made of it. The comments quoted in the Dominion Post article illustrate the sort of responses that would have been engendered, at least among some market participants. I am not persuaded that, at that more general level, the content of the 24 May announcement was misleading.

G An unwarranted positive tone was conveyed by the prospectus

[518] At various points throughout the extensive allegations of misleading content or omissions, the plaintiff made additional criticisms in relatively general terms, to the effect that the statements in the prospectus were conveyed in an unjustifiably or unwarranted positive tone. Further, that there was an unwarranted implied statement that Feltex had substance and that the shares were to be sold reflecting their true and fair value.[193] These allegations were addressed in closing submissions under the heading "Feltex was not a good investment".

[519] Some of these generic criticisms were not linked directly to more specific criticisms. However, they could obviously be pursued with greater credibility if there were factual errors or misleading content or omissions in more specific respects. I will assess the residual, generic criticisms in light of the findings that there were no specific misleading passages or omissions.

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[192] Plaintiff's closing at [31.15.].
[193] For example, 4ASC 34, 50, 51, 52 and 72.

[520] Professor Cornell treated the whole of the prospectus as having only an information-disseminating purpose. However, other witnesses for the defendants acknowledged that components of the prospectus were a form of sales pitch, intended to excite the interest of potential investors in subscribing for shares. Clearly, any promotional content has still to be factually accurate in all respects. It has to appear with all the sections that are required by the Regulations to adequately inform readers about the existing and prospective financial status of Feltex and the risks of investing in it.

[521] There is a difference between an issuer complying with the obligation to make adequate and accurate disclosure, and imposing an obligation on the issuer to cast a prospectus in the terms that might be used by a fully informed critic. In many respects, there will be scope for different views in assessing the character of the relevant business. That will always be the case in projecting its likely prospects.

"Feltex not a good investment"

[522] The plaintiff complained that express and implied statements in the prospectus as a whole represented that Feltex was fair value within the indicative price range of $1.70 to $1.95 per share when the enterprise value that implied was not reasonably or prudently justified. In the interdependent way the criticisms were pleaded, the plaintiff sought to bolster this criticism by whatever extent the more precise criticisms had been made out.

[523] The criticism also depended on an analysis Mr Meredith had undertaken of other indications of the value of Feltex at and before the time of the IPO.[194] Mr Meredith reviewed valuations conducted since mid 2003 (by PricewaterhouseCoopers (PwC), then by the JLMs and Macquarie in the period leading up to the IPO. The PwC valuation, completed as at June 2003, suggested a share value between $0.62 and $0.87. It was undertaken for tax purposes, and reflected the highly geared borrowing position of Feltex at the time. Mr Meredith purported to make some adjustments for subsequent events, but because it focused on a valuation at 30 June 2003, almost a year before the IPO, and was for a different

[194] Meredith BoE at [320]–[359].

and specific purpose, I would not be inclined to attribute weight to it as a component of a criticism of the price that was set for the IPO.

[524] A summary of the valuations done in contemplation of the IPO to which Mr Meredith had regard is as follows:

Valuer	Date	Low	High
ForBar	December 2003	$1.58	$1.76
FNZC	December 2003	$1.71	$2.03
FNZC	February 2004	$1.45	$1.76
Macquarie	April 2004	$1.18	$1.55

[525] Mr Meredith also included a ForBar research valuation done by analysts at ForBar who were not involved in the IPO. That valuation in May 2004 provided a range between $2.05 and $2.10.

[526] Mr Meredith also had regard to the feedback on the indicative price range that was provided to the JLMs during their promotion of the offer to New Zealand institutions. These purported estimates of value were apparently proffered by five institutions, all of whom were likely to be buyers if a lower price was set. The low and high point of ranges stipulated by those institutions was $1.40 and $1.84, with an average around $1.50. Mr Meredith appears to have taken those indications of feedback from institutions at face value, without acknowledging the prospect of any downwards bias on the part of institutions interested in influencing the share price down, for their own purposes as potential buyers.

[527] Mr Meredith's analysis of the price was also influenced by several criticisms of the prospectus that he had been asked to opine on, and on which he generally supported the allegations of misleading conduct as expressed in the 4ASC. On the basis of all those factors, he opined that the indicative price range in the prospectus appeared to be unreasonable.

[528] I do not accept that the matters Mr Meredith took into account ought to have caused the directors to nominate a lower range of prices for the shares to be offered in the IPO. It is legitimate for there to be a tension between seller and buyer in this context, just as in any other sale and purchase transaction. The obligations under the SA are for the vendor to provide adequate and accurate information to enable

potential purchasers of the shares to make their own fully informed decision on value. Provided the prospectus included adequate and accurate information about the business and its prospects to enable an independent evaluation of the likely cash flows it would generate, the price multiple stipulated by the vendor would be identifiable, and sophisticated investors would form their own view on it. For example, in the feedback from institutions who considered the indicative price range was too high, a number of them had formed their own view on the EBITDA multiple that should dictate the share price.

[529] The criticism of the price range being misleading because it was "unreasonable" cannot be sustained.

"No adverse circumstances" assurance wrong

[530] The statutory information section at the end of the prospectus included, at page 140, a standard form statement that was required of the directors in the following terms:

> The Directors, after due inquiry by them in relation to the period between 31 December 2003 and the date of this Offer Document, are of the opinion that no circumstances have arisen that materially adversely affect:
>
> (a) the trading or profitability of the Feltex Group;
>
> (b) the value of the Feltex Group's assets; or
>
> (c) the ability of the Feltex Group to pay its liabilities due within the next 12 months.

(31 December 2003 was the end of the period for which the last audited financial statements were available.)

[531] The plaintiff pleaded that this was incorrect and likely to mislead investors.[195] It was not separately addressed in closing.

[532] The allegedly misleading nature of the directors' statement depended on one or more of the other misleading or omitted statements as to the state of the company's business being made out in relation to an adverse change occurring

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[195] 4ASC at 33, 50.

between 31 December 2003 and 5 May 2004. The directors' statement would be wrong if there were material circumstances known to the directors that would materially affect any one or more of the three criteria cited in it.

[533] In the absence of argument relating specific adverse circumstances to this standard form of words required by the Regulations, the pleaded allegation cannot be pursued. In reflecting on all of the specific criticisms contended for the plaintiff in closing, no material criticisms arise which could reasonably be attributed to the directors at the time they provided the certificate, to anywhere near the extent that would be required for a finding that it was misleading for them to provide the standard form confirmation.

Assessing the prospectus overall

[534] The defendants insisted that the plaintiff was required to relate all criticisms of misleading conduct or omission to particular content in the prospectus. In resisting these arguments, Mr Forbes' recurring theme was that the Feltex prospectus had to be considered overall, for the impression it conveyed to the notional investor. I have essentially adopted the more specific level of analysis urged by the defendants, but note the plaintiff's position in the event that my approach is wrong.

[535] I had some sympathy for the plaintiff's concern that the cautionary signals, and description of the risks of investing in Feltex, were buried near the end of the document at a point where a proportion of prudent readers would have given up. Unbalanced presentation on its own would have to be extremely stark before an assessment of criticism of the prospectus got to the point of discounting the presence of appropriate cautions. The drafters of this prospectus signalled both the inclusion and the importance of risks near the outset of the document. This is not a case in which the lack of balance in the manner of presentation of the risks, where they are otherwise adequately expressed, requires their impact to be discounted in assessing the content of other passages that are the subject of criticism.

[536] The ultimate effect of Mr Forbes' approach was that notional investors would reasonably have gained the impression from the prospectus that Feltex was a materially less risky investment than it turned out to be. The corollary is that those

responsible for the prospectus ought to have known the nature and extent of those risks as they subsequently transpired, and ought therefore to have reflected those risks in the overall impression that the prospectus conveyed. That argument appeared stronger when invoked with the benefit of hindsight, than it did as a reconstruction of the position as reasonably apprehended by the defendants at the time.

[537] At this level of generality, many of the criticisms advanced were understandable. Others were misconceived. I do not discount the prospect of a prospectus being found misleading in the statutory sense, from an accumulation of misleading or relevantly omitted details that cumulatively prevent the notional investor from making an adequately informed assessment of the risks involved in the investment. This is not such a case.

[538] The SA must be taken to have deliberately required the accuracy of content to be measured by reference to specific statements in the prospectus. Very serious consequences, both financially and reputationally, inevitably follow from a finding of liability. In this case the directors and the vendor took legal advice as to the standard of disclosure required of them. There is no basis for questioning the bona fides of their belief that they produced a prospectus that met the legal standards as they were conveyed to them.

[539] The liability regime is precisely defined and does not permit of an open-ended inquiry as to whether the prospectus gave an overall impression of a less risky investment than history has shown was involved. All investments involve risk. Provided they are adequately and accurately described, the investors assume those risks.

The due diligence defence

[540] Section 56 had its own limit on the extent of liability created in the following terms:

> (3) No person shall be liable under subsection (1) of this section in respect of any untrue statement included in an advertisement or registered prospectus, as the case may be, if he or she proves that—

…

(c) As regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he or she had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true; or

…

[541] The defence for all the defendants coupled their arguments against any of the impugned passages being found to be misleading, with the fallback position that if any content was found to be misleading, then the defendants could establish that they had reasonable grounds to believe the truth of the impugned statements, and did so when the prospectus issued, and when the shares were allotted.

[542] I heard substantial argument on behalf of all parties on the availability of this so-called due diligence defence, and it is appropriate to record my views on it, notwithstanding that I have not found any untrue statements to be made out.

[543] The due diligence process was designed by Bell Gully, and appeared (without the benefit of comparison with any other processes undertaken for prospectuses at or around the same time) to be very thorough. Mr Cameron confirmed from his experience in such matters that the DDC conformed to best practice and in numerous respects he relied, in the opinions he offered in his evidence, on what he considered to be the thoroughness of the due diligence process.

[544] Responsibility for the preparation of various components of the prospectus was allocated to personnel best qualified to make those contributions. Each of three law firms involved were required to complete legal due diligence as to various components. Ernst & Young were contracted to provide the usual statutory report required under the Regulations. In addition, they were contracted to provide a review of the manner in which the prospective financial information had been prepared, and its content as included in the prospectus. Retaining the company's auditors to undertake that additional task appears to have been novel in 2004. It resulted in the auditors providing a form of negative assurance, to the effect that their review of the forecast and compilation of the projection did not make them aware of any material statement about the forecast which was misleading or deceptive in the

form and context in which it appeared, or which omitted a matter material to the forecast.[196]

[545] In respect of the narrative description of the nature of Feltex's business, senior management at Feltex were required to consider, and specifically sign off on, the accuracy of how various aspects of Feltex's business were described. In addition to providing those responses, the members of the DDC conducted management interviews with 11 senior Feltex managers to test the reasonableness of statements proposed for inclusion in the prospectus.

[546] The JLMs also had representatives attend due diligence meetings, and were invited to comment as the content evolved. Those involved for the JLMs had substantial experience in presenting such offer documents to the market, and had to assume formal responsibility for the listing of Feltex's shares on the NZX once the shares offered in the IPO were allotted.

[547] Mr Forbes' response to the defendants' concerted reliance on the thoroughness of the due diligence process as making out the due diligence defence was to argue that the apparent thoroughness of that process "should not allow there to be a triumph of form over substance". His point was that the apparent thoroughness of the process could not be a complete answer, and did not prevent the Court from analysing the reasonableness of the content resulting from the process. However thorough the process, if any material content of the prospectus was misleading in any respects where the defendants could not reasonably have believed in its accuracy, then the due diligence defence would not avail them, however thorough the process appeared to be. Put another way, the thoroughness of the process could not of itself make out the reasonableness of belief in the truth of the content of the prospectus, and ultimately that required an objective assessment of the reasonableness of purported justifications for statements that were now found to be untrue in the statutory sense.

[548] Mr Forbes' argument raised the prospect that if all those participating in settling the content of the prospectus were similarly reassured by, and relied on, the

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196 DD2 001006.

thoroughness of the process and the participation of others who were checking its content, then they could contribute to errors without individually having a reasonable basis for believing in the truth of that content. The criticism would be that instead of applying their own expertise to make a judgement on the material content, the defendants were lulled into a sense of reassurance by the apparent thoroughness of the process.

[549] I accept Mr Forbes' concern in abstract. An apparently thorough process for preparation of a prospectus is not a guarantee against misleading content making its way into the prospectus, nor does the thoroughness of the process of itself make out the due diligence defence.

[550] However, I would not be persuaded that there was any sense in which the thoroughness of the process was a charade, or that those who were attributed individual responsibilities to verify the accuracy of the content in any way shirked their responsibilities, or failed to apply themselves with appropriate care. If Mr Forbes' argument in this regard was intended to go so far as to suggest some mutual unspoken recognition that a thorough process could disguise an absence of genuine individual assessment of the accuracy of the content, then his case did not go anywhere near laying a foundation for a challenge to the due diligence process as being less than genuine.

[551] The proposition that directors did not genuinely participate in considering the accuracy of the content of the prospectus was not squarely put to any of them. It would be invidious to attempt any ranking of the directors on the basis of the evidence I heard, in terms of the genuineness or thoroughness of their testing of the content of the prospectus through the course of its preparation. However, taking Ms Withers as one example, it would be untenable for the plaintiff to suggest that her individual analysis of the justification for the terms in which the prospectus was issued was anything less than appropriately rigorous and genuine.

[552] Ms Withers had joined the Feltex Board a relatively short period before the IPO was undertaken. She had conducted her own due diligence as to the appropriateness of her becoming a director, before committing to do so. Ms Withers

described in her evidence her own individual analysis of the components of the prospectus that were material to her, and there was no scope for suggesting it was less than thorough and genuine. Certainly, she was not challenged on the character of her individual assessment of the prospectus. If it had been raised with her, I am confident that she would have rejected as anathema any suggestion that she participated in an unspoken arrangement to disguise the process for preparation of the prospectus as a thorough one, when in fact it was not. Variants of these observations could be made in respect of the other directors.

[553] I accept the submission for the directors that their individual responsibilities to be satisfied as to the accuracy of the prospectus does not import an obligation to conduct all relevant research personally. The relevant task is a form of "due inquiry" which is the subject of its own definition in s 2B of the SA, in terms more or less consistent with the more general authorisation in s 138 of the Companies Act 1993 for directors to seek and receive information and advice from those reasonably assessed by directors as being competent to provide it. In this case, no tenable challenge could be raised to the extent of reliance by directors on the senior managers of Feltex who contributed to the prospectus.

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

[555] All of the defendants also raised, as an alternative affirmative defence, their entitlement to relief from any liability that was made out against them under s 63 of the SA. That section provides as follows:

> **63 Power of Court to grant relief in certain cases**
>
> (1) If in any proceedings against any person for negligence, default, breach of duty, or breach of trust in connection with—
>
> (a) An offer to the public or allotment of securities; or
>
> (b) The distribution of a registered prospectus or advertisement; or
>
> (c) The management of securities offered to the public; or
>
> (d) Any matter related thereto—
>
> it appears to the Court hearing the case that the person is or may be liable in respect of the negligence, default, breach of duty, or breach of trust, but that he or she has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his or her appointment, he or she ought fairly to be excused for the negligence, default, breach of duty, or breach of trust, the Court may relieve him or her either wholly or partly from his or her liability, on such terms as the Court may think fit.
>
> …

[556] This provision applies in broader circumstances than s 56(3). It can be invoked where liability is not pursuant to the statutory regime, and extends to the prospect of liability at common law for negligence or breach of trust. I did not hear argument on the scope of circumstances in which s 63 might avail a defendant when the due diligence defence could not be made out in relation to liability for an untrue statement in a prospectus. In cases such as the present, it seems likely that the same considerations would apply.

[557] Given my provisional view that the defendants could bring themselves within the due diligence defence under s 56(3) of the SA, if the prospectus was found to contain untrue statements, then resort to s 63 would be unnecessary. If I were also held to be wrong on the availability of the due diligence defence, then I am not in a position to make findings of any distinguishable circumstances in which any of the defendants would nonetheless be entitled to some measure of relief under s 63. In those circumstances, the matter would need to be re-argued in light of the nature of the untrue statement, and the findings that lead to the rejection of the due diligence defence.

Were FNZC and ForBar promoters?

[558] The term "promoter" is defined in s 2 of the SA as follows:

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

[559] The plaintiff submitted that both FNZC and ForBar were "instrumental in the formulation of [the] plan or programme" pursuant to which the Feltex shares were offered to the public. Arguably, their roles brought them within the definition of "promoter" in the SA.

[560] The fourth and fifth defendants disputed that they were instrumental because they did not have the power to decide the terms on which the offer of securities was to be made. Even if they were instrumental, they submitted that they participated solely in their professional capacities, so that the exclusion in para (c) of the definition applies.

[561] The first legislative definition of a promoter was that in the Joint Stock Companies Act 1844 (UK) 7 & 8 Vict, C110. Although absent from companies legislation for a period in the 1860s, the concept has been a relatively standard component of the regulation of conduct by those responsible for forming and establishing limited liability companies, up to the time of their incorporation.

[562] Commenting on the common law rationale for attributing liability to promoters, the authors of *Morison's Company and Securities Law* suggest:[197]

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

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[197] Andrew Beck and others *Morison's Company and Securities Law* (looseleaf ed, LexisNexis) at [4.2].

[563] The exclusion of professionals from the definition of "promoter" was expressly enacted in the Directors Liability Act 1890 (UK) 53 & 54 Vict, c 64. Section 2 of that Act defined a promoter as:

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

[564] New Zealand adopted substantially the same definition in the Directors Liability Act 1890. This was carried forward into various Acts, the latest of which was the Companies Act 1955.[198]

[565] The present definition has been in the SA since its original enactment in 1978. References to promoter (generally coupled with directors) in the Companies Act 1993 depend by way of cross-reference on the definition in the SA.

[566] The fourth defendant submitted that the definition of "promoter" must be interpreted in light of the pre-existing case law, the overall scheme and purpose of the SA, and in a manner consistent with the use of the term "promoter" in the Companies Act 1993. For the fourth defendant, Mr McLellan QC submitted that the definition in the SA was intended to reflect the common law considerations of the concept of a promoter. He cited nineteenth century English decisions that included the following:[199]

> A promoter, I apprehend, is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose. That the defendants were the promoters of the company from the beginning can admit of no doubt. They framed the scheme; they not only provisionally formed the company, but were, in fact, to the end its creators; they found the directors, and qualified them; they prepared the prospectus; they paid for printing and advertising, and the expenses incidental to bringing the undertaking before the world.

and:[200]

> As used in connection with companies the term "promoter" involves the idea of exertion for the purpose of getting up and starting a company (of what is

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198 Companies Act 1955, s 53(5)(a).
199 *Twycross v Grant* (1877) 2 CPD 469 at 541.
200 *Emma Silver Mining Co Ltd v Lewis & Son* (1879) 4 CPD 396 at 407.

> called "floating" it) and also the idea of some duty towards the company imposed by or arising from the position which the so-called promoter assumes towards it.

[567] In reliance on the common law approach, it was submitted for the JLMs that the role of promoter connotes the initiator of an IPO who is able to control the terms on which it occurs. Arguably it should not extend to advisers who do not have decision-making power because they might otherwise be fixed with liability for the content of a prospectus that they could not control.

[568] That approach was said to be consistent with the purpose of imposing civil and criminal liability on those persons who are not issuers or directors but who nevertheless exercise an equivalent degree of influence over the offer making it appropriate and necessary for the protection of investors that equivalent obligations should apply.

[569] The plaintiff did not address how the statutory terms of the definition should be interpreted. Instead, Mr Forbes undertook a detailed analysis of the nature of the various tasks that the JLMs agreed that they had undertaken. He argued that those tasks brought the JLMs within the natural meaning of those who were instrumental in formulating the plan for offering the shares to the public.

[570] The plaintiff traversed extensively in evidence the extent to which the JLMs:

- attended DDC meetings;
- proposed the content for the prospectus itself;
- drafted components of the prospectus;
- proposed the form in which prospective financial information should be presented;
- urged a change in Feltex's thinking on the payment of a dividend in relation to FY2004;

- led the conduct of the book build;

- recommended the final share price; and

- promoted the offer to their own clients, and to institutions within New Zealand and overseas.

[571] In particular, the plaintiff drew attention to ForBar's claims as to the extent of work they had done in support of a request for a greater share of the incentive fee payable to JLMs.[201]

[572] Mr Forbes also argued that both FNZC and ForBar promoted themselves to the public, in particular to potential investors, to be professional and responsible firms whose advice and conduct could be relied on, and that they used their positions to attract investor demand, undertake transaction management, provide advice and leadership for the public offer, and developed investor relations programmes.

[573] The plaintiff also emphasised the names given to ForBar and FNZC in the prospectus. They were described as "Joint Lead Managers" and "Organising Participants". Their names appeared on the cover of the prospectus. Both labels arguably described roles that were "instrumental in the formulation of the plan" for the IPO. By way of contrast, the plaintiff pointed to the limited reference in the prospectus to the three legal advisers named in the Directory and to the auditor.

[574] An additional role assumed by the JLMs arose out of the difference of opinion between Credit Suisse as vendor and the participants who were acquiring shares in the IPO, in relation to the partial "lock up" preventing sale of those shares for a period after they were allotted. One aspect of the resolution of that difference was that the participants (that is, the majority of the directors plus senior managers) agreed to not transfer any of the shares acquired for 12 months from the date of issue, subject to being able to obtain agreement to any particular transfer from the

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[201] CB16 011449–011454.

JLMs.[202] The plaintiff treated that as another indication of the JLMs being instrumental in formulating the plan for the IPO.

[575] One further feature argued by Mr Forbes as indicative of their status as promoters was that the JLMs had obtained an indemnity in relation to any liability that might arise from their participation. I took his argument to be that the prospect of any such liability would arise by virtue of their status as promoters, and that therefore the existence of that indemnity tended to confirm that they had the status of promoters.

[576] The JLMs disputed that the nature of their involvement came within the definition of being "instrumental" in the formulation of the plan pursuant to which the shares were offered to the public. The JLMs did not consider themselves to be promoters, nor did the others involved in settling the terms of the prospectus and managing the IPO. Section 41(b) of the SA requires every promoter of the securities to which the prospectus relates to sign personally, or by its, his or her agent. The JLMs did not sign the prospectus, and throughout the extensive work, including input from the solicitors for the issuer and for Credit Suisse, there is no evidence to suggest that any of those involved considered the JLMs had the status of promoters.

[577] Of course, the perceptions of those involved at the time could not be decisive, but it is at least an indication that those involved in what I consider to have been a thorough process did not treat the JLMs as promoters.

[578] The representatives of both JLMs who gave evidence were consistent in their evidence that the nature and extent of their involvement did not go beyond that customarily assumed by JLMs, which they considered did not qualify them as promoters. Those witnesses were not challenged on their perception that sharebroking firms acting as lead managers for IPOs in New Zealand fell outside the definition of a promoter. The prominence given to the role of the JLMs in the prospectus does not alter the substance of their role.

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[202] Specified in the prospectus at 31.

[579] However, whether a person is a promoter is a question of whether that person comes within the statutory definition, not whether someone else might think he or she is a promoter. Mr Forbes acknowledged that applying the definition of promoter to include the roles taken by the JLMs might take the broking community by surprise, but argued that a widely shared erroneous view of how the definition applied was still erroneous. Any precedential effect of accepting the breadth of definition Mr Forbes contended for is minimised by pending changes in securities law.[203]

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

[581] Examples of the JLMs' suggestions as to the content of the prospectus or conduct of the IPO being adopted do not assist the plaintiff because, significantly in all respects, their involvement was limited to making recommendations and they always had to take instructions from Credit Suisse and Feltex. Some of the JLMs' recommendations were rejected. For instance, the recommendation that the prospectus should include a sensitivity table demonstrating the range of impacts of changes in relevant business conditions such as the New Zealand/Australian dollar exchange rate. There was rejection of the advice from FNZC that Credit Suisse should sell its shareholding in two stages, to retain a minority stake for a period, that the financial information presented for FY2005 would be better received as a forecast rather than a projection, and that the offer be pitched at a lower indicative price range. Further, the JLMs had suggested an amended description of the EIP

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[203] The Financial Markets Conduct Act 2013 will not include the concept of promoter among those liable for misleading statements.

arrangements for the majority of the directors and senior managers to enable them to fund acquisition of shares.

[582] Although in contractual terms the JLMs were clearly independent contractors, in one sense they were a specialised form of agent or broker for the vendor. Some of the respects in which the JLMs' recommendations were rejected by Credit Suisse reflect the difference in their interests: the JLMs were primarily concerned to have the IPO completed successfully so as to earn their fees, whereas Credit Suisse was concerned to maximise the sale proceeds.

[583] Accordingly, the JLMs did not share the power to make relevant decisions. At least in the circumstances of this IPO, I consider that is an important factor in taking them outside the contemplation of the primary element of the definition of promoter, namely those who were "instrumental".

[584] An IPO such as this could not be promoted to the public without at least one "participant", as defined in the NZX Rules. Those rules required a member of NZX who was an authorised Primary Market Participant to assume responsibility for the offer as "Organising Participant" and to ensure it complied with the rules for listing of the shares on the NZX.[204] Such participants are confined to entities that are accredited and designated by NZX to bring new offers of securities to a market provided by NZX. The label "Organising Participant" therefore derives from NZX's perspective of the role in interacting between it and the issuer. It does not connote an instrumentality in terms of control over the IPO, but rather a somewhat specialised agency function.

[585] The existence of an indemnity adds nothing to the plaintiff's argument. There were numerous prospects for liability to arise for the JLMs, other than by virtue of their being attributed with the status of promoters. There was no evidence as to whether JLMs ordinarily negotiated for an indemnity such as in the terms that were agreed here, but it can certainly not be taken as some covert acknowledgement that their involvement qualified them as promoters.

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[204] Rule 5.1 of the then NZX Listing Rules.

[586] The two exclusions in paragraph (c) of the definition are instructive in confining the character of the participation required for a promoter. I infer that directors are excluded because the liability regime under the SA catches directors by virtue of the requirement that they all sign the prospectus so that it is unnecessary to attribute responsibility to them in the discrete capacity as promoter.[205] Section 56 of the SA provides for civil liability for misstatements in a prospectus separately in relation to directors of the issuer and the promoters of the securities. Both categories are caught by the criminal liability provision.[206]

[587] The second aspect of the exclusion is for persons acting solely in their professional capacity. The rationale for this exclusion is that those involved in the issue of a prospectus because of their professional expertise in various components of how such undertakings are carried out fall outside the legislature's contemplation of those assuming liability as promoters. The current reality is that a prospectus cannot be used for an offer of securities to the public without the specialist involvement of securities lawyers and chartered accountants familiar with the audit requirements for a prospectus, together with a sharebroker who is a Primary Market Participant member of the NZX. In the commercial sense, without more, they are advisers in respect of the prospectus, but not promoters of it.

[588] Mr McLellan cited an early commentary on the SA definition that described the exclusion in the following terms:[207]

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

[589] On that approach, a firm could move beyond a role of acting solely in its professional capacity if it had a financial interest in the successful outcome that went beyond its normal mode of remuneration.

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205 SA, s 41(b)(i).
206 SA, s 58(3).
207 Paul Darvell and Richard Clarke *Securities Law in New Zealand* (Butterworths, Wellington 1983) at [2.55].

[590] Mr McLellan suggested there are no cases specifically considering whether a person acting as a lead manager is a person acting in a "professional capacity". He referred to a leading nineteenth century case of *Re the Great Wheal Polgooth Co Ltd*, in which the Court reasoned that it would be unreasonable to hold those acting in a professional capacity liable when they are not decision-makers and simply give advice or act on instructions.[208] He urged that the same reasoning ought to apply to lead managers who did not go beyond a professional capacity when they were subject to the decisions made by the issuer and the directors.

[591] The plaintiff characterised the JLMs' involvement as having a financial interest in the outcome to an extent that went beyond participation in their "professional capacity". Arguably, the JLMs had a financial interest by virtue of their firm commitments to each acquire $40 million worth of shares (on the basis that they could find buyers for them), and their partial underwrite of the priority offer to holders of the existing bonds that had been issued in 2003. Those bondholders could elect not to take up the offer to transform their bonds into shares (even although offered at a discount). In the outcome, the JLMs each had to take on approximately one half of the extent of the bonds they had agreed to underwrite, and ForBar put the value of their further commitment on this component at $6.4 million worth of shares.[209] On the plaintiff's analysis, this involvement took the JLMs beyond participation in their professional capacity.

[592] In addition, the plaintiff argued that in para (c) of the definition, those persons acting in their professional capacity should be interpreted as applying only to natural persons, so that bodies corporate involved in an IPO could not exclude themselves from being promoters, on the basis that they were acting solely in their professional capacity. Mr Forbes argued that the terms of para (c) contemplated only natural persons because that would always be the case with a "director" or "officer". He argued also that because persons who might be involved in their professional capacity were referred to in the limited terms of "his or her", if bodies corporate were included the wording would have been "his, her or its professional capacity".

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208 *Re the Great Wheal Polgooth Co Ltd* (1883) 53 LJ Ch 42 at 48.
209 CB16 011452.

[593] There is a conventional definition of "person" in s 2(1) of the SA which includes a corporation sole, or a company or other body corporate, as well as an unincorporated body of persons. I am not persuaded that there ought to be an idiosyncratic and inconsistent interpretation given to "person" where it appears in para (c) of the definition of promoter. Not only is there no justification for such an inconsistency, but it would involve a further inconsistency when it is clear that in the primary aspect of the definition of promoter in para (a), the reference to "person" must obviously accord with the definition of that expression in s 2(1).

[594] Because I have determined that the roles of the JLMs took them outside those who were instrumental in the plan for the IPO, the application of the exclusion for conduct in their professional capacity only arises if I am wrong in my application of the primary aspect of the definition of promoter. Addressing that point, the JLMs' commitments in the nature of underwriting did give them a significant interest in the successful outcome of the IPO. Whereas it is common practice for JLMs to be paid for involvement as such, at least in part, by way of success fees, a distinction might be drawn between that and making a financial commitment that could result in a significant loss if the JLMs were left with shares that they could only sell subsequently at lower prices. Is that significant stake in a successful outcome sufficient to take them outside participation in their professional capacity?

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

[596] Accordingly, I would not be persuaded that these financial interests of the JLMs took them outside the realm of involvement in their professional capacity. The claims against the JLMs on the basis that they were promoters would be unsuccessful.

Was CSAMP an individual issuer, or a promoter?

[597] The plaintiff sued CSAMP as the vendor, and also as an issuer of shares forming part of the public offer. In addition, the plaintiff claimed that CSAMP was liable as a promoter in that it was instrumental in the formulation of the plan and programme pursuant to which the IPO was undertaken.

[598] CSAMP denied that it could be liable under either head. Given the risk, particularly a decade after the transaction in issue, that one or other of the component Credit Suisse entities that participated in the transaction will no longer have assets in a jurisdiction in which any substantial judgment could be enforced, it is understandable that the plaintiff would seek to optimise the prospects of recovering a judgment by pursuing claims against both the Credit Suisse entities that were involved.

[599] There was no evidence to suggest that CSPE might not honour any judgment ordered against it, and certainly no suggestion from the plaintiff that Credit Suisse had taken steps to judgment-proof either of the entities that have been sued. Any such concern in abstract is not sufficient to influence the application of the legal test on the nature of involvement by CSAMP.

[600] Certain "Key statistics" on page 9 of the prospectus specified that CSAMP was the vendor and CSPE the promoter. On page 2, a formal statement in relation to registration of the prospectus specified that a copy of the prospectus had been delivered to the Registrar of Companies for registration, duly signed by or on behalf of:

- CSFB IGP as ultimate general partner of CSAMP;[210]

[210] The initials "IGP" do not appear to be explained anywhere in the prospectus.

- CSPE;

- the Directors of Feltex; and

- the directors of CSPE.

[601] An overview of the vendor and promoter at page 73 of the prospectus described them as:

> … members of the group of companies which operate the private equity business of Credit Suisse Group under the trading name Credit Suisse First Boston Private Equity. CSFB IGP, the ultimate general partner of the Vendor, is a wholly owned subsidiary of the Credit Suisse Group.
>
> …
>
> [CSPE] is a private equity manager with more than US$29 billion in committed capital. [CSPE] is comprised of investment funds that focus on United States of America and international leveraged buyouts, structured equity investments, … and investments in other private equity funds.

[602] In a letter to CSAMP dated 22 April 2004, CSPE confirmed its role as promoter of the IPO. The letter also confirmed that CSPE "… administers and directs [CSAMP]". The letter specified that for the purpose of the definition of promoter in s 2 of the SA, CSPE was the "person who is instrumental in the formulation of a plan or programme pursuant to which the [shares] are offered to the public".[211]

[603] In closing, the plaintiff argued that CSAMP was a promoter, adopting an analysis consistent with that contended for in respect of the JLMs. Mr Forbes argued that CSPE's participation was as agent for CSAMP in circumstances where CSPE's assumption of responsibility as the promoter was to carry out acts on behalf of its principal, so that the character of promoter could be attributed to CSAMP, thus making it a promoter as well.

[604] Mr Forbes cited the decision in *Meridian Global Funds Management Asia Ltd v Securities Commission* as authority for the attribution of acts of an agent to the

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[211] AF1 000024.

principal.[212] However, that case arose in the different context of a relatively senior level executive committing the company by which he was employed to actions that the board of the company subsequently sought to disavow. The relevant attribution was of the executive's actions to the company in circumstances where the sphere of his responsibilities brought the actions he took within those for which an executive with his level of authority might reasonably be attributed to the company. That analysis cannot apply where two entities agree to allocate responsibilities between them, and thereafter adhere to separate commitments in their separate legal identities.

[605] The designations chosen by CSPE and CSAMP, on the basis of legal advice, could not of themselves be decisive. However, in considering whether CSAMP was a promoter, it is inappropriate to attribute to it the independent conduct undertaken by CSPE in a context where CSPE assumed liability as promoter and carried out the tasks that qualified it as such.

[606] I am mindful that respecting the division of roles that CSAMP (as passive owner) and CSPE (as active manager and administrator) agreed between them could, in other circumstances, lead to the prospect of a special purpose, judgment-proof company being deployed as promoter to shield those with the substantive interest in the transaction from the risk of subsequent liability under the SA regime. The plaintiff made no such suggestion here, and other factors are likely to limit that risk in other circumstances. For instance, interposing a $100 company as the promoter would be likely to substantially dent the credibility of any IPO. Further, the vendor or issuer of the shares would generally also be liable for any breaches of the obligations under the SA.

[607] I am not persuaded that the limited role CSAMP played in the IPO in its own name was sufficient to attribute to it the status of a promoter. Nor can it be attributed with that status by virtue of the work undertaken in its interests by CSPE, when that entity had the status in its own right as a promoter.

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[212] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500 (PC).

[608] The alternative basis for pursuing CSAMP under the SA cause of action was as the issuer of the securities. For that to apply, CSAMP would have to be treated as "an individual" for the purposes of s 56(1)(a) that creates liability for the issuer of the securities where that issuer "is an individual".

[609] CSAMP disputed that s 56(1)(a) could apply to it because, consistently with other references to "individual" in the SA, it was submitted that the word is used in s 56(1)(a) to mean a natural person, in contradistinction to a body corporate.[213] It was not disputed that CSAMP, organised as a limited partnership, constituted a form of body corporate, and was certainly not an individual in the sense used in the section.

[610] Instead, liability for an issuer that was a body corporate is addressed under s 56(1)(c) where it imposes liability on the persons who are named in the prospectus as a director of the issuer.

[611] CSAMP had applied this analysis when the prospectus was drafted, and hence the signing of the prospectus on behalf of CSFB IGP in its capacity as the director of CSAMP. Consistently with the descriptions of the promoter and the issuer cited at [601], the confirmation of signing of the prospectus at page 140 relevantly specified:

> (b) for and on behalf of CSFB IGP, the ultimate general partner (and Director for purposes of the Securities Act 1978) of [CSAMP] by its agent authorised in writing.

[612] I accept that it is the director or directors of an issuer, where the issuer is in corporate form, that is or are liable in terms of s 56 of the SA. It follows that CSAMP could not be liable as an issuer, and liability as issuer could only have been made out against its director, CSFB IGP.

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[213] Consistently with the distinction drawn for pecuniary penalties as between individuals and bodies corporate such as in s 55F and s 60K, post the Securities Amendment Act 2006.

A co-existent cause of action under the FTA?

[613] The first two causes of action invoked the FTA. The first cause of action alleged that the involvement of all defendants up to the issue and allotment of the shares constituted conduct in trade that was misleading or deceptive, or likely to mislead or deceive. The second cause of action under the FTA related to conduct after the IPO, once all the shares had issued. It was pleaded only against Mr Magill, and gave rise to different considerations.

[614] All defendants denied that the FTA could apply. They relied on statutory provisions that enforce mutual exclusivity of conduct regulated respectively by the SA and the FTA. Section 63A of the SA provides:

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

[615] Section 63A was added to the SA by the Securities Amendment Act 2006, which came into force on 25 October 2006.

[616] Section 5A was added to the FTA, to come into effect on 29 February 2008:

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

[617] Both provisions were part of the Securities Legislation Bill, which was introduced to the House of Representatives on 30 November 2004. The intention of both provisions was to clarify the inter-relationship between the SA and the FTA. That is clear from the proposal by the Minister of Commerce to the Cabinet

Economic Development Committee entitled "Review of Securities Trading Law: Further Policy Approvals", which states:[214]

> Submitters, however, have pointed out that excluding conduct regulated by the Securities Markets Act from the Fair Trading Act would not create a gap in the coverage of the law and, furthermore, it would avoid any confusion that might arise (should any overlap between the two Acts exist) as to whether the Securities Commission or the Commerce Commission is the competent body for enforcing the regime.
>
> I am persuaded by submitters' logic. Accordingly, I recommend that the general prohibition against misleading or deceptive conduct in respect of dealings in securities be excluded from the coverage of the Fair Trading Act 1986.

[618] Section 24 of the Securities Amendment Act 2006 contained transitional provisions that were, in relevant part, in the following terms:

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

[619] Section 63A was within the subpart to which the transitional provision related. The subpart also contained numerous substantive changes to securities law. The Feltex prospectus issued more than two years before the amendment, although Mr Houghton's proceedings were not commenced until 26 February 2008, more than 18 months after the amendment.

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[214] At [28] and [29].

[620] There was no transitional provision as to the application of s 5A. It came into force three days after these proceedings were commenced. At earlier stages of the proceedings, it was recognised that there is an argument whether s 5A applied to a proceeding that had been commenced before it came into force.[215]

[621] The plaintiff opposed the application of s 63A on the basis that it came into force after the conduct in issue and its application would therefore require retrospective effect. Mr Forbes submitted that that would be contrary to s 7 of the Interpretation Act 1999.

[622] In considering the terms in which these mutual exclusivity provisions were expressed by the legislature, it is relevant that s 63A does not constrain commencement of proceedings in which causes of action invoke both the SA and the FTA. What is prohibited by both provisions is a finding of liability against a person under the FTA, if the claim relates to conduct that is regulated by the SA where the defendant would not be liable for the conduct complained of under the SA.

[623] Although there can be no doubt in the present circumstances, claims are likely to arise in contexts where the claimant is not able to be certain at the outset whether the conduct complained of is indeed regulated by the SA. An obvious example is whether the offer in question constituted an offer of securities to the public.[216] In such cases, an application to strike out a cause of action under the FTA might well fail because a determination is needed as to whether the conduct complained of is indeed regulated by the SA before the Court could exclude the prospect of a finding of liability against the defendant under the FTA.

[624] On that interpretation of the provisions, no issue of retrospectivity arises. In this case, the third cause of action under the SA is pleaded as an alternative to the first cause of action under the FTA. However, it is only when there is an admission or a finding that the conduct the plaintiff complains of is regulated by the SA that the Court is deprived of the jurisdiction to make a finding of liability under the FTA.

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215 *Houghton v Saunders* (2011) 20 PRNZ 509 (HC) at [158].

216 See, for example, *Securities Commission v Kiwi Co-operative Dairies Ltd* [1995] 3 NZLR 26 (CA).

[625] All other considerations about the application of these provisions consistently support this approach. It renders the need for a transitional provision when s 5A was added to the FTA unnecessary. The transitional provision in s 24 of the Securities Amendment Act 2006 was required to regularise the position with a number of the substantive amendments that had been made and s 63A would simply apply as the issue arose in any Court proceedings, irrespective of when they were commenced.

[626] To the extent that the provisions were seen as desirable to prevent overlapping regulatory regimes as between the Securities and Commerce Commissions, then the provisions would immediately have effect in relation to any on-going work, subject to resolving (if it was a relevant issue) whether indeed the SA regime did apply.

[627] From a policy perspective, it is readily understandable that the application and enforcement of a specific civil liability regime governing the issuance of securities should not be subverted by an overarching consumer protection statute. There are specific checks and balances between the interests of issuers of securities on the one hand, and potential investors on the other, that are provided for in the SA regime, whereas the legislature has not provided for comparable checks and balances in the generic consumer protection regime.

[628] The defendants invited an analogy with the equivalent provision in Australia. That had been preceded by views expressed in the Australian Government's Corporate Law Economic Reform Program, addressed in the following terms:[217]

> The balance struck in the Corporations Law between positive disclosure obligations and liability for non compliance is effectively undermined by the superimposed Trade Practices and Fair Trading Act liability.
>
> …
>
> Liability rules should not shift to fundraisers the investment risk properly accepted by investors in efficient securities markets. Investment in securities carries an inherent risk accepted by investors in order to receive the higher returns that such investments can bring. Imposing liability for failed investments on fundraisers regardless of fault either discourages capital raising at the outset or results in disproportionate due diligence and

[217] Australian Government Corporate Law Economic Reform Program *Proposals for Reform: Paper No 2* (1 April 1997) at 41.

> disclosure costs, ultimately borne by investors in increased prices for securities and lower returns. Reducing the return to investors will in turn dampen investment.

[629] Accordingly, I accept that s 63A of the SA and s 5A of the FTA apply to exclude causes of action under the FTA in relation to the conduct in issue in the proceedings because such conduct is inarguably regulated by the SA.

Second cause of action under the FTA

[630] The second cause of action under the FTA was pleaded only against Mr Magill in relation to his conduct in the period of 12 months following the allotment of shares. It alleged that Mr Magill continued a practice of forward dating sales to an extent that materially affected Feltex's reported financial performance. It was claimed that that practice, in conjunction with the timing of a profit downgrade announcement in April 2005, disguised the availability to the plaintiff and other qualifying shareholders of their entitlement under s 37A of the SA to avoid their allotments (ie force the issuer/vendor to take the shares back) and require repayment of their subscriptions.

[631] A parallel complaint that all those responsible for the prospectus had misled readers in respect of Feltex's financial performance by forward dating of invoices was abandoned towards the end of the trial. Although the discrete criticism made against Mr Magill in respect of the subsequent period was not also abandoned, no credible argument was advanced as to how the extent of the practice in the 12 months after allotment could be characterised as material. Nor was there any credible basis for attributing responsibility for the practice, to the extent it continued, to Mr Magill.

[632] Further, there was no detailed analysis of the respects in which the profit downgrade announcement in April 2005 was said to be misleading. I was accordingly not in any position to determine whether the profit downgrade announcement to the market was a competent attempt to quantify the extent of recent changes in Feltex's trading circumstances .

[633] There is no tenable basis on which the facts necessary to make out such a cause of action could be sustained.

[634] That obviates the need to consider whether the post-IPO conduct was regulated by the SA, so as to fall within or outside the exclusion of claims under the FTA.

FTA – claims brought out of time?

[635] A fallback position, advanced particularly for the second and third defendants in relation to parts of the claims under the FTA, was that, if the Court did have jurisdiction to entertain them, then they were nonetheless added after expiry of the three year time limit under the FTA from the point at which the plaintiff's rights of action were known to, or reasonably discoverable by, the plaintiff. The issue only becomes relevant if I am wrong in holding the mutual exclusivity provisions in s 63A of the SA and s 5A of the FTA apply to exclude liability under the FTA, in respect of the causes of action pleaded in this case.

[636] The limitation defence was argued on the basis that one or more of the new components of the allegations added in or after the first amended statement of claim constituted fresh causes of action. If that characterisation is wrong, then the new allegations are to be treated as amendments to existing causes of action, and no limitation issue would arise.

[637] The additional components of the claims that were challenged on limitation grounds were:

- the 24 May announcement;[218]

- the second cause of action (under the FTA against only Mr Magill);[219]

[218] 4ASC at 33.2, 53.
[219] 4ASC at 43 to 46.

- that the book build did not follow the steps described in the prospectus;[220] and

- the FY2004 shortfall in revenue.[221]

[638] Relatively difficult line drawing exercises can arise in determining whether additions to pleadings are sufficiently different to constitute a new cause of action. Although some variations to the test applied arise depending on the context, the Court of Appeal has observed that there must be a change to the legal basis of the claim. Although that might arise through the addition of new facts, it would only occur if the facts added are so fundamental that they change the essence of the case against the defendant.[222]

[639] In another case, the test posed was whether the amended pleading is something "essentially different", with a requirement that it sets up a new case that varies so substantially from previous pleading that it would involve investigation of factual or legal matters, or both, different from what have already been raised, and of which no fair warning had been given.[223]

[640] In assessing the criticisms, I dealt with the allegation of misstatement as to the book build process, and the allegation in relation to the content of the 24 May announcement, together.[224] At an earlier point in the proceedings, it appears that the plaintiff did not contest that the allegations about the book build process were sufficiently different in kind to amount to a separate and distinct claim.[225] However, as matters appeared at that time, French J ruled that a new cause of action in relation to the book build process was not statute barred under the FTA.[226]

[641] Both these criticisms are distinct chronologically in that they relate to matters after the prospectus had been registered. However, the relevant narrative of events had extended to the bringing down of due diligence and allotment of the shares in

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220 4ASC at 32.4, 40.
221 4ASC at 64.1.
222 *Commerce Commission v Visy Board Pty Ltd* [2012] NZCA 383 at [146].
223 *Transpower New Zealand Ltd v Todd Energy Ltd* [2007] NZCA 302 at [61].
224 At [495]–[517].
225 *Houghton v Saunders*, above n 215, at [170].
226 At [172].

early June 2004, after the book build was completed, and the 24 May announcement made. The chronological distinction would therefore not be determinative. The criticisms do involve consideration of discrete factual matters that are not otherwise relevant to assessing the criticisms of the prospectus in the other pleadings. From the outset, the defendants were confronted with a range of criticisms of the content of the prospectus, expressed in broad terms. Except to the extent that the defendants could restrict the range of criticisms by seeking further particulars prior to trial, then they were facing an expansive set of criticisms of the adequacy and accuracy of the prospectus.

[642] In the context of this pleading, it is not tenable to treat the additional criticisms in respect of the book build process in the 24 May announcement as changing the essence of the case against the defendants, or adding something that was essentially different. With respect to the relative scope of the original allegations as compared with the criticism of the book build process as they appeared in December 2010, assessing the scope of all the pleadings as the matter went to trial, I am not satisfied that either of these criticisms is sufficiently distinct to be treated as a fresh cause of action.

[643] Clearly the second cause of action, being that against Mr Magill alone, is a separate cause of action and the limitation defence would therefore apply to it if it was not commenced within time.

[644] The allegation of a material shortfall in FY2004 revenue was added in the third amended statement of claim in September 2013.[227] I dealt with this criticism at [164] to [192] above. Despite the prominence it eventually assumed in the plaintiff's case, I am not persuaded that the amended pleading addressing this criticism amounted to a new cause of action. Rather, it was an amplification of the criticisms of which the defendants previously had notice, in relation to the quality of the analysis undertaken in preparing the data for inclusion in the prospectus.

[645] In analysing whether amendments to pleadings introduce a fresh cause of action, a liberal approach should not apply to provide an unjustified reward for

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[227] Subsequently in 4ASC at 64.1.

vague or prolix pleadings. That point might well be made in this case. In the end, the relative scale and nature of what was in issue originally, when compared with the added scope introduced by these challenged amendments, means that they are less than fresh causes of action. It is a context-specific analysis.

[646] Accordingly, I accept that the second cause of action would be vulnerable to challenge on limitation defence grounds because it has the status of a fresh cause of action. There is no tenable basis on which that cause of action could be resurrected, so it does not justify further consideration. However, against the prospect that any one or more of the newer allegations in respect of the book build, the 24 May announcement and the FY2004 revenue shortfall should be recognised as fresh causes of action, (and against the prospect that I am wrong to exclude claims under the FTA because the SA applies) I will record the evidence and arguments addressed.

[647] The statutory limitation provision applying to claims under the FTA is set out in s 43(5) as follows:

> An application under subsection (1) may be made at any time within 3 years after the date on which the loss or damage, or the likelihood of loss or damage, was discovered or ought reasonably to have been discovered.

[648] The plaintiff pleaded that his right of action under the FTA only became known to him in July 2007. That was when the Christchurch solicitor who was then acting in relation to potential claims on behalf of investors in Feltex had obtained expert legal and accounting advice that revealed the prospect of claims such as were subsequently pursued, and provided generic advice to numerous Feltex shareholders.

[649] The second and third defendants disputed this timing on the discoverability of the cause of action and contended that time ran from a point in late 2006, which was more than three years before the challenged components of the FTA cause of action were pleaded.

[650] Section 43(1) of the FTA gives the Court jurisdiction to make various types of order where the Court finds that a person has suffered, or is likely to suffer, loss or damage by the conduct of any other person that is in contravention of the provisions of Parts 1 to 4 of that Act. It follows that a time limitation provision for the pursuit

of applications for such orders should also be measured by reference to the date on which the loss or damage, or likelihood of it, was either discovered or ought reasonably to have been discovered.

[651] The plaintiff relied on the analysis of Tipping J in the Supreme Court decision in *Commerce Commission v Carter Holt Harvey Ltd* for the proposition that the likelihood of existing or past loss had to be more probable than not.[228] The same passage in Tipping J's judgment included the further observation:[229]

> As loss is not relevant for present purposes unless it was occasioned by a contravention of the Act, the words "as a result of a contravention of the Act" are necessarily implicit in this question. The same concept of probability should apply, for present purposes, to the applicant's awareness that loss has been occasioned by a contravention.

[652] In *Carter Holt*, the Commerce Commission responded to a complaint from an industry body by commencing an investigation in relation to Carter Holt allegedly misrepresenting the quality of processed timber it was selling. The deficiencies in the processed timber were likely not to have been apparent to purchasers of the timber when the timber was used for building material, but only when the results of research as to the adequacy of the treatment of the timber became known to them.

[653] In those proceedings, where the Commission had not suffered any relevant loss itself, Carter Holt claimed that the proceedings were commenced out of time when the initial steps in the Commission's investigation had been taken more than three years before the date the Court proceedings were commenced.

[654] The defendants argued that these circumstances distinguished the analysis in *Carter Holt* from the application of the time limit in the present circumstances, because the focus in that case was solely on when it ought reasonably to have been appreciated that identified persons had suffered loss.

[655] In contrast, here there was no doubt that subscribers for shares in the IPO who held them until the company passed into receivership had suffered a loss. The date on which recognition of losses ought to have occurred was not in issue. Instead,

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228 *Commerce Commission v Carter Holt Harvey Ltd* [2009] NZSC 120, [2010] 1 NZLR 379.
229 At [31].

on the parallel inquiry Tipping J contemplated, the date in issue was that on which it was, or ought to have been, appreciated as more probable than not that the loss had been occasioned by an alleged contravention of the FTA.

[656] The evolution and intended meaning of s 43(5) was thoroughly analysed in the *Carter Holt* proceedings. In the Court of Appeal, Chambers J observed of amendments to ss 43 and 40 in 2001 and 2003 that:[230]

> Both amendments introduced into their respective regimes what is generally called a "reasonable discoverability" test. The wording of the test is, I suspect, expressed loosely for good reason. Exactly what has to be discovered is very much fact dependent.

[657] In her dissent in the Supreme Court, Elias CJ observed:[231]

> The time limit runs from the date when the loss or damage "was discovered or ought reasonably to have been discovered". As Chambers J pointed out, the legislative history indicates that s 43(5) was amended to refer to discovery and reasonable discovery of loss in the belief that the trigger for the limitation period for application to the compensation for loss would then be equivalent to the trigger for limitation periods for tort.

[658] There can be different components of a cause of action that can delay time starting to run for limitation purposes. In *Carter Holt*, it was an awareness of existing or future damage. Here, it would be an awareness of an alleged contravention of the FTA by those responsible for the loss suffered by the claimant. However, I am not persuaded that the difference is material. For the jurisdiction under s 43 to work subject to the time constraint imposed by s 43(5), I treat the Supreme Court's approach in *Carter Holt* as being capable of applying to both contingencies that might affect time running.

[659] The ascertainment of loss suffered by a potential claimant is an issue of fact, the identification of which will generally be under the control of the potential claimant. Ascertaining the elements of a cause of action under the FTA will likely require the application of the law to the facts, and in that sense could be seen as

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230 *Commerce Commission v Carter Holt Harvey Ltd* [2009] NZCA 40, [2009] 3 NZLR 573 (CA) at [180].

231 *Commerce Commission v Carter Holt Harvey Ltd*, above n 228, at [5]. The Chief Justice added in a footnote a caution that the premise on which members of the Court of Appeal approached s 43(5) might need to be reconsidered. That caution is not relevant to this analysis.

different from determining the existence of a qualifying loss. In many cases, once loss has crystallised, its existence is a certainty. In contrast, a claimant will never know if a cause of action is successful until judgment has been obtained. It is common for limitation provisions to have time running from the point at which a claimant knew, or ought reasonably to have been aware, of the existence of all the elements of the cause of action. In the present context, Tipping J's requirement that the applicant be aware that loss "has been occasioned by a contravention of the Act" cannot be taken literally to require knowledge that the claim must necessarily succeed. Rather, that all elements for a tenable claim exist.

[660] Accordingly, where the existence of loss or damage is not an issue, but reasonable discoverability of the elements to be made out in establishing a contravention of the FTA are, then time will run from the point where those elements were discovered, or ought reasonably to have been.

[661] Mr Houghton purported to rely on advice provided in July 2007 by means of a circular to potential claimants as the point in a sequence of correspondence from the solicitors then acting for potential claimants (Wakefield Associates) when he became aware of his right of action under the FTA. I allowed an application on behalf of the second and third defendants requiring discovery of the earlier components of that research and advice, to enable the defendants to test the plaintiff's claim as to the point in time at which awareness of the right of action arose.[232]

[662] When Mr Wakefield responded to a subpoena, I overruled his objection to producing the papers relevant to the research he had undertaken on potential claims, in the period between October 2006 and the circular advice in July 2007. Having gained access to those papers, the second and third defendants did not rely on any of them specifically in closing, as establishing an earlier point in time at which Mr Wakefield (in the imputed position of agent for Mr Houghton) became aware it was more likely than not that there was a tenable cause of action under the FTA.

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[232] *Houghton v Saunders* HC Wellington CIV-2008-409-348, 21 March 2014 (Ruling No 2).

[663] The second and third defendants argued that both Mr Wakefield and Mr Tony Gavigan (the investment banker who had sought to promote a class action on behalf of Feltex investors and who was liaising with Wakefield Associates) should be treated as Mr Houghton's agents. If so, then the defendants sought to attribute to Mr Houghton the state of awareness of rights of action enjoyed by Messrs Wakefield and Gavigan progressively from late 2006.

[664] I consider there were significant impediments to attributing Mr Gavigan's knowledge to Mr Houghton, for the purposes of assessing when there was the requisite awareness of rights of action. Numerous indicia likely to be relevant to a determination of whether Mr Gavigan constituted an agent whose state of knowledge would bind Mr Houghton as a principal were not sufficiently tested, particularly in the absence of any evidence from Mr Gavigan. Policy issues may arise in the context of a class action as to whether a person in Mr Gavigan's position is deemed to assume responsibilities that reasonably carry with them the attribution of knowledge to those who might at the time, or subsequently, seek to join a class action invoking claims that had been researched by someone in Mr Gavigan's position.

[665] A somewhat more conventional analysis was relied on to attribute to Mr Houghton the state of awareness of prospective causes of action being considered by Mr Wakefield. However, that analysis was complicated by Mr Wakefield's refusal to accept that Mr Houghton was a client of his, for relevant purposes, in the period from late 2006 to mid 2007. In liaison with Mr Gavigan, Mr Wakefield had canvassed Feltex shareholders for support for a possible class action in November 2006. He asked for a modest retainer from any shareholders who wished to join the action, and was adamant, on the basis of his records, that Mr Houghton had not paid the retainer, and was therefore not treated by Mr Wakefield as a client at that time.

[666] Mr Houghton was equally firm that he had paid the retainer. He was certainly represented by Mr Wakefield in Companies Act proceedings involving Feltex in the Auckland High Court in late 2006, because Mr Wakefield filed documents on Mr Houghton's behalf.

[667] For the purposes of resolving Mr Wakefield's objection to producing his documents, I preferred Mr Houghton's evidence that he was a client of Mr Wakefield in relation to instructions on potential claims for Feltex shareholders.[233] Different considerations might, however, influence a determination as to whether Mr Wakefield was to be attributed with a responsibility to share the product of his work in relation to possible claims with all of those who had paid the retainer, irrespective of the extent of individual contact Mr Wakefield had had with such prospective claimants. There is an artificiality in attributing to a solicitor an individual obligation to progress instructions of this type as if his state of knowledge was shared with all potential claimants, as his thinking evolved.

[668] Alternatively, the second and third defendants argued that, irrespective of the state of knowledge that could actually be attributed to Mr Houghton or his agents, then certainly by December 2006 he ought to have had sufficient knowledge to draw the connection between his loss and the alleged deficiencies in the prospectus as constituting the necessary elements for a claim under the FTA.

[669] By that time, Mr Gavigan's campaign to pursue legal action had attracted some publicity, and Mr Houghton was in periodic contact with Mr Gavigan. There had also been a two-part article in the New Zealand Herald on 30 October and 6 November 2006, written by Rebecca Macfie, revealing a range of criticisms of Feltex that was subsequently the subject of the original pleaded criticisms in the statement of claim. Certainly, by December 2006 Mr Houghton was aware that his investment had been rendered worthless. It was tenable for him by that time to draw the connection between the loss he had suffered and the discrepancies between the description in the prospectus of Feltex's prospects and the risks that it faced, and the acknowledgements of a different perspective by Messrs Saunders and Thomas at the 2005 AGM. In addition, there were the criticisms described in the Macfie articles, together with Mr Gavigan's initiatives to pursue claims. Making reasonable allowance for the relative complexity of the criticisms, I consider that it was reasonable for a claimant in Mr Houghton's position to appreciate by December

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[233] *Houghton v Saunders* HC Wellington CIV-2008-409-348, 8 April 2014 (Ruling No 8).

2006 that he had a tenable basis for advancing the elements for a cause of action under the FTA.[234] I consider that time would run from that point.

[670] Accordingly, any additional aspects of the claims under the FTA that are properly treated as new causes of action, and that were only added in or after the first amended statement of claim would, in any event, have been time barred.

A duty of care in tort?

Principles relating to a claim in negligent misstatement

[671] The plaintiff's fourth case of action was a claim against all of the defendants for negligent misstatement under the rule in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*.[235] At an early stage in these proceedings, the cause of action in negligence survived a strike out application on the basis that a duty of care might be made out. The existence of an alternative remedy was acknowledged as potentially a telling factor against recognising a duty of care in tort, but the point was left for determination at trial.[236]

[672] The ultimate question in determining whether to impose a duty of care is whether it is just and reasonable that a particular duty of care to the particular plaintiff should rest on the particular defendant. The courts have focused on two broad fields of enquiry.[237] First, whether the relationship between the plaintiff and the defendant is sufficiently proximate to justify imposing a duty of care. In the context of negligent misstatement, the proximity inquiry focuses on the inter-dependent concepts of assumption of responsibility and foreseeable and reasonable reliance.[238] Secondly, whether there are wider legal and other issues that militate for or against the imposition of a duty of care.

[673] The plaintiff did not cite any case where a duty of care had been imposed in the same circumstances. Mr Forbes did acknowledge a finding that directors who

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234 This analysis is on the assumption that I am wrong in interpreting ss 63A of the SA, and 5A of the FTA as precluding liability under the FTA.
235 *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL).
236 *Houghton v Saunders*, above n 5, at [53]–[54].
237 *Price Waterhouse v Kwan* [2000] 3 NZLR 39 (CA) at [6].
238 *Attorney-General v Carter* [2003] 2 NZLR 160 (CA) at [22].

had issued a prospectus to enable shareholders to consider a rights offer owed no duty to those who subsequently relied on the prospectus for the purpose of buying shares in the market.[239] Asserting a duty of care in the present circumstances would therefore involve creating a duty in novel circumstances. A brief summary of relevant considerations when doing so is provided in Chapter 5 of *The Law of Torts in New Zealand* and four relevant propositions are identified.

[674] First, a duty to take care should not interfere inappropriately with the autonomy of the defendant in deciding whether to act.

[675] Second, the existence or extent of any duty that is imposed on the defendant should represent a proportionate burden of liability in respect of the wrongdoing in question. In *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants & Investigations Ltd*, Cooke P said that the degree of likelihood that harm will be caused and the seriousness of the foreseeable consequences can be important factors in the balancing exercise.[240] A duty of care is likely to be limited or denied altogether where its recognition would tend towards the imposition on the defendant of potentially indeterminate liability.[241] In *South Pacific*, Richardson J referred to a balancing of the plaintiff's moral claim to compensation for avoidable harm and the defendant's moral claim to be protected from an undue burden of legal responsibility.[242]

[676] Third, it should be appropriate for the courts to recognise a duty to protect a person in the position of the plaintiff. Stephen Todd remarks that the ideas of vulnerability and self-protection overlap with the question as to the relationship between negligence and other causes of action:[243]

> If a person has or might have available another cause of action, should a novel negligence duty also be recognised? Arguably it should not if it would interfere inappropriately with that cause of action or … that other cause of action alone ought to be asserted.

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239 *Al-Nakib Investments (Jersey) Ltd v Longcroft* [1990] 1 WLR 1390.

240 *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants & Investigations Ltd* [1992] 2 NZLR 282 (CA) at 295.

241 Stephen Todd *The Law of Torts in New Zealand* (6th ed, Brookers, Wellington, 2013) at [5.4.02].

242 *South Pacific*, above n 240, at 306.

243 *The Law of Torts in New Zealand*, above n 241, at 5.4.03].

[677] Fourth, the proposed duty should operate coherently alongside an overall scheme of rights and responsibilities. In developing the law of negligence, the courts seek consistency with any relevant statutes. In *Attorney-General v Carter*, Tipping J said:[244]

> When … the environment which brings the parties together is legislative, the terms and purpose of the legislation will play a major part in deciding the issues which arise. It is the legislation which creates and is at the heart of the relationship between the parties. It will often contain policy signals bearing on that aspect of the inquiry.

[678] In *South Pacific*, Cooke P said:[245]

> Where a statute has a bearing on whether a duty of care should be recognised, the position is relatively straightforward if the true interpretation of the statute is either that it covers the field to the exclusion of the common law or that it gives rise to a statutory cause of action.
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> …
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> … a point telling against recognising a new common law duty of care arises when such a duty would cut across established patterns of law in special fields wherein experience has shown that certain defences, not dependent on absence of negligence, are needed; or wherein an adequate remedy is already available to a party who takes the necessary steps.

The plaintiff's claim

[679] The plaintiff alleged that the requirement of proximity was established by each of the defendants' involvement in making the statements in the prospectus and the 24 May announcement in circumstances where they ought reasonably to have foreseen that potential investors would place reliance on what was said. Further, that carelessness on their part would be likely to cause risk of loss to potential investors and they could have avoided such risk of loss by exercising reasonable care. Arguably, they each ought to have done so.

[680] The plaintiff alleged that the required "special" relationship existed because each defendant had a statutory obligation arising under the SA and was possessed of sufficient skill as to require them not to act negligently in giving misleading

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244 *Attorney-General v Carter*, above n 238, at [27].
245 *South Pacific*, above n 240, at 297–298.

information to potential investors, knowing the purpose for which that information was required and would be relied on.

[681] The plaintiff alleged that each of the defendants was negligent and in breach of the duty of care owed by them to potential investors under the IPO, the prospectus and the 24 May announcement, on the same grounds as are alleged under the first cause of action and in the further particulars pleaded against each of FNZC and ForBar in relation to their promotion and marketing of the prospectus.

[682] The second and third defendants argued that the claim in negligence in its present form was time-barred. Although a cause of action in negligence has been pleaded since the original statement of claim in February 2008, the nature of the cause of action was transformed in the third amended statement of claim in September 2013, at which time the claim in negligence was changed into a claim of liability for negligent misstatement. The second and third defendants argued that that constituted a new cause of action, pleaded more than six years after the events giving rise to the cause of action, and was therefore out of time.

[683] I did not hear argument on the extent of the difference between the original pleading in negligence, and the refinement of it as a claim for liability for negligent misstatement. Within the confines of the factual matters pleaded from the outset, and the elements of the relationship allegedly giving rise to the existence of a duty of care, I would not be persuaded that the repleading in the third statement of claim amounted to a new cause of action.

[684] The primary ground for the defendants' argument that no such tortious duty should arise was that the relevant conduct is governed by the SA. The scheme of the SA dictates the standard of care owed by the defendants to potential investors, and there could be no justification for imposing a common law duty of any different scope. To do so would risk cutting across an established pattern of law that is deemed to correctly address the balance of interests between investors and promoters.

[685] Clearly, any special relationship in this case arises from the statutory obligations owed under the SA. Where the source of the obligations is the statute itself, and the statute prescribes a specific regulatory regime for prospectuses, it is difficult to contemplate the utility of an additional claim in negligence.

[686] An analogy can be drawn with the decision in *Tait v Austin*.[246] In that case, the plaintiffs and others they represented were former employees of Fortex Group Limited, a public company listed on the NZX that was placed in receivership and liquidation in 1994. Prior to its liquidation, Fortex established a number of deferred payment share schemes for its employees. Under the schemes, employees could purchase shares by instalments paid by way of deductions from salary and wages. The parties accepted that the share scheme was an offer of securities to the public for subscription in terms of ss 33 and 37 of the SA. Fortex had not issued a registered prospectus.

[687] The plaintiffs commenced proceedings alleging breach of s 37 of the SA and negligence. Under the claim in negligence, the plaintiffs argued that the defendants had a duty of care in respect of the share schemes to ensure that:

(a) the scheme was lawful and/or that it complied with all relevant statutory and legal provisions for a scheme of its kind; and/or

(b) the position of each claimant was properly protected under the scheme; and/or

(c) all monies paid by each claimant were properly protected until the claimant received his or her shares.

[688] Master Venning noted that the effect and intent of these duties was the same as the duties outlined in s 37(5) and (6) of the SA. The defendants sought an order striking out the claim on the basis that common law remedies are not available to enforce the provisions of the SA. Master Venning found that the case came within a category where a liability not existing at common law is created by a statute that

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246 *Tait v Austin* (2000) 8 NZCLC 262,167 (HC).

provides a special and particular remedy for enforcing that liability. Master Venning concluded that the liability of the directors was pursuant to s 37(6) of the SA and it was not open to the plaintiffs to pursue directors in negligence for failing to ensure the share schemes complied with the SA, when the Act itself provides a clear remedy against the directors in that situation.

[689] Similarly in the present case, those responsible for the prospectus are the issuer, promoters and directors. A special relationship does not arise for the purposes of a negligence claim because the obligations owed by promoters or directors are already defined by the SA. The situation is akin to that identified by Cooke P,[247] where the true interpretation of the statute is either that it covers the field to the exclusion of the common law or that it gives rise to a statutory cause of action. An existing remedy is available and a claim in negligence would not augment that remedy in any way.

[690] Further, it is difficult to see how a plaintiff in this particular situation is vulnerable in a way that is not already addressed by the SA. This would militate against the imposition of a duty of care.

[691] In the case of the fourth and fifth defendants, both claim that the SA does not apply to them because neither was a "promoter" in relation to the IPO. I have found that they were not promoters so their involvement was not governed by the SA. If I am wrong in that finding, so that their conduct is governed by the SA, then the same considerations outlined above in relation to the first and second defendants would apply.

[692] On the basis of my finding that the JLMs and CSAMP were not promoters, they are not subject to a relevant statutory liability that is a ground for resisting the imputation of a tortious duty of care. The assessment in relation to imputing a duty of care to the JLMs or CSAMP should nonetheless take into account that the SA creates a civil liability regime for the directors and promoters that is essentially of the same type as might be attributed to those responsible for the prospectus at common law, if the statutory liability regime did not exist. Given that the JLMs and

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[247] Cited at [678] above.

CSAMP fall outside the net of those who are obliged to accept statutory liability for any untrue statements in the prospectus, it would be artificial to extend the category of those liable by imputing a common law duty to them when the nature of their involvement left them beyond the statutory civil liability regime.

[693] In addition, the context of involvement by the JLMs places them further away from an imputed assumption of responsibility to readers of the prospectus when, under the statutory regime, those who have to answer for the accuracy of the prospectus are the directors and promoters, whereas the JLMs participated in a more limited role as advisers without having decision-making authority to determine the terms on which the prospectus issued.

[694] I am accordingly satisfied that any relationship that can be imputed as between the JLMs and investors in the IPO by virtue of their reliance on the prospectus is not of a type that justifies the imposition of a novel tortious duty of care.

[695] So far as CSAMP was concerned, its director assumed liability, and the promoter role was separately performed by CSPE. Therefore CSAMP similarly falls outside the scope of those who might be attributed with a novel duty of care.

[696] I am mindful that my analysis of the alternative causes of action to the claim under the SA would have enabled the JLMs to avoid liability for misleading content or omissions in the prospectus entirely. They are not promoters and therefore not liable under the SA. The exclusion of the application of the FTA relates to conduct regulated by the SA (rather than the narrower liability of participants governed by the SA regime) and it is not appropriate to attribute a novel tortious duty of care to the JLMs in relation to their conduct in that capacity in favour of investors who relied on the prospectus. Therefore the JLMs would have avoided liability entirely for misleading content or omissions in the prospectus.

[697] I am comfortable with that outcome. The claim in negligence did not focus in any way on the relationship between the JLMs and clients of those firms who invested in reliance on the firms' recommendation that Feltex was a good or

appropriate investment. In Mr Houghton's case, it appeared that he had made numerous investments, including his subscription for Feltex shares, in reliance on ForBar recommendations. A range of interesting issues may have arisen if Mr Houghton had claimed against ForBar for negligent misstatement in its recommendation to him to invest in Feltex. Issues could arise as to whether ForBar as a firm could distance the client advisers responsible for recommendations to clients such as Mr Houghton from the very detailed knowledge of the content of the prospectus that the firm possessed by virtue of its involvement as a JLM. That is an issue for another day.

[698] This analysis of the lack of grounds for a cause of action in negligence also means that CSAMP avoids liability on any of the potential causes of action. On my analysis, it was sued in error when the director of CSAMP was the entity that would have been liable under the SA regime. An error of that type cannot add anything to the grounds for imputing a common law duty of care, and in any event CSAMP was sufficiently distanced from the preparation of the prospectus for there to be other grounds for negativing the existence of any requisite special relationship.

Quantification of loss

[699] The ultimate fallback position for all defendants was that if the Court found any untrue statements on which there had been requisite reliance, and in respect of which the defendants could not make out an affirmative defence, then the extent of loss claimed by the plaintiff was not, in any event, recoverable. The defendants submitted that the extent of any compensation they became liable for would be assessed on a tort measure. That is, the plaintiff would be entitled to the difference between the sum paid for the shares, and the fair value of the shares if the share price had been adjusted to reflect the untrue statement.

[700] The first to third defendants jointly called two experts on quantification of loss. A primary analysis was undertaken by Professor Cornell. His analysis relied on the efficient market theory which stipulates that the market for publicly traded shares will quickly assimilate the price effect of new information relevant to the value of those shares. It would follow that once a less than fully informed market

becomes fully informed, the impact of the new information is very quickly assimilated and reflected in the price at which the shares will trade.

[701] Professor Cornell's analysis was considered from a New Zealand perspective by Mr Cameron. He opined that there was a more than sufficient market for Feltex shares to justify applying the efficient market theory to price responses to new information. He also analysed the price history of Feltex shares, relative to various milestones that would have affected the value of the shares.

[702] The efficient market theory is relatively widely accepted, and was not challenged by the plaintiff.

[703] The plaintiff did not call any evidence on loss. The closing submission on loss occupied less than two of a 227 page submission. The hypothesis put forward by Mr Houghton was that if there had been sufficient disclosure, he would not have invested and he should therefore be entitled to a full refund of the money paid, plus statutory interest. On that basis, I took the plaintiff's claim on quantum to be akin to a total failure of consideration.

[704] The difficulty with that approach is that the shares inarguably did have substantial value. On a balance sheet basis, Feltex had net assets as at December 2003 of $28.147 million. At that time, the private equity owners had highly leveraged the extent of debt borrowed to operate the business, so that substantial repayment of debt would increase the value of net assets.[248] In forecasting the company's financial position at the end of FY2004, the prospectus stated net assets or equity attributable to shareholders at $90.250 million.[249]

[705] The plaintiff's approach also overlooks the plaintiff's obligation to mitigate his loss. Given a daily market for the shares from 2 June 2004, when Mr Houghton discovered the discrepancies (or arguably when he ought reasonably to have discovered them if he monitored his investment prudently), then opportunities would have arisen to minimise the loss by selling the shares on market. If indeed he was

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[248] Prospectus at 93.
[249] Prospectus at 87.

materially misled as to the nature of Feltex's trading to 30 June 2004 because of the non-disclosure of the adverse variance in gross revenue, then an appropriate opportunity arose in the period after the August 2004 announcement of the FY2004 result. For months after that disclosure, numerous opportunities arose for Mr Houghton to quit the stock at no or minimal loss. During that time, broking firms who followed the stock and produced analysts' research in respect of Feltex were reporting on its progress.

[706] Plaintiff's counsel also suggested during the hearing that had the alleged untrue statements been corrected, then the IPO would not have taken place because full disclosure would have substantially reduced the price to a level that Credit Suisse would not have accepted for their shareholding in Feltex. As to price, the plaintiff argued that the lowest price Credit Suisse was prepared to accept, of $1.70 per share, was only achieved by virtue of the participation of Hunter Hall. If Hunter Hall had been told of each of the matters about Feltex that were characterised as untrue statements, it would not have bid for shares, and the proposed offer would therefore have failed.

[707] This hypothesis was not raised in closing. An evidentiary foundation for it was not laid. In particular, whilst Credit Suisse's negotiations with the JLMs and Feltex directors adopted the stance that $1.70 per share was the minimum for which they would sell the Feltex shares, I am far from satisfied that Credit Suisse would have rejected a sale if the book build process produced full coverage for the offer at, say, $1.60. It seems more likely that Credit Suisse would have been a reluctant seller, rather than abandoning the IPO process for the sake of 10 or 15 cents per share.

[708] The plaintiff's ultimate fallback position was that the quantum of loss ought to be reserved for a subsequent inquiry. At the end of 11 weeks of hearing in which the plaintiff had made very limited response to relatively extensive evidence on behalf of the defendants in relation to quantification of loss, that was not an appealing prospect. In fairness to Mr Forbes, that prospect was one of the pleaded alternatives in the prayers for relief. However, the division of issues to be resolved within Mr Houghton's claim at the first stage of the representative proceedings

contemplated a complete resolution and the defendants had joined issue on that basis.

[709] Had there been a finding of liability, I would not have been prepared to adjourn quantification of the compensation payable in the circumstances. The plaintiff's primary position, which I consider was untenable, was effectively that there had been a complete failure of consideration. The plaintiff had not joined issue, even by way of reply evidence, on the defendants' relatively extensive case challenging the existence of any recoverable loss.

[710] Had I found misleading content or omissions, I would have required the plaintiff to establish that the market remained unaware of the true position in relation to that aspect of Feltex's business, for the period of nine months or so until there was a significant drop below the initial issue price for the shares.[250] Unless that proposition was made out, the plaintiff had an adequate opportunity to avoid or minimise loss by selling when the market was informed, and (for that period of nine months or so) did not treat the further information about Feltex as materially affecting its share price.

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

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[250] The chart of Feltex's share price (exhibit 2 to Professor Cornell's BoE) shows that the price was briefly above the $1.70 issue price, and traded in a range between $1.55 and $1.70 until 23 February 2005. That day, Feltex reported its result for the six months to 31 December 2004, and the share price thereafter dropped from near $1.70 to $1.57, before rebounding somewhat.

[712] That is a tenable approach. It is not appropriate to rule on it definitively in the absence of a finding that there was indeed one or more untrue statements in the prospectus. There would then need to be a more specific analysis of the value the market placed on the misleading content, once the correct position was known to the market.

Costs

[713] Assuming the quantum of the defendants' entitlement to costs and disbursements cannot be agreed, I invite memoranda first on behalf of the defendants within 28 days of the release of this judgment, and then on behalf of the plaintiff within 14 days of service on his solicitors of the last of the memoranda on behalf of the defendants.

Dobson J

Solicitors:
Wilson McKay, Auckland for plaintiff
Bell Gully, Auckland for first to third-named and fifth to seventh-named first defendants
Clendons, Auckland for fourth-named first defendant
Russell McVeagh, Wellington for second and third defendants
Jones Fee, Auckland for fourth defendant
McElroys, Auckland for fifth defendant

Appendix A

Glossary of Abbreviations and Terms

AF	Affidavits and Correspondence Bundle
APC	Australian Productivity Commission
BoE	Brief of evidence
BP	Board Pack Bundle
CB	Common Bundle
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CSAMP	Credit Suisse First Boston Asian Merchant Partners LP (the third defendant)
CSPE	Credit Suisse Private Equity Inc (the second defendant)
Credit Suisse	Second and third defendants, jointly referred to throughout the judgment
DD	Due Diligence Bundle
DDC	Due Diligence Committee
EBITA*	Earnings before interest, tax, amortisation and write-offs
EBITDA*	Earnings before interest, tax, depreciation, amortisation and write-offs
EIP	Equity incentive plan
Feltex	Feltex Carpets Limited
FNZC	First New Zealand Capital (the fourth defendant)
ForBar	Forsyth Barr (the fifth defendant)
FRS	Financial Reporting Standards
FTA	Fair Trading Act 1986
FY2004	2004 financial year (1 July 2003 to 30 June 2004)
FY2005	2005 financial year (1 July 2004 to 30 June 2005)
IPO	Initial public offering
JLMs	Joint Lead Managers (FNZC and ForBar)
MIP	Management incentive plan
Mr Houghton	The plaintiff
NoE	Notes of evidence at trial
NPAT	Net profit after tax
NZX	New Zealand Stock Exchange
SA	Securities Act 1978
SB	Supplementary Bundle
Shaw	Shaw Industries Inc
SIP grants	Australian government support that subsidised capital expenditure on innovations for textile manufacture
The directors	The first defendants
The Regulations	Securities Regulations 1983
The 24 May announcement	An announcement by Feltex to the market by means of a statement released to the New Zealand Stock Exchange on 24 May 2004. It stipulated the final share price of $1.70.
2005 AGM	Feltex's Annual General Meeting held on 1 December 2005
4ASC	Fourth amended statement of claim dated 12 March 2014
* The definitions used in the glossary in the prospectus. (There were inconsistencies in the elements included in EBITDA in various places in the prospectus.)	