

# **Prospectus Liability Under the Corporations Law**

**Donna Croker**

**Centre for Corporate Law and Securities Regulation**

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**CENTRE FOR CORPORATE LAW AND SECURITIES REGULATION  
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Donna also worked on the development of fundraising policy for ASIC including:

- Offers, invitations and advertisements of securities on the Internet;
- Concise prospectuses for managed investment schemes;
- Business introduction or matching services;
- Additional investments in managed investment schemes; and
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# Abbreviations

ACCC	Australian Competition and Consumer Commission
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
CASAC	Companies and Securities Advisory Committee
CL	Corporations Law
CLERP	Corporate Law Economic Reform Program
SIRC	Securities Information Review Committee
TPA	Trade Practices Act 1974 (Cth)



# Chapter 1

## Introduction

The aim of this book is to examine the system of statutory liability in Australia associated with raising equity capital (generally described as fundraising). Statutory liability arises primarily under the Corporations Law<sup>1</sup> (the ‘CL’) but can also be found under s52 of the Trade Practices Act 1974 (Cth) (the ‘TPA’) and the corresponding provision of the Fair Trading Act of each of the States and Territories.<sup>2</sup> The book examines the liability system found in the current law and considers the likely effect of the Government’s Corporate Law Economic Reform Program (‘CLERP’).

The CLERP proposals, if implemented, will result in radical changes to fundraising in Australia in terms of both disclosure obligations and the liability that attaches to that disclosure. Therefore, it is useful to commence with a broad overview of the proposed changes to the Corporations Law. This is undertaken in Chapter 2.

This is followed in Chapters 3 and 4 by discussion of the philosophy underpinning prospectus requirements and by a short discussion of the public policy behind the disclosure and liability provisions. This is relevant because, in order to properly analyse the liability provisions, it is necessary to understand their purpose — which is inextricably linked to that of the disclosure provisions.

Chapters 5 to 10 then consider the central theme, an examination of the liability provisions as they apply to offers of securities of a corporation for subscription where the mandatory disclosure provisions apply. That is, when a prospectus must be lodged with the Australian Securities & Investments Commission (‘ASIC’).<sup>3</sup>

Finally, in Chapter 11 the effect of the CLERP proposals involving changes to the liability provisions will be examined in greater detail. Conclusions will be drawn about whether the revised provisions are capable of delivering the benefits that have been promised.

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1. The Corporations Law is described as a national scheme law. It is found in s82 of the Corporations Act 1989 (Cth) which operates by its own force in the Australian Capital Territory and is applied throughout the rest of Australia by the Corporations (Name of State) Act 1990 in each state and the NT.

2. 1985 (Vic); 1987 (NSW); 1987 (Qld); 1987 (SA); 1987 (WA); 1990 (Tas); 1990 (NT); and (1992) ACT. The State and Territory Fair Trading Acts do not suffer from the same Constitutional limits as the Commonwealth Trade Practices Act (1974).

3. On 1 July 1998 ASIC was formed in accordance with Recommendation 1 of the Financial System Inquiry Final Report (also known as the ‘Wallis Report’). ASIC incorporates and expands the role of the former Australian Securities Commission (ASC). See Financial System Inquiry, *Final Report* (March 1997) 242–5.

## Chapter 2

### Outline of the CLERP Proposals

In October 1997 the Federal Treasurer released 21 proposals for the reform of the fundraising provisions of the Corporations Law as part of the Corporate Law Economic Reform Program.<sup>4</sup> Since that time legislation has been introduced into Parliament in order to give effect to the proposed policy reforms (the 'CLERP Bill').<sup>5</sup> The CLERP proposals follow on from, and significantly expand, work done by the previous Government's Corporations Law Simplification Task Force.<sup>6</sup>

The CLERP fundraising reform proposals are intended to achieve the Federal Government's aims of promoting business, economic development and employment. The proposals have been developed with a recognition of the need to balance the goals of improving the efficiency of the economy with maintaining investor protection and market integrity. At a more specific level, two key goals in the reform of the fundraising provisions of the Corporations Law have been to improve the comprehensibility of disclosure documents and facilitate fundraising by small and medium sized enterprises.<sup>7</sup>

The fundraising proposals can be broken up into a number of broad rafts in the areas of: disclosure; advertising; liability; and small and medium enterprises.<sup>8</sup> In addition, there are several miscellaneous amendments.

#### Disclosure

The disclosure changes relate primarily to improving the likelihood that retail investors will read and understand offer documents. Two mechanisms will be used to achieve that aim. The first is the introduction of shorter prospectuses. This will be achieved by permitting issuers to move information that is 'primarily of interest to professional advisers and analysts' into a secondary document (or documents) that is available upon request.<sup>9</sup> The second is the introduction of short 'profile statements' that contain key information of

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4. Corporate Law Economic Reform Program, *Proposals for Reform: Paper No. 2, Fundraising* (8 October 1997).

5. The *Corporations Law Economic Reform Bill* was introduced into Federal Parliament on 2 July 1998.

6. Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995).

7. Corporate Law Economic Reform Program, above n 4, 7–8; Peter Costello, 'Capital Raising Initiatives to Build Enterprise and Employment', *Press Release from the Treasurer* (Canberra), 8 October 1997.

8. The fundraising proposals are set out and discussed in Corporate Law Economic Reform Program, above n 4; see also Corporate Law Economic Reform Program, *Policy Reforms* (17 March 1998).

9. See ss709(1) and 712 CLERP Bill. This amendment will give statutory force to relief granted by the ASC in the Telstra privatisation and, more recently, in the AMP demutualisation.

importance to prospective investors.<sup>10</sup> The information to be contained in profile statements is to be developed on an industry specific basis by ASIC.<sup>11</sup>

## Advertising

The advertising proposals allow securities in a class that is quoted to be freely advertised prior to the issue of the prospectus, as long as the advertisement contains prescribed information about the prospectus.<sup>12</sup> The proposals also allow limited pre-prospectus advertising of securities in an unquoted class.<sup>13</sup> This will permit very limited information about the coming offer to be publicised and for persons interested in the offer to register their interest in receiving a prospectus.

There is also a proposal to permit the circulation of draft or 'pathfinder' prospectuses to institutional investors in order to assist with the pricing of the offer.<sup>14</sup> Finally, an attempt has been made to delineate a company's ordinary advertisements promoting their products and services from advertisements that are regulated by the fundraising provisions due to their promotion (which may be indirect) of the offer of securities.<sup>15</sup> This kind of advertising is commonly known as 'image advertising' and is currently a grey area of the law.<sup>16</sup>

## Liability

Of particular importance in the context of this book are the proposals to simplify the liability provisions and, in so doing, develop a clear and consistent policy for the provisions. That policy is to encourage a process of inquiry designed to produce a document that enables prospective investors to make informed investment decisions, tempered by the philosophy that investment in securities, by its very nature, involves risk.<sup>17</sup>

## Small and Medium Enterprises

There are a number of proposals aimed at making it easier for small and medium enterprises to gain access to capital. These proposals include the introduction of an offer

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10. See ss709(2) and (3), and s714 CLERP Bill.

11. This relief similarly provides statutory force to the relief granted by the ASC in its Simpler Managed Investments Project. See Australian Securities Commission, *Simpler Managed Investment Prospectuses — ASC Policy Proposal* (June 1998); Australian Securities Commission, *Information Statement [330] Simpler Managed Investment Prospectuses* (June 1997); Australian Securities and Investments Commission, *Policy Statement 137 Concise Prospectuses for Managed Investments* (4 September 1998). This project has been conducted in consultation with the managed investments industry body — the Investment and Financial Services Association Ltd.

12. See s734(5)(a) CLERP Bill.

13. See s734(5)(b) CLERP Bill.

14. See s734(9) CLERP Bill.

15. See s734(3) CLERP Bill.

16. For a detailed discussion of image advertising refer to Australian Securities and Investments Commission, *Policy Statement 54 Pre-prospectus Advertising* (11 May 1993, updated 3 March 1997).

17. Part 6D.3 CLERP Bill.

document that is cheaper to produce than a prospectus (it is accepted that it is likely to produce less comprehensive information). This document will be called an 'Offer Information Statement'. It will be available to raise a limited amount of funds and must contain prominent warnings about the risk of investing in reliance on a lower standard of information.<sup>18</sup>

It is also proposed to broaden the exclusion from the prospectus provisions for offers of an essentially private kind, that is, those made 'personally'<sup>19</sup> to a small number of persons, to raise a limited amount of capital.<sup>20</sup> Under the proposal it will be possible for securities to be issued to up to 20 persons in any 12 month period. However, the amount of capital that may be raised in reliance on this exclusion will be limited.

The final proposal that aims to make it easier for small and medium enterprises to gain access to capital expands the categories of 'sophisticated investors' for whom there is no disclosure obligation.<sup>21</sup> This exclusion from the disclosure obligation will encompass persons who are considered sophisticated due to: the large size of the investment;<sup>22</sup> the extent of the person's assets or income; or because of their previous investment experience (and therefore ability to look after their own interests without legislative intervention).

## Miscellaneous

In addition, miscellaneous reforms will facilitate the use of electronic disclosure documents,<sup>23</sup> replace prospectus registration with lodgment followed by a delay<sup>24</sup> before subscriptions can be accepted to allow public scrutiny of the offer,<sup>25</sup> and remove government immunity from the fundraising provisions.<sup>26</sup>

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18. See ss709(4) and 715 CLERP Bill.

19. The requirements for a 'personal' offer will be prescribed. They encompass a number of categories that broadly require some kind of connection with the person to whom the offer is made (s708(2) CLERP Bill).

20. See ss708(1)-(7) CLERP Bill.

21. See ss708(8)(c) and (d) CLERP Bill.

22. Of these tests of 'sophistication' the only one available at present is for large investments of at least \$500,000 (s66(3)(a) CL).

23. For example, application forms will be permitted to 'accompany' the prospectus and the offer rather than be 'attached' to the prospectus (s723 CLERP Bill).

24. The CLERP Bill imposes a delay for 'non-quoted securities' but not for quoted securities (s727(3) CLERP Bill).

25. See ss718 and 727(3) CLERP Bill.

26. See CLERP Bill Schedule 5, items 10 and 11.

## Chapter 3

### Why Mandate for Disclosure?

In order to critically analyse the liability provisions of the Corporations Law it is necessary to first understand the public policy behind the mandatory disclosure obligations. This is because the liability provisions exist in order to lend force to the disclosure regime.

#### Prospectus Philosophy

In the area of securities regulation there has been a departure from the general principal of caveat emptor in developed nations across the world (including the United Kingdom, the United States and Australia) and a recognition of the difficulties inherent in assessing the value of securities due to their intangible nature. The problem is succinctly stated in a leading text book as follows:

Securities are unlike physical commodities. Being choses in action, their value is determined by the rights which they confer — they have no intrinsic value. They are created rather than produced, and they are not used or consumed. The rights which they confer are typically rights to income or capital distributions from a business enterprise, so their value depends upon assessing the value of the enterprise. Fundamental to that process is access to reliable information.<sup>27</sup>

The difficulty of assessing the underlying value of securities in the face of unscrupulous practices was recognised in the earliest English cases. In order to provide a degree of protection for investors the principle that emerged was one of full disclosure, that is, an obligation to:

state everything with strict and scrupulous accuracy, and not only to abstain from stating as facts that which is not so, but to omit no one fact within their knowledge the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares.<sup>28</sup>

That principle was adopted in the United States and was best summarised by the statement: ‘Sunlight is said to be the best of disinfectants, electric light the most efficient

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27. H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (8th ed, 1997) 874.

28. *The New Brunswick and Canada Railway and Land Company v Muggeridge* (1860) 1 Dr and Sm 418, 425. See also *The Directors of the Central Railway Company of Venezuela v Kisch* (1867) LR 2 HL 99, 113.

policeman.<sup>29</sup> This philosophy has also been adopted in Australia where disclosure, rather than merit regulation,<sup>30</sup> is the tool that has been chosen to provide investor protection.<sup>31</sup>

If it is accepted that reliable information is needed in order for investors to be able to make rational investment decisions then a number of questions follow. Firstly, if investors demand information, is it not in the interests of corporations to provide that information in order to gain access to capital, and secondly, will not investors be willing to pay a premium for information that is adequate and reliable?<sup>32</sup> Put another way, will not competition for capital result in adequate disclosure?<sup>33</sup> If these questions are answered in the affirmative, then a mandatory disclosure standard would appear to provide an unnecessary layer of regulation.<sup>34</sup>

However, leaving disclosure to the discretion of the corporation has a number of risks. Some issuers will have an interest in withholding or misrepresenting information in order to reap insider profits from their informational advantage. If there is insufficient incentive to provide full and frank disclosure then public confidence in the integrity of the securities market will suffer. This will in turn affect the volatility of market prices and the level of investment. Conversely, the adoption of a mandatory disclosure standard coupled with liability provisions will reduce fraud and improve investor confidence.<sup>35</sup>

## Position Adopted by CLERP

A number of arguments in favour of mandatory disclosure are set out in the Government's CLERP proposals for reform of the fundraising provisions.<sup>36</sup> In that paper it is argued that the availability of reliable information is essential for the confidence and stability of the market — which is in turn essential for the economy because the capital market is the

29. L D Brandeis, *Other People's Money* (1914), Ch 5; quoted in Paul Redmond, *Companies and Securities Law Commentary and Materials* (2nd ed, 1992), 801.

30. Merit regulation requires the regulator to make a decision about the merits of the investment. If it is judged satisfactory, the offer is permitted. This differs from disclosure based regulation where the likelihood of success of the venture and the benefits to investors are not examined by the regulator. Instead, disclosure about the venture, including its prospects, is required.

31. Investor protection has been recognised as the primary reason for mandatory disclosure in relation to offers of securities in Australia: Securities Information Review Committee, *Reforming the Law Relating to Offers of Securities — An Interim Report* (July 1988) 1–2; and Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 9.

32. John Azzi, 'Disclosure in Prospectuses' (1991) 9 *Company and Securities Law Journal* 205, 215.

33. Implicit in this question is the assumption that adequate disclosure at the choice of the fundraiser is superior to a mandatory disclosure standard because of the undesirable externalities that may result from a prescribed standard — such as the disclosure of confidential information that may assist competitors. See Gregory Herder, 'Corporate Finance Theory and the Australian Prospectus Legislation' (1993) 6 *Corporate and Business Law Journal* 181, 189. See also Corporate Law Economic Reform Program, *Proposals for Reform: Paper No. 2, Fundraising* (8 October 1997) 75–6.

34. For a general overview see Redmond, above n 29, 801–5; and Mark Blair and Ian Ramsay, 'Mandatory Corporate Disclosure Rules and Securities Regulation', Gordon Walker, Brent Fisse and Ian Ramsay (eds), *Securities Regulation in Australia and New Zealand* (1998) 55–87.

35. Redmond, above n 29, 803.

36. Corporate Law Economic Reform Program, above n 33.

mechanism by which capital is distributed. It is also argued that placing the disclosure obligation on the issuer of securities will reduce the search costs of investors. This is a benefit if the reduction in investors' search costs is greater than the cost of preparing a prospectus.

To summarise, the provision of information in response to a mandatory rule ensures that a base level of information is provided to the market, sufficient to promote allocative efficiency of scarce resources in the economy. The result:

An efficient capital market [that] will allocate capital to its most efficient application. It will promote economic growth and employment, and result in an economy which is more vigorous and responsive to both economic and international changes.<sup>37</sup>

Without a mandatory base level requirement there would be less certainty about the reliability of disclosure due to difficulties in distinguishing between fundraisers who adopt a high level of disclosure and those who 'free ride' on the reputation of diligent fundraisers without adopting a similarly high level of disclosure.<sup>38</sup>

Of course, the mandatory disclosure obligation must be set at an appropriate level — too high and potentially profitable ventures will be discouraged from seeking equity capital (and possibly not be pursued at all).<sup>39</sup> The right balance must be struck in order to promote confidence in the capital market and allocative efficiency of scarce resources without creating too great a barrier to equity fundraising (which would also reduce allocative efficiency). The CLERP fundraising proposals attempt to achieve this balancing act by reducing the barriers to fundraising (particularly for small and medium enterprises which are most affected by high fixed costs allegedly associated with the current regulatory regime) without compromising investor protection and confidence in the capital market.<sup>40</sup>

## Criticisms of Mandatory Disclosure

This reasoning has been the subject of extensive criticism. Arguments against mandatory disclosure have included disputing that it has provided any beneficial effect,<sup>41</sup> arguing that it results in externalities and a level of disclosure that is not optimal,<sup>42</sup> and most importantly, that the information that is disclosed is not particularly useful to investors as it is mainly historical and sophisticated investors and intermediaries use other sources of information.<sup>43</sup>

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37. Corporate Law Economic Reform Program, above n 33, 73.

38. Ibid 75.

39. Ibid 74; see also Herder, above n 33, 192.

40. Corporate Law Economic Reform Program, above n 33, 7–8. That is, 'The proposed reforms of the fundraising rules are designed to provide:

- a better framework for capital raising by small, medium and large enterprises;
- investors with relevant, comprehensible and cost-effective information for informed investment decisions; and
- improved opportunities to fund new and growing businesses.'

41. Blair and Ramsay, above n 34, 64; Redmond, above n 29, 803–4; and also discussed in Robert Baxt, *The Rae Report — Quo Vadis?* (1974) 170.

42. Herder, above n 33, 189; see also Blair and Ramsay, above n 34, 62.

43. Blair and Ramsay, above n 34, 86.

However, these criticisms have not provided conclusive evidence that mandatory disclosure provides no net social or economic benefits. They have also not been sufficiently persuasive to result in a shift away from mandatory disclosure as a tool for investor protection in the major financial centres, such as the United States and the United Kingdom. Similarly, in Australia the advantages and disadvantages of the mandatory disclosure requirement in s1022 CL have been reviewed, first by the Companies and Securities Advisory Committee (CASAC) headed by Wayne Lonergan and more recently by CLERP, and the advantages have been found to outweigh the disadvantages.<sup>44</sup>

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44. Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 27–31; this report is known as the Lonergan Report. See also Corporate Law Economic Reform Program, above n 33, 11–15.



## Chapter 4

# The Public Policy of Legislative Liability

### Compensation vs Deterrence

There are two possible policy rationales for having liability provisions associated with the mandatory disclosure obligation — compensation and deterrence. In relation to s11 of the Securities Act 1933 (US) which, like the Australian Corporations Law, provides for liability for disclosure documents tempered with inquiry based defences for those involved in their preparation (other than the issuer which is strictly liable), it has been said that although its function is compensatory, its effect is primarily deterrent.<sup>45</sup> This view is well summarised in *Globus v Law Research Service*:

[Securities legislation] was designed not so much to compensate the defrauded purchaser as to promote enforcement . . . to deter negligence by providing a penalty for those who fail in their duties.<sup>46</sup>

The need to deter negligent conduct and breaches of duty or trust was also recognised in the United Kingdom by the Greene Committee. That committee suggested that indemnifying directors and other officers of the company for such breaches of duty ran contrary to the policy of the law which aims to encourage the conscientious discharge of duties and responsibilities. The Greene Committee recommended that legislation be introduced to void any contract or provision for such an indemnification.<sup>47</sup>

Similarly, the Securities and Exchange Commission in the United States takes the view that indemnification arrangements are ‘against the public policy embodied in the Securities Act and are therefore unenforceable.’<sup>48</sup> This position is reinforced (to some extent) by the decision in *Globus v Law Research Service* that:

the Securities Act renders void any indemnification agreement to the extent that as applied it would cover fraudulent misconduct. The Court’s rationale was that invalidating all such indemnification agreements would “encourage diligence, investigation and compliance with the requirements of the statute by exposing issuers and underwriters to the substantial hazard of liability for compensatory damages”.<sup>49</sup>

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45. John Turner, ‘The Potential Civil Liability of Solicitors for Misrepresentations in Offer Documents’ (1989) 10 *The Company Lawyer* 3, 6; see also Senaka Weeraratna, ‘Civil Liability and Due Diligence’ (1991) 65 *Law Institute Journal* 854; and G E Hart, ‘The Deterrent Effect of Civil Liability in Investor Protection’ (1987) 5 *Company and Securities Law Journal* 162.

46. 418 F 2d 1276, 1288 (1969); quoted in Turner, above n 45, 9.

47. Board of Trade, *Company Law Amendment Committee Report* (1925–6) 20; this report is known as the Greene Report.

48. Thomas Hazen, *The Law of Securities Regulation* (3rd ed 1996) 373.

49. 418 F 2d 1276 (1969); quoted in Hazen, *ibid* 343.

In Australia it has been argued that the compensatory effect of the legislation is low 'because the legal costs are prohibitive, and these costs often involve throwing good money after bad.'<sup>50</sup> Nevertheless, despite the practical difficulties facing a retail investor bringing an action for damages, the liability provisions of the Corporations Law appear to be aimed at producing an *in terrorem* effect.<sup>51</sup>

The aim of encouraging a high standard of conduct in the preparation of prospectuses was recognised in the Explanatory Memorandum to the Corporations Law where it was noted that the range of persons who may be held liable for a defective prospectus had been broadened as a means of 'ensuring prospectus integrity'.<sup>52</sup> In addition, liability was said to be tempered as each of the persons who may be liable was 'provided with a defence and in general will only be liable if they have not exercised due diligence.'<sup>53</sup>

### The Differences Between 'Consumer' Protection and 'Investor' Protection

It is interesting to contrast the policy for investor protection, which is aimed at producing a high standard of conduct, with the strict liability consumer protection philosophy of the Trade Practices Act 1974 (Cth). Strict liability in the consumer field is considered to be beneficial because 'the costs of liability to individuals are absorbed by the manufacturing or retailing corporation and then spread over all consumers.'<sup>54</sup> This is not necessarily the case with fundraising liability because the issuing corporation may be in liquidation leaving the investor to seek compensation from experts as the only available 'deep pockets'.

Strict liability is not a necessary element of provisions that are intended to have a deterrent rather than a compensatory effect. This is because deterrence can be achieved by simply placing the defences at the correct height. On the other hand, strict liability, when associated with the risk inherent in securities investment, will have the undesirable side-effect of restricting legitimate commercial activities.<sup>55</sup>

The recognition of the differences between 'consumer' and 'investor' protection formed the basis for the recommendations of the previous Government's Corporations Law Simplification Task Force to remove the application of strict liability provisions in relation

50. Hart, above n 45, 162; referring to LCB Gower, 'Review of Investor Protection — A Discussion Document', *London HMSO* (January 1982), para 3.41. These practical difficulties are tempered to some extent by s50 of the Australian Securities and Investments Commission Act 1989 (Cth) and s1325(3) CL which allow ASIC to institute proceedings on behalf of the aggrieved persons and seek a compensatory order; Gregory Herder, 'Corporate Finance Theory and the Australian Prospectus Legislation' (1993) 6 *Corporate and Business Law Journal* 181, 186.

51. Weeraratna, above n 45, 854; and see discussion at Corporate Law Economic Reform Program, *Proposals for Reform: Paper No. 2, Fundraising* (8 October 1997) 40–1; and Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 5.

52. Explanatory Memorandum to the Corporations Bill 1988 (Cth) 735.

53. Ibid 736. Also discussed by Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 66.

54. Hart, above n 45, 179.

55. But see Alistair Hood and Dimity Boswell, 'Due Diligence Reviews For Fund-raising Under the Australian Corporations Law', Gordon Walker, Brent Fisse and Ian Ramsay (eds), *Securities Regulation in Australia and New Zealand* (1998) 331.

to the issue of prospectuses.<sup>56</sup> This reasoning is explicit in the reasons given in the following excerpt from the Simplification Task Force recommendations:

- The defences under the Corporations Law, which are based on making reasonable inquiries and ensuring due diligence, achieve a reasonable balance between the interests of investors and the interests of those raising capital.
- Applying the Trade Practices Act, which imposes liability regardless of the amount of care exercised, undermines the operation of these defences and upsets this balance.
- Investing in securities necessarily involves the voluntary assumption of risks which issuers cannot eliminate completely by making exhaustive inquiries.
- Excessive liability for those involved in fundraising and takeovers potentially increases the costs for Australian business of engaging in this conduct.
- If a choice has to be made between the Corporations Law and the Trade Practices Act regimes, the overall level of investor protection under the Corporations Law is preferable to that provided under the Trade Practices Act . . .
- The Corporations Law regime is consistent with international practice.<sup>57</sup>

More recently, the necessary differences in philosophy between consumer protection and investor protection regimes have been recognised in the CLERP proposals where it was stated:

The Trade Practices and Fair Trading Acts have an economy-wide consumer protection function. Strict liability, where it applies under those Acts, has the advantage of imposing liability on the person best placed to avoid the harm at the lowest cost. However, while this is consistent with having a liability regime which deters misleading conduct, it fails to adequately take into account the distinguishing characteristics of investing, the inherent function of which is allocating and pricing risk.<sup>58</sup>

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56. Corporations Law Simplification Task Force, above n 51, 3.

57. Ibid.

58. Corporate Law Economic Reform Program, above n 51, 41. In a similar vein see Greg Golding, 'Prospectus Misstatement Liability in the 1990s: Where Does the Director Really Stand (Pt 2)' (1997) 7 *Australian Journal of Corporate Law* 299, 321: 'For example, each of the Jenkins Committee in 1929, the Cohen Committee in 1945 and the Greene Committee in 1929 noted the undesirability of imposing restrictions that would seriously restrict the activities of "honest" men and not fettering business conducted in an "efficient and honest" manner. Clearly the fundamental policy concerns in the securities law context differ from those of consumer protection law and should be respected [references omitted].'

## Chapter 5

# Civil Action for a Defective Statutory Prospectus

The focus of this book is on liability for defective statutory prospectuses. A statutory prospectus is an offer document that must be lodged with ASIC and comply with the information requirements of Part 7.12 CL. Offers and invitations of securities of a corporation must comply with Part 7.12 CL unless they fall within prescribed exclusions.<sup>59</sup>

The principal disclosure obligation for a statutory prospectus is found in s1022 CL. The central element of s1022 CL is a requirement for the prospectus to contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find in the prospectus. A statutory prospectus will be defective if it breaches a provision in Part 7.12 CL (primarily the disclosure obligation) or Part 7.11 CL (the liability provisions).

The primary provision that provides for recovery of loss or damage in the event of a breach of the disclosure or liability provisions, including the issue of defective statutory prospectus, is s1005CL. An understanding of the elements of s1005 CL is vital to an analysis of the liability provisions because the extent to which recovery of loss or damage is possible has a significant impact on whether the liability provisions have sufficient force to influence the behaviour of those involved in the issue of a statutory prospectus.

### Means of Recovery — s1005 CL

Section 1005 CL provides a cause of action:

- to a person who suffers loss or damage;
- *by* conduct of another person;
- where that other person was engaged in a contravention of Part 7.11 or Part 7.12 CL.

The section then goes on to provide that loss or damage can be recovered from:

- the person *engaged* in the contravention; and
- any person *involved* in the contravention,

even if there has been no conviction for an offence in respect of the contravention.

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59. See ss 1018, 1017, 66(2) and 66(3) CL and Corporations Regulations 7.12.05 and 7.12.06. I use the term statutory prospectus to describe a prospectus that is required to be lodged with ASIC and comply with the mandatory disclosure requirements of Part 7.12 CL because 'prospectus' as defined in s9 CL could also encompass an offer document used only to make offers that are excluded from Part 7.12 (also known as an 'excluded prospectus' — s9 CL) and which is therefore not subject to the disclosure requirements of Part 7.12 CL including the requirement to be lodged with ASIC.

In order to understand this provision, in the absence of judicial decisions considering its meaning, it is useful to turn to the Trade Practices Act 1974 (Cth) for assistance. This is because s1005 CL is very closely modelled on s82 TPA.<sup>60</sup>

However, caution should be exercised when relying on Trade Practices Act 1974 (Cth) cases for similar provisions because, ‘statutory construction calls for examination of the terms of the statute in their context, using “context” to embrace the other provisions of the statute, the pre-existing state of the law, other statutes *in pari materia*, and the mischief the Court can discern as that the statute was intended to remedy [citations omitted].’<sup>61</sup> Therefore, the differences associated with the Trade Practices Act 1974 (Cth) as consumer protection legislation, and the Corporations Law as investor protection legislation, could result in some divergence in interpretation by the Courts.

## Causation

The first element that must be shown in a civil action under s1005 CL is that the plaintiff has suffered economic loss or damage *by* conduct of another person. There has been a great deal of judicial consideration of the meaning of the word ‘by’ in the Trade Practices Act 1974 (Cth) context. At the most general level the High Court has given us the following formulation:

“By” is a curious word to use. One might have expected “by means of”, “by reason of”, “in consequence of” or “as a result of”. But the word clearly expresses the notion of causation without defining or elucidating it . . . In this situation, as at common law, acts done by the representee in reliance upon the misrepresentation constitute a sufficient connexion to satisfy the concept of causation. And, if those acts result in economic loss, that is, loss other than physical injury to person or property, that economic loss would ordinarily be recoverable under s82(1) [TPA].<sup>62</sup>

Thus, an investor who received, read and relied on a defective prospectus should be able to establish the necessary causal connection between the loss and the conduct (being the issue of a defective prospectus). However, recovery in these circumstances would also have been possible under the narrower provisions of the previous law which provided for a right to compensation for persons who subscribed or purchased securities ‘on the faith of

60. See Explanatory Memorandum to the Corporations Bill 1988 (Cth) 734, para 2989; see also s82(1) TPA which states, ‘a person who suffers loss or damage by conduct of another person that was done in contravention of a provision of Part IV or V may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.’

61. *Elna Australia Pty Ltd v International Computers (Australia) Pty Ltd* (1987) ATPR 40–795, 48,677 in relation to the construction of s82 TPA.

62. *Wardley Australia Limited v The State of Western Australia* (1992) 175 CLR 514, 525; see also *Kabwand Pty Ltd v National Australia Bank Limited* (1989) ATPR 40–950, 50,378: “[B]y” signifies no more than that the loss or damage has to have been brought about by virtue of the conduct . . . a person claiming damages must show either that he has been induced to do something or to refrain from doing something which gives rise to damage or has been influenced to do or refrain from doing something giving rise to damage by the conduct contravening s52 [TPA].’

the prospectus'.<sup>63</sup> On an ordinary reading 'by' would seem capable of supporting a much more expansive reading, and therefore, a less direct link between the prospectus and the loss than the expression, 'on the faith of the prospectus' would require.

In *Janssen-Gilag Pty Limited v Pfizer Pty Limited*<sup>64</sup> it was held that s82 TPA does not require the plaintiff to have relied on the conduct complained of, and that it is sufficient if the 'contravenor's conduct caused other persons to act in a way that led to loss or damage to the applicant.'<sup>65</sup> In the Trade Practices Act 1974 (Cth) context examples of third party reliance include conduct by a corporation (such as a misleading advertisement or tender) that causes a competitor to lose business because potential customers rely on the misleading statements.

An analogy in the prospectus context, which should also meet the causation threshold, is where the investor does not rely on the prospectus but takes the advice of an investment adviser who has read and relies on the prospectus in making a securities recommendation. This would seem an appropriate interpretation when s1005 CL is examined in the context of Part 7.12 CL — as s82 TPA is routinely examined in light of Parts IV and V TPA.<sup>66</sup> This is because it is clear that the fundraising provisions of Part 7.12 CL envisage that investors will seek assistance from investment advisers and that those advisers will rely on the prospectus when giving advice.<sup>67</sup> Thus an approach similar to that taken in *Janssen-Gilag v Pfizer* is appropriate, that is, 'applicants may claim compensation when the contravenor's conduct caused other persons to act in a way that led to loss or damage to the applicant.'<sup>68</sup>

An alternative approach which will lead to the same conclusion is to examine the degree of proximity between those responsible for the prospectus and the investor. Clearly the flow of information from the prospectus through the adviser to the ultimate subscriber (who subscribes using an application form taken from the prospectus)<sup>69</sup> would be sufficiently direct and proximate to sustain a cause of action under s1005 CL.<sup>70</sup> This was the test used by Einfeld J after analysing the case law in support of the contention that reliance on the part of the plaintiff is not always necessary.<sup>71</sup>

Less direct is the relationship between the prospectus and investors who purchase securities on the secondary market (eg the stock market of the Australian Stock Exchange) after the issue of a prospectus. There is an argument that, relying on the efficient market

63. The former Companies Act 1981 (Cth) and Companies ([State]) Codes, s107.

64. (1992) 37 FCR 526; cited with approval in *Haynes v Top Slice Deli Pty Limited* (1995) ATPR (Digest) 46–147, 53,151; *Emanuele v Chamber of Commerce & Industry SA Inc* (1994) ATPR (Digest) 46–121.

65. *Janssen-Gilag Pty Limited v Pfizer Pty Limited* (1992) 37 FCR 526, 529; see also *Pacific Coal v Idemitsu* (1992) ATPR (Digest) 46–094.

66. *Janssen-Gilag Pty Limited v Pfizer Pty Limited*, above n 65, 531; *Elna Australia Pty Ltd v International Computers (Australia) Pty Ltd*, above n 61, 48,677.

67. For example, s1022(3)(c) CL provides: 'In determining what information is required to be included in a prospectus by virtue of this section, regard shall be had to...the fact that certain matters may reasonably be expected to be known to professional advisers of any kind whom those persons may reasonably be expected to consult.'

68. *Janssen-Gilag Pty Limited v Pfizer Pty Limited*, above n 65, 529.

69. As required by s1020 CL.

70. *Patrick v Steel Mains Pty Ltd* (1988) 77 ALR 133, 136.

71. *Haynes v Top Slice Deli Pty Limited*, above n 64, 53,151–2.

hypothesis which asserts that current market prices fully reflect public knowledge about the underlying company,<sup>72</sup> the price at which securities are traded on the secondary market will be based on all of the public information including the information released in the prospectus. Therefore, if defective information in the prospectus causes the price of the securities to rise, any loss occasioned by purchasing those securities at an overvalue in these circumstances, flows from the defective prospectus.

In the United States a doctrine has developed along these lines known as the ‘fraud on the market theory’:

The fraud of the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements . . . The causal connection between the defendant’s fraud and the plaintiff’s purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.<sup>73</sup>

Thus, if it can be shown that the market price was affected by the fraud, even if the investor never saw the statements, this is sufficient to establish a presumption of reliance on the statements.<sup>74</sup> However, the effect of the fraud may be dissipated over time or by the introduction of accurate information into the market.<sup>75</sup> This theory has not been universally accepted by United States courts.<sup>76</sup>

There is no authority for such a theory in the United Kingdom or Australia. However, the Financial Services Act 1986 (UK) contains a cause of action in the securities context for loss suffered ‘as a result of’<sup>77</sup> defective listing particulars and it has been commented that: ‘[r]eliance does not seem to be a prerequisite to incur liability under FSA, s150. Provided there is an untrue or misleading statement which results in the investor’s loss, the issuer is liable.’<sup>78</sup>

Whether s1005 CL would provide a cause of action for loss suffered in a scenario that would fall within the fraud on the market theory is uncertain. It may be that such an action would not be sufficiently direct and proximate to sustain the cause of action in the absence of an intention that the information be used to encourage secondary trading.<sup>79</sup> There is authority to support the proposition that knowledge that the information will be relied on by

72. Gregory Herder, ‘Corporate Finance Theory and the Australian Prospectus Legislation’ (1993) 6 *Corporate and Business Law Journal* 181, 182–5.

73. *Peil v Speiser*, 806 F2d 1154, 1160-1 (CA3 1986); cited in *Basic, Inc. v Levinson*, 485 US 224 (1988), 215 which concerned an action under Securities and Exchange Commission Rule 10b–5 (promulgated under the Securities Exchange Act 1934 (US)) — which is a securities antifraud provision for which it was accepted that reliance was an element.

74. Thomas Hazen, *The Law of Securities Regulation* (3rd ed 1996) 812–3.

75. *Ibid* 814.

76. *Ibid* 815.

77. Section 150 Financial Services Act 1986 (UK) — this formulation probably achieves the same result as the use of ‘by’ in s1005 CL; note *Wardley Australia Limited v The State of Western Australia*, above n 62.

78. Ahal Besorai, ‘Disclosure of Tentative Information by Listed Companies (Pt 2)’ (1995) 16 *The Company Lawyer* 263, 268.

79. *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All ER 774; see also *Al-Nakib Investments v Longcroft* (1991) BCLC 7 where the plaintiff was unable to establish the necessary degree of proximity.

others is sufficient,<sup>80</sup> however, in the cases cited, the knowledge was accompanied by a close relationship between the person to whom the information was originally directed and the person who ultimately suffered loss.

In addition, it may be argued that the action must relate to securities issued under the prospectus itself. This may be implied by the defence to civil liability in s1007 CL that applies when the plaintiff knew about the defect in the prospectus when that person ‘subscribed for the securities to which the prospectus relates.’<sup>81</sup> However, it would seem odd to limit the cause of action to only apply in the circumstances that one of the defences applies for several reasons.

Firstly, s1005 CL applies to more than conduct involving the issue of a prospectus as it is expressed to apply in respect of any breach of Part 7.11 or Part 7.12 CL. These provisions regulate much more in the securities context than the prospectus proper, including securities advertising and pressure selling. Secondly, s1005 CL would need to be read down in the case of defective prospectuses, but read in accordance with its terms in relation to the other forms of actionable conduct which would seem to be a tortured construction in order for s1007 to provide an adequate defence.

The better construction is the one that accepts that the defence in s1007 is inadequate because it fails to recognise that those who suffer loss or damage resulting from the issue of a defective prospectus may not have subscribed for the securities to which the prospectus relates. The inadequacy of s1007 is unlikely to have any real effect because a person with knowledge of the defect should not be able to succeed in an action for damages in any event. That principle is discussed below.<sup>82</sup>

It is interesting to note that prior to the introduction of the Corporations Law concerns were expressed by the Securities Information Review Committee (SIRC) about the adequacy of the civil liability provision (s107 of the Companies Act and Codes).<sup>83</sup> As discussed earlier, that provision made persons who authorised or caused the issue of the prospectus civilly liable for loss or damage sustained by reason of untrue statements or omissions from the prospectus that were known, and known to be material. Recourse was limited to persons who invested on the faith of the prospectus. It was considered to be too difficult for a plaintiff to establish their case under this provision in light of the fact that the prospectus is produced expressly to induce investments.<sup>84</sup>

80. *Patrick v Steel Mains*, above n 70, 136; *Emanuele v The Chamber of Commerce & Industry SA Incorporated*, above n 64, 53,576.

81. Section 1007 CL; R M A Mangioni and J P Hambrook, ‘Fundraising’, *Australian Corporations Law — Principles and Practice Looseleaf Volume 2* (1997) para 7.4.0160.

82. See discussion in Chapter 5 under the *Multiple Causes* heading at n 94.

83. Securities Information Review Committee, *Reforming the Law Relating to Offers of Securities — An Interim Report* (July 1988) 5–6 and 17–18. SIRC was set up by the National Companies and Securities Commission (NCSC) in 1986 due to concerns about the appropriateness of the fundraising provisions of the Companies Act and Codes. It was made up of senior corporate regulators and experienced market professionals. The committee’s work was overtaken by the introduction of the Corporations Bill which prompted the release of the ‘interim’ report in order to assist debate on the law reform proposals.

84. *Ibid.*, 5 and 17, paras 2.2.4 and 6.2.



The solution recommended by SIRC involved a presumption that the investment was made ‘on the faith of the prospectus’. In relation to secondary purchases concerns were expressed about how far such a presumption should be taken, because the investor may never have seen the prospectus, while recognising that the prospectus is the source of the market’s information about the company.

SIRC’s recommendation, intended to achieve a fair balance between these considerations, was to provide a right of compensation for purchasers for the life of the prospectus equivalent to that available to a subscriber except for two differences. Purchasers in the secondary market would have to show that they invested on the faith of the prospectus and liability would be subject to a defence if that reliance was not reasonable.<sup>85</sup> A cause of action for purchasers in the secondary market similar to that available to subscribers was considered appropriate because, ‘[i]n the day to day operation of the market, there is no difference in substance between one person who receives an allocation of shares in a float and another who buys them in the market shortly after listing.’<sup>86</sup>

If this recommendation had been adopted then reliance on the ‘fraud on the market theory’ would not have been available as investing on the faith of the prospectus would appear to require a more direct link between the decision and the prospectus. However, there would have been civil liability in a situation analogous to the facts in *Possfund Custodian Trustee Ltd v Diamond*,<sup>87</sup> that is, where the plaintiff has relied on the prospectus when making a purchase in the secondary market and that reliance was reasonable in the circumstances because the prospectus was intended to inform and encourage the aftermarket. As discussed above, this fact situation would also appear to fall within the ambit of the current formulation of s1005 CL.

### *Multiple causes*

It has been established, for an action in terms equivalent to s1005 CL,<sup>88</sup> that it is not sufficient to show that the impugned representation ‘might’ have caused the entry into the contract.<sup>89</sup> At the other extreme, it is not necessary for the impugned representation to be the only reason for entering the contract,<sup>90</sup> nor is it necessary to satisfy a ‘but for’ test (ie but for the impugned representation the plaintiff would not have entered the contract).<sup>91</sup> The true position is somewhere in the middle — the impugned conduct must have played at

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85. *Ibid*, 6 and 18, paras 2.3.4 and 6.3.3.

86. *Ibid*, 18, para 6.3.2.

87. Above n 79.

88. Section 82 TPA.

89. *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Limited* (1993) ATPR 41–235, 41,227.

90. *Elna Australia Pty. Ltd. v International Computers (Australia) Pty. Ltd.*, above n 61, 48,677.

91. *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Limited*, above n 89, 41,227.

least some part in inducing the plaintiff to enter into the contract<sup>92</sup> and this is a question of fact to be decided on the basis of all of the evidence.<sup>93</sup>

Flowing from the need for the impugned conduct to be linked to the decision (in the prospectus context it will be the decision to invest in the securities) common sense would dictate that knowledge of the true situation would break the link.<sup>94</sup> This principle has been incorporated into the Corporations Law in s1007 as a defence for persons who are deemed to be involved in a contravention giving rise to civil liability under s1005 CL.

It is also worthwhile, in this context, to consider the evidential burden of an action pursuant to s1005 CL. The cases show that common sense may result in an inference of reliance being drawn in circumstances where it is shown that the impugned representation was intended to induce the investor to enter into a contract and the representation is of a kind likely to produce such an inducement.<sup>95</sup> Of course, it must be remembered that this is no more than a presumption that may be rebutted with evidence to the contrary.

## Loss or Damage

A further requirement of s1005 CL is that 'loss or damage' must be suffered. This has been held to mean 'no more than the disadvantage which is suffered by a person as the result of the act or default of another in the circumstances provided for in the section.'<sup>96</sup>

Neither s1005 CL nor s82 TPA provide any indication of the measure of damages that applies when civil liability is proved. Again, without the benefit of any cases on s1005 it is reasonable to consider the cases on s82 TPA when considering this issue. In cases considering loss or damage in a cause of action brought under s82 TPA the Courts have generally adopted a tortious measure of damages due to the similarity between misleading and deceptive conduct (s52 TPA) and the tort of deceit. The tortious measure has been adopted in preference to the contractual measure of damages.<sup>97</sup>

92. *Gould v Vaggelas* (1983–1985) 157 CLR 215, 236; quoted in *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Limited*, above n 89, 41,227; see also *Elna Australia Pty. Ltd. v International Computers (Australia) Pty. Ltd.*, above n 61, 48,677.

93. *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Limited*, above n 89, 41,227.

94. Warren Pengilly, 'Causation and Reliance in Misleading and Deceptive Conduct Law' (1994) 2 *Competition & Consumer Law Journal* 134, 139.

95. *Ricochet Pty Ltd v Equity Trustees Executor and Agency Company Limited*, above n 89, 41,226; quoting *Gould v Vaggelas*, above n 92, 238; see also *Dominelli Ford (Hurstville) Pty Limited v Karmot Auto Spares Pty Limited* (1992) ATPR 41-198, 40,661-2; and *Smith v Chadwick* (1884) 9 App Cas 187, 196.

96. *Demagogue Pty Ltd v Ramensky* (1992) 110 ALR 608, 625. This decision considers s87(1) TPA however the words would appear to have the same meaning in the context of s1005 CL: Robert Baxt and HAJ Ford and Ashley Black, *Securities Industry Law* (5th ed, 1996) 77.

97. *Kizbeau Pty Ltd v WGB Pty Ltd* (1995) 184 CLR 281; quoted in John P Hamilton QC et al, 'At the Cash Register: Computation of Damages and Valuation Issues Arising on the Misrepresentation of Profits on a Sale of Business' (1996) 4 *Trade Practices Law Journal* 175; *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1; Greg Golding, 'Where does the Director Really Stand (Pt1)' (1997) 7 *Australian Journal of Corporate Law* 177, 183.

A tortious measure of damages has the effect of assessing how much worse off the plaintiff is as a result of the misleading or deceptive conduct.<sup>98</sup> This will generally be the difference between the price paid and the value of what was received at the time the contract was made.<sup>99</sup> However, concern has been expressed about taking an approach that limits recovery to the tortious measure of damages in the context of s82 TPA because the provision itself contains no such restriction. This issue was explored by Gummow J in *Elna Australia Pty. Ltd. v International Computers (Australia) Pty. Ltd.* where, after considering the leading case<sup>100</sup> and exploring the relevance of equitable remedies he said:

In any event, it would be unfortunate if sec. 82 of the TP Act were to be applied to particular cases by a process that encouraged the Court first to turn to common law concepts, whether as to causation, remoteness or measure of damages.<sup>101</sup>

Consequential losses may also be recovered, for example, the loss of a different profitable commercial contract as a consequence of relying on the misleading or deceptive conduct<sup>102</sup> and losses associated with the termination of an earlier investment or the costs of borrowing. However the plaintiff must act reasonably to mitigate the damage — although this obligation would seem less relevant in a securities context where the investor has no real control over the commercial enterprise.<sup>103</sup> In summary, any loss suffered as a direct consequence of the conduct may be recovered.<sup>104</sup>

## A Contravention

Persons from whom loss or damage under s1005 CL may be recovered must be engaged in a contravention of a provision of Part 7.11 CL (the liability provisions) or Part 7.12 CL (the fundraising provisions), or involved in the contravention. Therefore, in the prospectus context civil action could be based on a breach of one of the specific prohibitions (s996, 995, 999 or 1000 CL) or on a breach of one of the informational requirements in Part 7.12 CL, for example, s1022 CL. The specific prohibitions are explored in greater detail below as the most likely bases for an action (particularly the broad prohibitions in ss995 and 996 which are not limited by any requirement for recklessness, dishonesty or knowledge).

## Engaged in the Contravention

The persons against whom a civil action under s1005 may be brought must be ‘engaged in’ or ‘involved in’ the contravention, although it is not necessary for there to be any criminal

98. David Harland, ‘The Statutory Prohibition of Misleading or Deceptive Conduct in Australia and its Impact on the Law of Contract’ (1995) 111 *Law Quarterly Review* 100, 120.

99. *Wardley Australia Limited v The State of Western Australia*, above n 62, 530; G E Hart, ‘The Deterrent Effect of Civil Liability in Investor Protection’ (1987) 5 *Company and Securities Law Journal* 162, 174.

100. *Gates v City Mutual Life Assurance Society Ltd*, above n 97.

101. Above n 61, 48,679.

102. *Sellars v Adelaide Petroleum N.L.* (1994) 179 CLR 332; discussed in Harland, above n 98, 121.

103. Harland, above n 98, 121; *Haynes v Top Slice Deli Pty Limited*, above n 64, 53,154.

104. *Milner v Delita Pty Ltd* (1985) 9 FCR 299, 308–9.

conviction in respect of the contravention. The term 'engaged in' is designed to cover the principal offenders, that is, the persons who actual do the act or make the omission that constitutes the contravention. This should include, in the context of the issue of a defective prospectus, any person who issues the prospectus.

The Corporations Law contains several provisions to assist a determination of whether a person was 'engaged in' the contravention in ss762 and 764 CL (which are given effect in relation to s1005 CL by s760 CL). Subsection 762(1) CL states that '[a] reference to engaging in conduct is a reference to doing or refusing to do any act, including the making of, or the giving effect to a provision of, an agreement.' Further explanation of the phrase 'doing any act' is provided by s764 CL which states, '[i]n this Chapter [Chapter 7], unless the contrary intention appears, a reference to doing any act or thing includes a reference to causing, permitting or authorising the act or thing to be done.'

Therefore, in the prospectus context persons who authorised or caused the issue of the prospectus will have 'engaged in' the contravention, within the definition of s762 CL as expanded by s764 CL. Persons who 'cause or authorise' the issue of a prospectus will be discussed in greater detail later in the context of the s996 CL prohibition and would include, as a minimum, the corporation as the issuer of the prospectus and its directors whose signature is required if the prospectus is to be issued.<sup>105</sup>

In the fundraising context primary participants in a contravention have been characterised as persons who 'adopt' the impugned statements; whereas secondary participants, that is, persons who are 'involved in' the contravention, are described as 'persons who pass on the statement for what it is worth,' relying on the proposition that conduct is unlikely to be misleading or deceptive if it merely involves passing on information for what it is worth.<sup>106</sup> This is commonly described as acting as a 'mere conduit' which 'will in some cases result in persons such as agents and professional advisers . . . being regarded as not personally making any misleading representation and as therefore not contravening s52 [TPA].'<sup>107</sup> This is of course, in the context of being a principal offender. Such an adviser may nevertheless amount to a secondary participant, that is, a person 'involved in' the contravention (secondary participants are discussed below).

In the Trade Practices Act 1974 (Cth) context there is judicial authority for the view that the corporation will be engaged in misleading or deceptive conduct under s52 (that is the issue of the defective offer documents) whilst its directors (who were also the promoters) are persons 'involved in' the contravention by aiding and abetting the principal offence if the directors have knowledge of the facts which establish the elements of the offence.<sup>108</sup> (The requirement for knowledge for accessorial liability is discussed in further detail below.)

However, while the Trade Practices Act 1974 (Cth) has a provision very similar to s762(1) CL in s4(2)(a), the Trade Practices Act 1974 (Cth) does not contain an interpretive provision equivalent to s764. The inclusion of s764 in the Corporations Law fits sensibly

105. Subsection 1021(13) CL.

106. Baxt, Ford and Black, above n 96, 92–3; with reference to *Yorke v Lucas* (1985) 158 CLR 661, 666.

107. Harland, above n 98, 130.

108. *Milner v Delita Pty Ltd*, above n 104, 302.

with the prohibition under s996 against authorising or causing the issue of a defective prospectus as common sense would dictate that persons who actually authorise or cause the issue of a defective prospectus, as prohibited by s996 CL, will be persons ‘engaged in’ the contravention.

Under s762(1) CL omissions to act must be deliberate in order to amount to ‘refusing to do an act’ because the word ‘refusing’ connotes deliberateness.<sup>109</sup> It should be noted that silence will not be an omission to act when it amounts to an implied representation, as this will constitute an act.<sup>110</sup>

Section 762 CL also contains a provision, in sub-s(4), that imputes conduct to a body corporate that is engaged in on its behalf by a director, servant or agent who is acting within their actual or apparent authority. There is one further extension in that conduct by any other person at the direction or with the consent or agreement of a director, servant or agent of the body corporate, is imputed to that body corporate if it is within the scope of the actual or apparent authority of the director, servant or agent. In addition, a similar imputation applies under s762(6) CL for persons other than body corporates in respect of the conduct of their servants or agents.

It is necessary for the acts of others to be imputed to a body corporate in order for it to be held responsible for conduct flowing from its operation. Even without the assistance of s762 CL the common law has developed theories which impute conduct to bodies corporate. For example:

A corporation can have knowledge through two categories of natural persons:

- under the organic theory, persons who constitute the company’s directing mind and will; and
- under the law of principal and agent, individual directors, employees and other agents who have authority to receive and communicate relevant information to the company.<sup>111</sup>

## Involved in the Contravention

In addition to the principal offender, s1005 CL also provides for a wider category of persons who are civilly liable for the contravention, that is, persons who are ‘involved in’ the contravention. Involvement clearly requires less than being engaged in the contravention and captures the criminal law concept of accessories to an offence. Assistance as to the degree of involvement required is provided by s79 CL.

Section 79 CL specifies a number of classes of person who will be liable as accessories. These categories include persons who: aid, abet, counsel or procure the contravention; induce the contravention; are knowingly concerned in or party to the contravention; or

109. *Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Ltd* (1986) 68 ALR 77, 84; and quoted in Baxt, Ford and Black, above n 96, 78; and Michael Gillooly, ‘Misleading or Deceptive Conduct Under Section 995 Corporations Law’ (July 1995) *Centre for Commercial and Resources Law Misleading or Deceptive Conduct Conference* 7.

110. Baxt, Ford and Black, above n 96, 78. For example, where silence gives rise to a reasonable expectation that if particular matters exist they will be disclosed — then silence about those matters will amount to a representation that they do not exist.

111. H A J Ford, R P Austin and I M Ramsay, *Ford’s Principles of Corporations Law* (8th ed, 1997) 691.

conspire with others to effect the contravention. The terms of s79 CL are very similar to s5 of the Crimes Act 1914 (Cth) and have been interpreted as importing from the criminal law the requirement for knowledge of the essential elements of the contravention.<sup>112</sup> That is, there must be an intention to commit the acts that constitute the offence although there is no requirement for knowledge that the acts constitute an offence.<sup>113</sup>

Section 762 CL also provides assistance in establishing state of mind for the purposes of accessorial liability. State of mind is defined in sub-s(7) as including knowledge, intention, opinion, belief or purpose and the reasons for it. An extended characterisation of state of mind is provided for a body corporate in sub-s(3) and for others in sub-s(5). These characterisations impute the knowledge of servants, agents, and in the case of body corporates, directors, to the person or body corporate when the conduct engaged in by the servant, agent or director is within the scope of their actual or apparent authority.<sup>114</sup>

Finally, the Corporations Law provides for a further group of persons who are 'involved in' the contravention. This group is found in s1006(2) CL which operates in conjunction with s79CL.<sup>115</sup> Section 1006(2) CL lists 8 categories of persons who are deemed to be involved in a contravention for the purposes of civil liability under s1005 CL where the contravention involves the issue of a prospectus which contains a false or misleading statement or from which there is a material omission. These categories include the corporation and those closely associated with the corporation (ie directors and promoters) as well as underwriters, experts and advisers.<sup>116</sup> No mental element is required in order to be a person involved in a contravention by virtue of s1006 CL. Therefore it is easier to prove involvement pursuant to s1006 CL than under s79 CL.

112. *Yorke v Lucas*, above n 106; quoted in R S French J, 'A Lawyer's Guide to Misleading or Deceptive Conduct' (1989) 63 *Australian Law Journal* 250, 266; see also *Sutton v AJ Thompson Pty Ltd* (1987) 73 ALR 233.

113. *Giorganni v The Queen* (1985) CLR 473, 506; quoted in David Ravech, 'Case Notes *Yorke v Lucas*, *Hamilton v Whitehead*' (1990) 17 *Melbourne University Law Review* 521, 523.

114. Baxt, Ford and Black, above n 96, 80.

115. The concurrent application of s1006 CL is expressly preserved by the words '[s]ubject to section 1006' at the commencement of s79 CL. Section 79 CL then goes on to limit the ways in which a person may be involved in a contravention to the list contained in that section, that is, 'a person is involved in a contravention if, and only if, the person ...'

116. The categories listed in s1006(2)(a)–(h) CL are as follows: (a) the corporation; (b) a person who was a director of the corporation at the time of the issue of the prospectus; (c) a person who authorised or caused himself or herself to be named, and is named, in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time; (d) a promoter of the corporation; (e) if the prospectus includes a statement that purports to be, or to be based on, a statement by an expert and the expert gave consent under section 1032 to the issue of the prospectus — that expert; (f) a person named, with the consent of the person, in the prospectus as a stockbroker, sharebroker or underwriter of the corporation or for or in relation to the issue or proposed issue of securities; (g) a person named, with the consent of the person, in the prospectus as an auditor, banker or solicitor of the corporation or for or in relation to the issue or proposed issue of securities; (h) a person named, with the consent of the person, in the prospectus as having performed or performing any function in a professional, advisory or other capacity not mentioned in paragraph (e), (f) or (g) for the corporation or for or in relation to the issue or proposed issue of securities.

## Chapter 6

# The Prohibitions that Apply to a Defective Statutory Prospectus

There are a number of prohibitions in the Corporations Law that have a direct application to a defective statutory prospectus and which will provide a basis for a civil action under s1005 CL. These provisions are ss995, 996, 999 and 1000 CL.<sup>117</sup> In addition, s52 TPA and the equivalent provisions of the State and Territory Fair Trading Acts<sup>118</sup> provide a similar cause of action and will apply to misleading or deceptive conduct involving the issue of a defective statutory prospectus.

This book will not canvass contraventions of s999<sup>119</sup> or 1000<sup>120</sup> CL because, in the context of a defective statutory prospectus, they do not provide liability for any conduct that is not already caught by s995 or 996 CL or s52 TPA and they are more difficult to prove. This is because ss999<sup>121</sup> and 1000 CL<sup>122</sup> both have a mental element that must be proved — unlike ss995 and 996 CL and s52 TPA.

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117. In addition, it should be noted that rights under the general law for a breach of a defective prospectus are expressly preserved by s1005 CL. Therefore actions for the tort of deceit or negligent misstatement remain available, as does breach of contract and rescission.

118. 1985 (Vic); 1987 (NSW); 1987 (Qld); 1987 (SA); 1987 (WA); 1990 (Tas); 1990 (NT); and (1992) ACT.

119. For a discussion of the ambit of the s999 CL prohibition see: Ashley Black, 'Regulating Market Manipulation: Sections 997–999 of the Corporations Law' (1996) 70 *Australian Law Journal* 987; see also Robert Baxt, HAJ Ford and Ashley Black, *Securities Industry Law* (5th ed, 1996) 121–2.

120. See, for example, Baxt, Ford and Black, above n 119, 123–7.

121. Section 999 CL provides as follows: A person must not make a statement, or disseminate information, that is false in a material particular or materially misleading and:

- (aa) is likely to induce other persons to subscribe for securities;
- (a) is likely to induce the sale or purchase of securities by other persons; or
- (b) is likely to have the effect of increasing, reducing, maintaining or stabilising the market price of securities; if, when the person makes the statement or disseminates the information:
- (c) the person does not care whether the statement or information is true or false; or
- (d) the person knows or ought reasonably to have known that the statement or information is false in a material particular or materially misleading.

122. Section 1000(1) provides as follows: A person shall not:

- (a) by making or publishing a statement, promise or forecast that the person knows to be misleading, false or deceptive;
  - (b) by a dishonest concealment of material facts;
  - (c) by the reckless making or publishing (dishonestly or otherwise) of a statement, promise or forecast that is misleading, false or deceptive; or
  - (d) by recording or storing in, or by means of, any mechanical, electronic or other device information that the person knows to be false in a material particular or materially misleading;
- induce or attempt to induce another person to deal in securities.

## Misleading or Deceptive Conduct — s995 CL

There are a number of benefits in commencing a consideration of the prohibitions that apply to a defective statutory prospectus with s52 TPA<sup>123</sup> (which, as discussed above gives rise to liability under s82 TPA in terms very similar to s1005 CL). This is because of the extensive judicial consideration of that provision which in turn provides assistance when interpreting s995 CL,<sup>124</sup> as well as s996 CL which will be shown to have much in common with s995 CL and s52 TPA in the context of a defective statutory prospectus.

In the analysis that follows, the principles that apply in respect of s52 TPA are generally presumed to apply equally in the context of s995 CL. There is authority for this approach in the decision of the Full Court of the Federal Court in *Fraser v NRMA Holdings Ltd* where it was stated that '[i]n the circumstances of the present case each section had application [s52 TPA and s995 CL]. In each section the relevant proscription is expressed in identical terms, and had the applicants sought to rely on s995(2) the issues for determination would have been substantially the same.'<sup>125</sup>

Both s52 TPA and s995 CL apply to misleading or deceptive conduct or conduct that is likely to mislead or deceive. As was stated by Gibbs CJ (in relation to s52 TPA but equally relevant to s995 CL) in the leading case of *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*:

The words of s52 [TPA] require the court to consider the nature of the conduct of the corporation against which proceedings are brought and to decide whether that conduct was, within the meaning of that section, misleading or deceptive or likely to mislead or deceive. Those words are on any view tautologous. One meaning which the words "mislead" and "deceive" share in common is "to lead into error". If the word "deceptive" in s52 stood alone, it would be a question whether it was used in a bad sense, with a connotation of craft or overreaching, but misleading carries no such flavour, and the use of that word appears to render "deceptive" redundant.<sup>126</sup>

The use of the analysis that the conduct must 'lead into error,' 'cause to err' or to be 'inconsistent with the truth' is typical in the cases and literature considering s52 TPA.<sup>127</sup>

The words 'likely to mislead or deceive' have also been held to add nothing to the proscription although they do clarify the fact that it is not necessary to show that anyone was

123. Section 52 TPA has been successfully used as a basis for civil action in the securities context, see for example, *Milner v Delita Pty Ltd* (1985) 9 FCR 299; *Fraser v NRMA Holdings Ltd* (1995) 15 ACSR 590; *Pancontinental Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463. There is no need for any additional consideration of the State Fair Trading Acts as those Acts reflect the prohibition in s52 TPA.

124. See f-n 60 above.

125. Above n 123, 599–600; see also Michael Legg, 'Misleading and Deceptive Conduct in Prospectuses' (1996) 14 *Company and Securities Law Journal* 47.

126. (1981) 42 ALR 1, 6.

127. Colin Lockhart, *The Law of Misleading or Deceptive Conduct* (1998) 44–5; R S French J, 'A Lawyer's Guide to Misleading or Deceptive Conduct' (1989) 63 *Australian Law Journal* 250, 256–7; David Harland, 'The Statutory Prohibition of Misleading or Deceptive Conduct in Australia and its Impact on the Law of Contract' (1995) 111 *Law Quarterly Review* 100, 108; Philip Clarke, 'Misleading or Deceptive Conduct in Relation to Takeovers' (1989) 7 *Company and Securities Law Journal* 111.



in fact misled or deceived in order to prove a contravention.<sup>128</sup> In fact, the addition of these words in s52 TPA was recommended by the Swanson Committee in response to submissions suggesting that it was uncertain whether s52 TPA required actual proof of damage or whether the possibility of damage is sufficient.<sup>129</sup> Conduct will be sufficient to meet the ‘likely to mislead or deceive’ test if there is ‘a real or not remote chance or possibility regardless of whether it is less or more than 50 per cent.’<sup>130</sup>

### *Conduct*

The question has arisen whether the word ‘conduct’ which is used to describe the misleading or deceptive activity is limited to representations or extends to encompass ‘statements of opinion or statements that are purely promissory or predicative in character.’<sup>131</sup> Initially, it was considered to be necessary for a representation to be conveyed,<sup>132</sup> however, in the later Full Federal Court decision of *Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Ltd*<sup>133</sup> the earlier authority was cited to support the view that the conduct will ‘usually’ need to convey a representation.<sup>134</sup>

### *The class of persons affected*

Misleading or deceptive conduct must be examined not with reference to its effect on a ‘reasonable person’ but with reference to the entire class of ‘possible victims’.<sup>135</sup> The question of whether, when considering ‘the astute and the gullible, the intelligent and the not so intelligent, the well educated as well as the poorly educated, men and women of various ages pursuing a variety of vocations’<sup>136</sup> reference should be limited to ‘reasonable’ members of that class, who take reasonable care of their own interests, remains uncertain.<sup>137</sup> The need for a filter when examining the class of possible victims has been approached in a number

128. *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 42 ALR 1, 6. This is of particular importance when the remedy sought is an injunction.

129. French, above n 127, 257–8; referring to Trade Practices Act Review Committee, *Report* (August 1976), para 9.55.

130. *Global Sportsman Pty Ltd v Mirror Newspapers Ltd* (1984) 55 ALR 25, 30; quoted in Lockhart, above n 127, 45.

131. French J, above n 127, 256.

132. *Taco Company of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177, 202; *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*, above n 130, 30.

133. (1986) 68 ALR 77, 84.

134. See also *Henjo Investments Pty Limited v Collins Marrickville Pty Limited* (1988) 39 FCR 546, 555; and issues discussed in French J, above n 127, 254–6.

135. *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*, above n 130, 34; relying on Murphy J in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, above n 128, 19; and *Taco Company of Australia Inc v Taco Bell Pty Ltd*, above n 132, 202.

136. *Taco Company of Australia Inc v Taco Bell Pty Ltd*, above n 132, 202.

137. This limitation was suggested by Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, above n 128, 6. For a discussion of the uncertainty surrounding this question see Lockhart, above n 127, 57–9.

of ways — one method is by excluding those who are ‘unusually stupid or foolish’ from the class or considering whether a ‘significant section’ of the relevant class would be misled.<sup>138</sup>

In my submission the use of a ‘reasonableness’ filter with reference to a broad class to whom the conduct is directed is different from and broader than examining the conduct with reference to its effect on the mythical ‘reasonable person’<sup>139</sup> and provides an appropriate barrier to recovery. In fact the test was approached in this way by the Full Federal Court in the leading fundraising related s52 decision, *Fraser v NRMA Holdings Ltd*, where it was stated that ‘[t]he need to make full and fair disclosure must be tempered by the need to present a document that is intelligible to reasonable members of the class to whom it is directed [emphasis added].’<sup>140</sup>

It may be that a similar result to that flowing from an assumption of ‘reasonableness’ with reference to the class to whom the conduct is directed, could be achieved through other forms of unreasonable reliance on the part of the plaintiff. For example, an unreasonable person who falls within the class to whom the conduct is directed may be acting unreasonably by either making erroneous assumptions that do not flow from the impugned conduct or by relying on representations that no normal person would take seriously.<sup>141</sup> Clearly these factors would indicate a lack of ‘causal relationship between the conduct in issue and the fact or prospect that people will be led into error by it’ and would mean that the conduct complained of could not be said to be misleading or deceptive.<sup>142</sup>

### *State of mind*

It is well established that, for statements of past or present fact it is not necessary to establish the intent of the person whose conduct is impugned in order to establish that conduct is

138. Lockhart, above n 127, 59; see also Robert Langton, ‘Material and Immaterial Omissions from a Prospectus: Reflections of a Puzzled Observer on the Decision(s) in *Fraser v NRMA Holdings Ltd*’ (1996) 6 *Australian Journal of Corporate Law* 410, 413.

139. In support see Baxt, Ford and Black, above n 119, 89: ‘Since s995 is part of legislation obviously intended for the protection of persons who invest in securities the notional person is, presumably, a reasonable person about to make a decision about securities.’; and French J, above n 127, 264; contra see Harland, above n 127, 108 who equates the test suggested by Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, above n 128, with a ‘reasonable man’ test.

140. Above n 123, 603.

141. French, above n 127, 258 & 264.

142. Ibid 258. The ‘erroneous assumptions’ doctrine described in *McWilliam’s Wines Pty Ltd v McDonald’s System of Australia Pty Ltd* (1980) 33 ALR 394 was questioned in *Taco Co of Australia Inc v Taco Bell Pty Ltd*, above n 132, 200 by the Full Federal Court. Although, the same Judges who cast doubt on this doctrine also held that in the context of *Lego Australia Pty Ltd v Paul’s (Merchants) Pty Ltd* (1982) 42 ALR 344 any misconception that “Lego” sprinklers were in any way connected with the plastic toys was ‘as a result of unwarranted assumptions that they themselves made.’ All three of these cases relate to claims of ‘passing off’ and it is probably in relation to such claims that this doctrine is clearest. In the securities context it is difficult to provide analogies and it is probably more helpful to break the doctrine down into the simple concepts used by French J, ibid 258, which can also be described as ‘no more than part of an exposed process of reasoning in the course of deciding a question of fact.’: *Taco Co of Australia Inc v Taco Bell Pty Ltd*, above n 132, 200.

misleading or deceptive or likely to mislead or deceive.<sup>143</sup> As was stated in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* with reference to s52 TPA (although also applicable to s995 CL by analogy):

There is nothing in the section that would confine it to conduct which was engaged in as a result of a failure to take reasonable care. A corporation which has acted honestly and reasonably may therefore nevertheless be rendered liable to be restrained by injunction, and to pay damages, if its conduct has in fact misled or deceived or is likely to mislead or deceive.<sup>144</sup>

Thus, liability under s52 TPA is unrelated to fault.

The position is slightly different in relation to promises, predictions and opinions (including prospectus forecasts) because such statements ‘involve the state of mind of the maker at the time when the statement is made . . . A statement which involves the state of mind of the maker ordinarily conveys the meaning (expressly or by implication) that the maker of the statement has a particular state of mind when the statement was made and, commonly at least, that there was basis for that state of mind.’<sup>145</sup>

The fact that a promise or prediction is not fulfilled does not render it misleading or deceptive. This is because it must be examined at the time that it was made<sup>146</sup> and with regard to the implicit representations.<sup>147</sup>

In the statutory prospectus context predictions (known as forecasts) are commonly made about the likely returns on the investment. Prospectus forecasts clearly involve not just a representation that those responsible believe that it will be achieved, but also a representation that it is based on reasonable grounds. The representation about reasonable grounds is implicit in a financial forecast and serves to differentiate it from a mere projection.<sup>148</sup> The ‘reasonable grounds’ on which a forecast is based can be described as the ‘assumptions’. It is ASIC’s view that the following information must be included in the prospectus:

- (a) the assumptions made when preparing the forecast...;
- (b) the limits of the forecast in terms of the period of the forecast and the risks that the forecast will not be achieved . . . ; and

143. *Hornsby Building Information Centre Proprietary Limited v Sydney Building Information Centre Limited* (1978) 140 CLR 216, 228; *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, above n 128, 5; *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*, above n 130, 30; French, above n 127, 265; Baxt, Ford and Black, above n 119, 88; Warren Pengilly, ‘Section 52: Can the Blind Mislead the Blind’ (1997) 5 *Trade Practices Law Journal* 4, 5.

144. Above n 128, 5.

145. *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*, above n 130, 31.

146. *Bill Acceptance Corporation Ltd v G W A Ltd* (1983) 78 FLR 171; quoted in French J, above n 127, 259–60; and Lockhart, above n 127, 81.

147. *Global Sportsman Pty Ltd v Mirror Newspapers Ltd*, above n 130, 31; *Bateman v Slatyer* (1987) ATPR 40–762, 48,257; *Stanton v Australia and New Zealand Banking Group Ltd.* (1987) ATPR 40-755, 48,193; see also Warren Pengilly, ‘“But you Can’t Do That Any More!” — The Effect of Section 52 on Common Negotiating Techniques’ (1993) 1 *Trade Practices Law Journal* 113, 117–8.

148. Forecasts relate to ‘likely future results prepared on best-estimate assumptions,’ whereas projections are ‘based on hypothetical assumptions or a mixture of best-estimate and hypothetical assumptions’: Australian Securities Commission, *Issues Paper, Inclusion of Financial Forecasts in Prospectuses* (October 1996) 5.

- (c) an explanation of how the forecast was calculated. If the figures are not calculated on a basis that is in accordance with accounting standards or decisions of the Urgent Issues Group this will generally need to be explained . . .

A clear statement of the assumptions on which the forecast is based puts the forecast in its proper context and reduces any tendency for it to be misleading.<sup>149</sup>

The obligation for a forecast to be based on reasonable grounds is echoed in s51A TPA and s765 CL. These provisions deem a representation to be misleading unless the maker has reasonable grounds for the representation (as discussed above, lack of reasonable grounds will result in a forecast being misleading even without this provision). They then go on to reverse the onus of proof placing the onus on the defendant to show reasonable grounds for the belief.

This reversal of the onus of proof in relation to statements about future matters recognises ‘the difficulty that may attach to proving lack of reasonable grounds for an unperformed promise or unfulfilled prediction,’<sup>150</sup> particularly as the fact that the prediction or promise has not been fulfilled is not evidence of a lack of reasonable grounds for belief in its truth. However, the position of the plaintiff in the case of a forecast is not subject to the same difficulty, even without the assistance of s765 CL, due to the obligation to disclose the material assumptions that form the basis of the forecast.<sup>151</sup> Those assumptions will form the basis for the reasonableness (or lack thereof) of the belief, no matter who has the onus of proof.

### *Silence and half truths*

There is no universal general law obligation to disclose — instead the law favours the general principal of caveat emptor. However, this rule is not absolute and there are a number of circumstances in which a duty to disclose arises.<sup>152</sup> The absence of disclosure when such a duty exists will also amount to misleading or deceptive conduct.<sup>153</sup> In the fundraising context there are two relevant circumstances when such a duty arises. Firstly, there is a duty to disclose where circumstances have changed causing a representation that was true when it

149. Australian Securities and Investments Commission, *Practice Note 67 Financial Forecasts in Prospectuses* (4 August 1998) paras 5 and 19; see also *Pancontinental Mining Ltd v Goldfields Ltd*, above n 123, 472: ‘An offeree, when faced with a complex and lengthy prospectus should not have to forage through the whole prospectus, seeking out fragments of information in order to piece together assumptions . . . The offeree is entitled to have the forecast clearly set out, in a lucid and direct form, in a prominent part of the statement, so that attention can be focussed on the critical matter of earning potential.’; and see David Nathanson, ‘A Modest Judgment on What Should and Should Not be in Takeover Documents? Or a New Disclosure Standard for Scrip Takeovers and New Issue Prospectuses?’ (1995) 18 *The University of New South Wales Law Journal* 523; and Howard Belcher, ‘Advisers Misread the Prospectus Issue’ (1995) 145 *Companies and Securities Bulletin* 2, 3.

150. French J, above n 127, 260–1.

151. See above at n 149.

152. Lockhart, above n 127, 103–4; Baxt, Ford and Black, above n 119, 90–1.

153. *Collins Marrickville Pty Ltd v Henjo Investments Pty Ltd*, above n 134, 609–10; also Warren Pengilly, above n 147, 118–20.

was made, to become false. This is based on a theory of continuing representation that continues until the contract is made.<sup>154</sup> Secondly, there is a duty to disclose when an express statement amounts to a half-truth. This can be done by saying something that is literally true but, due to the omission of certain facts, creates a misleading impression. It is also now well established that, ‘a failure to reveal facts will not be misleading unless the circumstances are such as to give rise to a reasonable expectation that if some relevant fact exists it would be disclosed.’<sup>155</sup>

Many of the difficulties at the limits of this test<sup>156</sup> will not arise in the fundraising context because there is a duty of disclosure at law and its limits are very clearly set out. Both the disclosure obligation and its limits are found in s1022 CL. This was also the case in *Fraser v NRMA Holdings Ltd*<sup>157</sup> where there was a fiduciary duty to provide sufficient information to fully and fairly inform members of matters to be considered at a general meeting in order to determine whether to attend and how to vote. The Court provided the link between the fiduciary duty<sup>158</sup> and misleading or deceptive conduct by stating that ‘a failure to properly discharge the duty [to make full and fair disclosure] may itself constitute a contravention of s52 [TPA] as well as s995 of the [Corporations] Law.’<sup>159</sup> This failure ‘would occur even if the corporation through its directors and officers did not have knowledge of the undisclosed facts which rendered the conduct in breach of s52 [TPA].’<sup>160</sup>

Clearly, the examination of a statutory prospectus should proceed in broadly the same way as the examination of the notice of meeting and accompanying documents in *Fraser v NRMA Holdings Ltd* — except that the disclosure test to be considered would be that found in s1022 CL<sup>161</sup> rather than a ‘full and fair’ disclosure test.

154. It was in reliance on the continuing representations theory and the availability of rescission that the Eggleston Committee recommended against introducing any mechanism into the statutory regime for fundraising to deal with changes in circumstances that may occur between the issue of the statutory prospectus and its expiry. It was commented in the Eggleston Committee’s report that a statutory mechanism ‘would necessarily be elaborate, and would impose further burdens on companies seeking funds, for the purpose of dealing with changes of circumstances arising after the issue of the prospectus.’: Company Law Advisory Committee, *Fifth Interim Report to the Standing Committee of Attorneys-General on Fund Raising by Corporations* (18 November 1970) 11–12, para 32. However, this principle has now been incorporated into the Corporations Law in the provisions that provide for supplementary and replacement prospectuses (ss1023A–1024D).

155. Harland, above n 127, 115; see also Pengilly, above n 143, 7; and *Demagogue Pty Ltd v Ramensky* (1992) 110 ALR 608, 618–9; quoting French J in *Kimberley NZI Finance Ltd v Torero Pty Ltd* (1989) ATPR (Digest) 46-054, 53, 195: ‘However, unless the circumstances are such as to give rise to the reasonable expectation that if some relevant fact exists it would be disclosed, it is difficult to see how mere silence could support the inference that the fact does not exist.’

156. For example see the discussion of *Des Forges v Wright* (1996) 5 NZBLC 104,030 in Pengilly, above n 143, 8–16.

157. Above n 123, 601–602.

158. It is worth noting in passing that even without the benefit of the statutory disclosure obligation in s1022 CL the general law has found a fiduciary obligation for promoters to make extensive disclosure to investors. Although this obligation would appear to be limited to information within the promoters knowledge: *The New Brunswick and Canada Railway and Land Co v Muggeridge*, (1860) 1 Dr and Sm 418, 425; *The Directors of Central Railway Co of Venezuela v Kisch* (1867) LR 2 HL 99, 113.

159. *Fraser v NRMA Holdings Ltd*, above n 123, 602.

160. Ibid 603; contrast the earlier decision of *Demagogue Pty Ltd v Ramensky*, above n 155, 619–20 where there was a deliberate choice to keep silent; see also Lockhart, above n 127, 117.

161. For offers of prescribed interests s1022 CL is modified by Corporations Regulation 7.12.12.

Section 1022 CL is a more sophisticated disclosure obligation in a number of respects because in addition to describing the disclosure test<sup>162</sup> it also specifies the extent of the inquiries that must be made to satisfy the test,<sup>163</sup> which alleviates troublesome questions about whether there is an obligation to disclose information that is unknown and unknowable in order not to be misleading by silence. In addition, it specifies a number of matters that affect the extent of the general disclosure test,<sup>164</sup> for example, the information required may be reduced in light of information already provided to offerees due to a mandatory disclosure obligation, or known to advisers whom investors may reasonably be expected to consult. Similarly, if the securities have a simple structure (such as an ordinary share) less information will be required than if they have a complex or unusual structure.

### *Materiality*

The imputation of a requirement for materiality in misleading or deceptive conduct was made very clearly by the Full Federal Court in the unanimous judgment in *Fraser v NRMA Holdings Ltd*. In that case the Court made the following unambiguous statement:

It is important that the adequacy of the information provided by the prospectus and supporting documents be assessed in a practical, realistic way having regard to the complexity of the proposal. In the circumstances the court should not be quick to conclude that a contravention of s52 [TPA] has occurred because other information could have been provided that was not. *The need for the applicants to establish the materiality of errors and omissions is an important step in the proof of their claims* [emphasis added].<sup>165</sup>

The addition of this threshold test is important in the context of modern commercial transactions where the dangers of prospective investors being swamped with too much detail (for example a 200 page statutory prospectus) are as great as being provided with too little information.<sup>166</sup> In *Fraser v NRMA Holdings Ltd*, after taking ‘a practical and realistic view of the effect of the statement in the overall circumstances’<sup>167</sup> it was held that even though, on an analysis of the strict legal position, the impugned statements about control of Insurance by the Association were not wholly correct — they were nevertheless a fair statement of the situation. The alternative, a long and technical explanation of the strict legal position, would be unlikely to be useful to members when making a properly informed judgment about the proposals.<sup>168</sup>

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162. Sub-section 1022(1) CL.

163. Subsection 1022(2) CL.

164. Subsection 1022(3) CL.

165. Above n 123, 604.

166. *TSC Industries, Inc v Northway, Inc*, 426 US 438 (1976) 448–9: ‘if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholder in an avalanche of trivial information — a result that is hardly conducive to informed decision making.’

167. *Ibid* 613.

168. *Ibid*.

The more general question of what amounts to ‘material’ information is discussed below in the examination of s996 CL as the terms of the s996 CL prohibition state that it applies only in respect of misstatements and omissions that are ‘material’.

### *Contributory negligence*

There is no defence of contributory negligence in respect of misleading or deceptive conduct, therefore failure to verify the representations or inadequate checks will not prevent recovery.<sup>169</sup> It has been said that ‘to hold otherwise would be akin to saying “you should not have believed me when I misled you.”’<sup>170</sup>

There are some comments that at first glance appear to imply a requirement to take reasonable care, however, a closer examination soon shows that is not the case. In *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*, Gibbs CJ stated that s52 TPA could not be intended ‘for the benefit of persons who fail to take reasonable care of their own interests.’<sup>171</sup> However, that comment must be read in the context of a consideration of the class of persons who should be considered when determining whether conduct is misleading or deceptive or likely to mislead or deceive. This point of differentiation has been summarised as follows:

One would not judge conduct as misleading or deceptive by considering its effect upon persons who are careless of their own interests. To put it another way, the fact that conduct would mislead or deceive a person careless of his own interests in relation to it, is not sufficient to enable it to be characterised as misleading or deceptive. That is not to say that if conduct is misleading or deceptive, the fact that its victim is careless will deprive it of that character.<sup>172</sup>

Similarly, reference in *Sutton v AJ Thompson Pty Ltd* to a representation that ‘no normal person would take seriously’<sup>173</sup> in fact prevents recovery due to a break in the chain of causation. In fact it is later commented in that very case that:

there is nothing in the principles cited, or in any other authority which has been brought to our attention, to suggest that a person who has been misled into entering a contract, by false representations of a type which were likely to produce that result, and in fact did so, can be deprived of his remedy because of a failure to check the accuracy of those representations [citations omitted].<sup>174</sup>

### **Misstatements in or Omissions from a Lodged Prospectus — s996 CL**

Section 996 CL gives rise to both criminal and civil liability and applies specifically to statutory prospectuses. It prohibits authorising or causing the issue of a statutory prospec-

169. *Henjo Investments Pty Limited v Collins Marrickville Pty Limited*, above n 134, 558; French J, above n 127, 264–5; see also *Haynes v Top Slice Deli Pty Limited* (1995) ATPR (Digest) 46–147, 53, 154; Lockhart, above n 127, 51–2; and for arguments in favour of proportionate responsibility: Nick Seddon, ‘Misleading Conduct: The Case for Proportionality’ (1997) 71 *Australian Law Journal*, 146.

170. Pengilley, above n 143, 7.

171. Above n 128, 6.

172. French J, above n 127, 264; and see n 137 above.

173. (1987) 73 ALR 233, 240.

174. Ibid 240–1, see also French J, above n 127 for a discussion of these issues.

tus that is defective due to either a material statement that is false or misleading or a material omission.

### *Authorise or cause the issue*

The meaning of the phrase ‘authorise or cause the issue’ is uncertain<sup>175</sup> and concerns about its possible breadth seem to create a great deal of anxiety amongst corporate advisers, particularly due to the common use of a due diligence committee for the preparation of a prospectus.<sup>176</sup>

The phrase ‘authorise or cause the issue’ is a hangover from s108 of the Companies Acts and Codes and its meaning under that act was no clearer than under the Corporations Law.<sup>177</sup> Clearly, the corporation will meet this test having the closest link to the prospectus of all, and cases have proceeded on the basis that directors who sign-off on the prospectus authorise or cause its issue<sup>178</sup> but it is uncertain as to whether this phrase extends any further.

The concept of ‘authorisation’ has been considered in copyright cases. In *University of New South Wales v Moorhouse*<sup>179</sup> (a copyright case) Gibbs J provided an analysis:

The word “authorize”, in legislation of similar intendment to s36 of the [Copyright] Act [1968 (Cth)], has been judicially considered to have its dictionary meaning of “sanction, approve, countenance”. It can also mean “permit” . . . *A person cannot be said to authorize an infringement of copyright unless he has some power to prevent it.* Express or formal permission or sanction, or active conduct indicating approval, is not essential to constitute an authorization; “Inactivity or ‘indifference, exhibited by acts of commission or omission, may reach a degree from which an authorization or permission may be inferred.’” *However, the word “authorize”*

175. Greg Golding, ‘Where does the Director Really Stand (Pt1)’ (1997) 7 *Australian Journal of Corporate Law* 177, 179; Norman O’Byrne, ‘Prospectus Liabilities and Defences’, *Centre for Professional Development — New Corporations Law Conference* (March 1991) 3.

176. For a discussion of the due diligence committee approach to prospectus preparation see: Stephen Minns and Greg Golding, ‘Prospectus Due Diligence — A Focused Approach’ (1993) 11 *Company and Securities Law Journal* 542; Bob Austin and Norman O’Byrne, ‘Due Diligence Procedures to Protect Directors’, *New Prospectus Laws IIR Conference* (March 1993) 17; R M A Mangioni and J P Hambrook, ‘Fundraising’, *Australian Corporations Law — Principles and Practice Looseleaf Volume 2* (1997) para 7.4.0163.

177. Securities Information Review Committee, *Reforming the Law Relating to Offers of Securities — An Interim Report* (July 1988) p17 which notes the uncertain meaning of this phrase; see also Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 66 and 95 recommending that the persons who ‘authorise or cause’ the issue should be prescribed and limited (in the case of a primary issue) to directors, underwriters and promoters (with the caveat that ‘promoters’ should not include experts merely because of their role on the due diligence committee).

178. *Flavel v Giorgio* (1990) 2 ACSR 568; contra Bob Austin and Norman O’Brien, ‘Due Diligence Procedures to Protect Directors’ (March 1993) *New Prospectus Laws IIR Conference* 17: ‘But the fact that the director must sign [the prospectus under s1021(13) CL] does not of itself imply that by doing so they authorise or cause the issue of the prospectus document. Certainly the section does not say so. In normal circumstances the prospectus will be issued only upon a resolution of the board. But in so resolving, the directors act as a corporate organ rather than in their individual capacities. It would be consistent with general corporate theory to conclude that the directors’ resolution is an act of authorisation or causing the issue on the part of the company, but not on the part of each individual director.’

179. (1974–1975) 133 CLR 1.



*connotes a mental element and it could not be inferred that a person had, by mere inactivity, authorized something to be done if he neither knew nor had reason to suspect that the act might be done. [Emphasis added and citations omitted.]*<sup>180</sup>

The requirements for a mental element and the power to prevent the infringement would appear to be logical minimum requirements when considering the meaning of ‘authorise or cause the issue’ and would appear to require a greater level of control than available to corporate advisers. However, that said, the position of an underwriter in a corporate fundraising is different from other advisers and the degree of control exerted is often far greater — it may even be the case that the withdrawal of the underwriter would mean that the offer could not proceed (from a practical perspective). Therefore the position of the underwriter may be less clear than that of other corporate advisers on this analysis.<sup>181</sup>

However, there is authority against using the interpretation of ‘authorise’ in copyright cases to aid an understanding of the phrase ‘authorise or cause the issue’ in the corporate fundraising context. In *Smithers v Beveridge*,<sup>182</sup> after referring to a number of cases decided in relation to the Copyright Act 1968 (Cth), including *University of New South Wales v Moorhouse*,<sup>183</sup> Dunford J said:

The language and context of the statutes under consideration in these cases was quite different to that under consideration here and as Gummow J pointed out in *WEA International Inc v Hanimex Corporation Ltd* [(1987) 77 ALR 456], *supra*, at 466, the use of the word “authorise” in Copyright legislation must be understood in the context of the development of such legislation over a number of years; and in my view these cases are not helpful in the construction of the Companies (NSW) Code.<sup>184</sup>

The breadth of the class of persons who fall within the ambit of s996 CL is an essential question when considering criminal liability under s996. However, it is far less important in the context of civil liability due to the interaction of ss 996, 1005 and 1006 CL. That is, in a civil claim under s1005 CL to recover loss or damage flowing from a breach of s996 CL, s1006 CL will deem persons who fall within the extremely broad classes listed in sub-s(2) to be ‘involved in the contravention’. In addition, persons who in fact ‘authorised or caused the issue’ of the defective prospectus will be liable as persons who ‘engaged in’ the contravention, and accessories within the s79 CL definition will also be liable as persons ‘involved in’ the contravention.

### **Materiality**

Section 1006 CL will apply to all civil actions under s1005 CL that are based on a breach of s996 CL because the terms of s996 CL are very similar to but slightly narrower than the

180. *Ibid* 12.

181. For a discussion of the position of underwriters under s996 CL see Greg Golding, ‘Underwriters Liability in Australian Securities Offerings’ (1993) 11 *Company and Securities Law Journal* 401, 407–8.

182. (1994) 14 ACSR 197, 204–5 considering s107 Companies (NSW) Code and the liability of experts as accessories to those who authorised or caused the issue of the prospectus.

183. (1974–1975) 133 CLR 1.

184. *Above* n 182, 204.

terms of s1006 CL. Both sections are expressed to apply where a prospectus has been issued which contains a material statement that is false or misleading or from which there is a material omission, however, the scope of s996 CL is also limited to prospectuses that are required to be lodged under Part 7.12 CL whereas no such limitation is included in the terms of s996 CL.

The requirement for materiality is an appropriate *de minimus* filter and is no more onerous on the plaintiff than the requirement for materiality that is implied in s52 TPA (and therefore s995 CL) which has been discussed above.

The Corporations Law does not provide a definition of materiality for the purposes of either the prospectus provisions or the liability provisions and there is no Australian authority on this issue. Clearly, in order to be 'material' it must be pertinent or germane<sup>185</sup> however that definition does not provide sufficient detail about the requirement.

It has been suggested by ASIC that, for the purposes of the supplementary prospectus provisions,<sup>186</sup> 'a statement or omission is material if it is objectively capable of influencing the decision making of a person who commonly invests in securities (see s1001D and 1002 C [CL]).'<sup>187</sup> The references to material statements that are false or misleading and material omissions are echoed in s996 CL. In light of the use of the same language and the relationship between s996 and the prospectus provisions (s996 CL is intended to uphold the integrity of statutory prospectuses) it would seem reasonable to assume that 'material' is used in the same context in both provisions.

However, ASIC's interpretation of materiality has not been adopted by commentators who instead look to the United States jurisprudence as potentially relevant in the Australian context.<sup>188</sup> The United States position is intended to provide an appropriate balance between disclosing sufficient information and not burying prospective investors in 'an avalanche of trivial information'.<sup>189</sup> For this reason the United States Courts have rejected the suggestion that materiality should attach to 'a fact that a shareholder *might* consider important [as], "too suggestive of mere possibility, however unlikely"' [citation omitted].<sup>190</sup> The Court instead formulated a test that:

there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.<sup>191</sup>

185. Shorter Oxford Dictionary; quoted in Robert Austin, 'The New Prospectus Provisions in Operation: A Review' (1991) 4(1) *Corporate & Business Law Journal* 1, 16.

186. See s1023B CL which requires a supplementary prospectus to be lodged if a statutory prospectus becomes deficient because it contains a *material statement that is false or misleading* or there is a *material omission* from the prospectus.

187. Australian Securities and Investments Commission, *Practice Note 60 Updating and Correcting Prospectuses and Application Forms* (23 January 1995, last updated 8 October 1997) para 5.

188. Golding, above n 175, 180–1; Baxt, Ford and Black, above n 119, 106; Brenda Marshall, 'Section 52 of the Trade Practices Act and the External Legal Order: Lessons from the NRMA Case' (1996) 4 *Trade Practices Law Journal* 126, 130; see also Austin, above n 185, 16–17. Contrast H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (8th ed, 1997) 910 where the s1022 CL test is favoured over the ss1001D and 1002C CL formula.

189. *TSC Industries, Inc v Northway, Inc*, above n 166, 448–9; see also discussion at n 166.

190. *TSC Industries, Inc v Northway, Inc*, above n 166, 449.

191. *Ibid.* This test was expressly adopted in *Basic Incorporated v Levinson* 485 US 224 (1988) 231–2.

### ***False or misleading statements***

In my submission the use of the words, ‘false or misleading’ in the first limb of the s996 CL prohibition will proscribe exactly the same conduct in the context of a statutory prospectus as the words ‘misleading or deceptive’ in s52 TPA and s995 CL. This is submitted to be the case due to the common use of the broad term ‘misleading’ which in each case is associated with a narrower term, ‘false’ in the case of s996 CL, and ‘deceptive’ in the context of s995 CL.

It was said by Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* that ‘deceptive’ adds nothing to ‘misleading’ therefore it is not necessary to delve into whether the word deceptive should be read with a negative connotation. Both ‘misleading’ and ‘deceptive’ conduct share the meaning ‘to lead into error’.<sup>192</sup>

A similar conclusion can be drawn from the use of the words ‘false or misleading’ as a ‘false’ (ie untrue) statement would appear to be a subset of ‘misleading’ statements. That is, one way of misleading an investor is to provide false information. This view is supported by the definition of ‘false’ in the Macquarie Dictionary as: ‘deceptive; used to deceive or mislead’.

### ***Omissions***

The second limb of s996 CL proscribes material omissions from a statutory prospectus. No definition of material omissions is provided for the purposes of Part 7.11 CL which leaves two possible constructions of what amounts to a material omission from a statutory prospectus.

The first is that s996 CL contains a disclosure requirement that is additional to the disclosure obligation found in Part 7.12 CL. If this is the case, in addition to satisfying the disclosure obligations found in Part 7.12 CL when preparing a statutory prospectus, including the general disclosure test in s1022 CL (the crux of which requires all of the information that investors and their professional advisers would reasonably require and reasonably expect in order to make an informed investment decision),<sup>193</sup> an issuer must also consider whether there is any material omission from the prospectus.

So, for example, after meeting the requirements of s1022 CL by providing all of the information that investors and their professional advisers would reasonably require and reasonably expect in order to make an informed investment decision, on this view, it would also be necessary to include any other information that is objectively capable of influencing the decision making of a person who commonly invests in securities.<sup>194</sup>

192. (1981) 42 ALR 1, 6.

193. For a recent analysis of the level of disclosure required to satisfy s1022 CL see *Exeter Group Limited v Australian Securities Commission* (Administrative Appeals Tribunal, Mr B J McMahon, 25 May 1998).

194. When considering material omissions in the context of the supplementary prospectus provisions (see for example s1023B CL) ASIC has stated that in its view a material omission in the context of a statutory prospectus is something that is ‘objectively capable of influencing the decision making of a person who commonly invests in securities (see s1001D and 1002C [CL]).’: Australian Securities and Investments Commission, above n 187, para 5.

This construction has many flaws (certainly enough to be fatal). Firstly, it would imply a test that is not found in Part 7.12 CL despite the fact that Part 7.12 CL appears to provide a complete code for prospectus disclosure. Secondly, it would nullify the elements of s1022 CL that attempt to place reasonable limits on the amount of information that must be included in a prospectus. For example, the reasonable requirements of investors and their advisers are tempered by their reasonable expectations<sup>195</sup> and s1022(3) CL lists a number of factors that may reduce the level of information that must be disclosed. Finally, ASIC has the power to modify and exempt from the disclosure obligation under ss1084(2) and (6) CL but no power to modify or exempt from the liability provisions (including s996).<sup>196</sup> Therefore a modification or exemption from any part of the disclosure obligation would be of no benefit if it resulted in a material omission from the prospectus.<sup>197</sup>

The second and preferred construction is to read s996 CL in light of the provisions it is meant to uphold (the disclosure provisions of Part 7.12 CL). This reading would give s996 CL an operation equivalent to s995 CL and s52 TPA in respect of omissions as none of these provisions is read to impose a disclosure requirement of its own. However, when there is a reasonable expectation of disclosure in the prospectus context due to the statutory disclosure obligation, the prohibition will be read in light of that obligation to disclose.

### Similarities Between ss996 and 995CL

Thus we have seen that a breach of s996 CL should also amount to a breach of s995 CL and s52 TPA for two reasons. Firstly, they each apply to conduct that is misleading (whether because it is false, deceptive or otherwise), although s996 CL has a more restricted ambit as it applies only where the conduct is a misleading statement in a prospectus whereas s995 CL and s52 TPA apply to broader categories of conduct. Secondly, s996 CL, s995CL and s52 TPA each apply to material omissions from a statutory prospectus that result when the statutory disclosure obligation is not met. In the case of s996 this is because such omissions are specifically prohibited and, in the case of s995 CL and s52 TPA, because silence is misleading or deceptive when there is a reasonable expectation that the information would be disclosed if it exists. In the context of a statutory prospectus, the reasonable expectation must be that the statutory obligation will be satisfied.

195. Reasonable expectations will often temper the level of detail needed to meet the reasonable requirements of investors and their advisers. For example, information about the company's products would be a reasonable requirement but details of secret formulae would not be reasonably expected. This relationship between reasonable expectations and reasonable requirements has been clarified in the CLERP Law Reform Proposals: Corporate Law Economic Reform Program, *Commentary on Draft Provisions* (17 March 1998) 7.

196. Although s996 CL can be indirectly avoided by removing the obligation for a statutory prospectus (this could be achieved by exempting from Part 7.12 CL on condition that a certain level of disclosure is made to prospective investors).

197. For example, if ASIC grants relief under s1084(6) CL modifying the disclosure obligation in s1022 CL, such relief would be useless if compliance with the modified s1022 CL was insufficient to satisfy the requirements of s996 CL.

## Chapter 7

# Relationship Between the Prohibitions and the Defences

The extent to which the defences in ss1007 — 1011 CL apply in respect of a defective statutory prospectus has been the subject of much debate. The question that arises is whether the defences apply to a civil action under s1005 CL in respect of a breach of s995 CL for a prospectus which is defective due to a material statement that is false or misleading, or a material omission. It is accepted that the defences would apply if such an action was brought in respect to a breach of s996 CL.

Section 1006 CL provides a list of persons who will be deemed to be involved in a contravention for the purposes of a civil action under s1005 CL. There is a close match between s1006 CL and s996 CL as both apply only to conduct involving a material statement in a prospectus that is false or misleading or a material omission from a prospectus. However, s996 CL is narrower than s1006 CL in one respect — the s996 CL prohibition applies only to prospectuses that are required to be lodged with ASIC, and not to excluded prospectuses.<sup>198</sup> Section 1006 does not include (or imply) a similar limitation on its face.

On the other hand, s995 CL applies to misleading or deceptive conduct in connection with any dealing<sup>199</sup> in securities,<sup>200</sup> including any prospectus issued in relation to securities. Clearly s995 CL is wider than both s996 CL and s1006 CL, as it applies to more than misleading or deceptive conduct in relation to both statutory and excluded prospectuses. But, as has been discussed above, s995 CL also prohibits the class of conduct prohibited by s996 CL, that is, statutory prospectuses that are defective due to either a material statement that is false or misleading or a material omission from the prospectus.

It follows naturally that s995 CL will also prohibit such conduct (ie material false or misleading statements or material omissions) in relation to an excluded prospectus. However, it would be necessary for such a test to be applied differently in respect to omissions from an excluded prospectus as it would be necessary to apply the 'reasonable expectations' test<sup>201</sup> and examine the fiduciary duty of disclosure under the general law<sup>202</sup> which is different from the statutory obligation of disclosure under Part 7.12 CL.

The alignment between ss996CL and 1006CL raises questions not just about the ambit of s1006 CL itself, but also in relation to the breadth of application of the defences that

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198. See definition of 'excluded prospectus' in s9 CL.

199. See the broad definition of 'deal' in s9 CL.

200. See s92(1) CL definition of securities. However, for the purposes of s1018 CL, s92(2) CL provides the relevant definition due to the requirement for the securities to be 'of a corporation'. For example see Australian Securities and Investments Commission, *Policy Statement 56: Prospectuses* (20 May 1996, last updated 4 August 1997) paras 94 and 184.

201. See discussion above in Chapter VI under the *Silence and Half Truths* heading at about f-n 155.

202. See discussion at n 158 above.

apply, for the most part, to the classes of persons who are listed in s1006 CL.<sup>203</sup> This must be explored in order to understand when the defences found in ss1007 — 1011 CL apply in the context of an issue of a defective statutory prospectus.

It has been argued that the similarity of language between s996(1) CL and s1006(1) CL, when examined with reference to the derivation of these sections from s107 of the previous Companies Code, supports the contention that the operation of s1006 CL is limited to the s996 CL prohibition.<sup>204</sup> It is also contended that Parliament intended that s995 CL operate in the same way as s52 TPA which provides no defences to civil liability.<sup>205</sup> However, it is respectfully submitted that these arguments cannot prevail over the plain meaning of the provisions which in no way excludes s995 CL from s1006 CL and the defences.<sup>206</sup>

It is interesting to note that, prior to 18 December 1991, the alignment between s996 CL and 1006 CL was complete as they were both expressed to apply to 'prospectuses'. However, s996 was modified, initially not to apply to excluded offers, and later to be limited to prospectuses required to be lodged under Part 7.12 CL, because of concerns that if the provision applied in respect of prospectuses generally<sup>207</sup> the content of unregulated offer documents (ie excluded prospectuses) would be regulated by Part 7.12 CL in a de facto way through s996 CL.<sup>208</sup> No modification was made to s1006 to narrow its scope to statutory prospectuses. Thus, on its face, s1006 and the defences that follow continue to apply to all 'prospectuses' as defined in s9 CL in the same way that s996 applied to all 'prospectuses' before the 18 December 1991 modification.

It has been argued that reading s1006 CL as applicable to s995 CL leads to a result that 'seems so odd that it is unlikely to have been intended.'<sup>209</sup> This argument is based on the following example:

Suppose that whether the plaintiff founded a case on s996 or s995, the persons listed in s1006 could be persons involved in the contravention. But if the plaintiff alleges some misleading or deceptive conduct other than a misleading statement or material omission, there is no warrant for applying s1006 to the case. Accessorial liability would then have to depend on s79. The plaintiff would then have the burden of proving the state of mind of the accessory. Hence we arrive at the result that for some contraventions of s995 the plaintiff would not have the burden of proving the accessory's state of mind and for others the plaintiff would have that burden.<sup>210</sup>

203. Vicky Priskich, 'Webb Distributors Revisited: The Interaction Between the Principle of Preservation of Share Capital in Winding up to Claims for Misleading and Deceptive Conduct' (1998) 16 *Company and Securities Law Journal* 35, 44.

204. Robert Baxt and HAJ Ford and Ashley Black, *Securities Industry Law* (5th ed, 1996) 81–82.

205. Explanatory Memorandum to the Corporations Bill 1988 (Cth) 723–4, paras 2956–2962: 'This clause [s995] is drafted along the lines of TPA s. 52 and will operate in addition to the specific prohibitions found in the [Corporations] Bill': para 2958. See H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (8th ed, 1997) 911.

206. D. J. Gifford and K. H. Gifford, *How to Understand an Act of Parliament* (7th ed, 1991) 90: 'The words of an Act must be given their plain meaning even if doing so creates practical difficulties: "these difficulties cannot displace the plain meaning of words." It is for Parliament and not for the courts to cure any injustice in what Parliament has enacted.' See also Michael Gillooly, 'Misleading or Deceptive Conduct Under Section 995 Corporations Law' (July 1995) *Centre for Commercial and Resources Law Misleading or Deceptive Conduct Conference*, 15.

207. See definition of 'prospectus' in s9 CL: 'in relation to securities of a body corporate, means a written notice or other instrument: (a) inviting applications or offers to subscribe for securities; or (b) offering securities for subscription.'

208. Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 92–3.

209. Baxt, Ford and Black, above n 204, 82.

210. *Ibid* 82–3.

In my respectful submission this is not an odd result at all. Firstly, it is appropriate that the plaintiff only have the advantage of deemed liability in the context of the prospectus — as this is the document that must be prepared with the utmost of care and diligence such that those involved in its preparation should be liable for its defects (to the extent that they could be prevented by exercising due care). In addition, there will be no regulatory gap in the context of a written document such as a prospectus, as statements in the document and omissions from the document form the bounds of liability in respect of the ‘prospectus’ itself.

Similarly, if we examine the other side of the coin, that is, the benefits of the defences available to defendants who are subject to deemed liability — the result will also be shown not to be odd. In the securities context the carefully constructed liability and defence regime is an appropriate adjunct to the mandatory disclosure obligation which is concerned with the efficient allocation of resources and the voluntary assumption of risk by investors.<sup>211</sup> In contrast, conduct outside of the prospectus, which is not forced on the issuer at law but is instead discretionary (such as advertising of the offer), does not warrant the protection of the statutory defences.

In fact it is the opposite contention that would produce an odd result, that is, ‘it seems ludicrous to introduce a complex regime of liability provisions tempered by due care defences at the same time as introducing a separate regime of strict liability for the same conduct.’<sup>212</sup> Therefore, it would appear that an argument to reject the literal meaning of the words in s1006 CL because it leads to ‘so great an absurdity or so great an injustice that a court must give a more restricted meaning to it’<sup>213</sup> should not be accepted.

Although these arguments are not as strong in relation to an excluded prospectus — due to the absence of any statutory mandatory disclosure obligation and the fact that it is less clear what will amount to an omission from such a prospectus — it is nevertheless not unreasonable for s1006 CL and the defences to apply to an excluded prospectus. This is because the mere fact that the excluded prospectus offers securities will cause it to be treated as requiring conduct of utmost good faith<sup>214</sup> and therefore it is not illogical to expect all those responsible for its preparation to take responsibility for it, subject to appropriate defences that encourage due care while recognising the function of risk allocation inherent in securities transactions.<sup>215</sup>

211. See discussion above in Chapter III under the *Why Mandate for Disclosure?* heading and in Chapter IV under *The Public Policy of Legislative Liability* heading.

212. Greg Golding, ‘Underwriters Liability in Australian Securities Offerings’ (1993) 11 *Company and Securities Law Journal* 401, 424.

213. *Mangin v Commissioner of Inland Revenue* [1971] AC 739, 746; quoted by Gifford and Gifford above n 206, 94.

214. *The New Brunswick and Canada Railway and Land Company v Muggeridge* (1860) 1 Dr and Sm 418, 425. See also *The Directors of the Central Railway Company of Venezuela v Kisch* (1867) LR 2 HL 99, 113.

215. The Simplification Task Force accepted that it was arguable that the defences apply to a breach of s995 where the misleading or deceptive conduct is constituted by a false or misleading statement in or an omission from a prospectus and that ‘[t]his view is at its strongest in connection with prospectuses required by the Corporations Law to be lodged with the ASC.’: Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 27.

Another argument that has been made in support of the application of the defences to s995 CL is as follows:

Further support for this conclusion can be obtained from the principle of statutory interpretation of “*generalalia specialibus non derogant*”. On this basis it can be argued that s. 995, as a remedy of broader application than s. 996, should be read as subject to the defences relevant to s. 996, to the extent of any overlap between the two provisions.<sup>216</sup>

Finally, it is suggested that the intention of Parliament in respect of the interrelationship of these provisions is confused at best. For example, in addition to comments (referred to above) about intending s995 CL to operate in the same way as s52 TPA,<sup>217</sup> the Explanatory Memorandum to the Corporations Bill 1998 also states that:

[t]he [Corporations] Bill aims to make all of the persons involved in the preparation of a prospectus responsible for the prospectus. At the same time it can be noted that the provision does not act indiscriminately or unfairly. *Each of the persons who may be liable under cl. 1005 is provided with a defence* [emphasis added].<sup>218</sup>

This intention could not be achieved if s1006CL and the associated defences did not apply to s995 CL because each person who may be liable under s1005 CL would not necessarily be provided with a defence. That would be entirely dependant on whether the action for a false or misleading statement in or an omission from the statutory prospectus was brought under s996 CL or s995 CL.<sup>219</sup>

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216. Golding, above n 212, 423–4.

217. See n 205 above.

218. Explanatory Memorandum to the Corporations Bill 1988 (Cth) 735–6, para 2996; see also Gillooly, above n 206, 28–9.

219. None of the above discussion is relevant to persons who are involved in a contravention by virtue of being a s79 CL accessory. If such a person does not also fall within one of the categories in the s1006 CL list, and is thereby unable to take advantage of the defence regime, then, subject to knowledge of the facts that make up the essential elements of the offence, such an accessory will be treated more harshly than a principal who, for example, authorised or caused the issue of the defective prospectus. This would appear to be a defect in the legislation and has been subject to law reform recommendations: Companies and Securities Advisory Committee, above n 208, 96.



## Chapter 8

### Overlap of s995 CL and s52 TPA, and the Side Wind Argument

It has been said that the argument about the application of the defences to s995 CL is now ‘of academic interest only in that the plaintiff can overcome the argument by pleading liability based on s52 [TPA] rather than s995 [CL].’<sup>220</sup> This is said to be demonstrated by *Fraser v NRMA Holdings Ltd*.<sup>221</sup> However, in my submission, that case can be argued to support the argument that whilst, ‘[t]he Trade Practices Act is unquestionably a piece of innovative legislation...it is not to be seen as eliminating, “by a side wind”, the detailed provisions’<sup>222</sup> relating to fundraising.

It is indisputable that s52 TPA is not subject to any defences to civil liability,<sup>223</sup> whereas, as discussed above, there are strong arguments in favour of the view that s995 CL (in addition to s996 CL) is subject to the defences in ss1007-1011 CL in respect to the issue of a defective statutory prospectus. The question that follows is, does s52 TPA render that carefully balanced structure of liability and defences useless and replace it with strict liability — whatever the cost?

The Trade Practices Act 1974 (Cth) provides an extremely far reaching prohibition in s52 which, if given an unfettered operation would, in certain circumstances, have unintended and undesirable consequences. Such consequences were considered in *Parkdale Custom Built Furniture Ltd v Puxu Pty Ltd*.<sup>224</sup> There Brennan J stated:

It would be surprising if s52 of the Trade Practices Act were to alter the “careful balance” of the Patents Act 1952 and the Designs Act by a side-wind and, after four centuries, open the way to the creation of prescriptive monopolies in the manufacture of goods.<sup>225</sup>

This argument was then used by Brennan J to limit the operation of s52 TPA with reference to the ‘milieu of the external legal order’.<sup>226</sup> The result of this analysis was that a consumer who was ‘not labouring under any mistake or imperfection of understanding of law’<sup>227</sup> would not be misled or likely to be misled by a manufacturer who

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220. Greg Golding, ‘Prospectus Misstatement Liability in the 1990s: Where Does the Director Really Stand (Pt 2)’ (1997) 7 *Australian Journal of Corporate Law* 299, 323.

221. (1995) 15 ACSR 590; *ibid*.

222. *Webb Distributors (Aust) Pty Ltd & Ors v The State of Victoria* (1993) 11 ACLC 1,178, 1,186; and see *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 42 ALR 1, 27.

223. Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 8, 11 and 32.

224. Above n 222.

225. *Ibid* 27.

226. *Ibid*.

227. *Ibid*.

exercised their right to manufacture goods using a design that is not protected by a valid registration.

This reasoning was approved and adopted in the majority judgment of the High Court in *Webb Distributors (Aust) Pty Ltd v The State of Victoria*.<sup>228</sup> In that case the extent to which s52 TPA and winding up provisions of the predecessor to the Corporations Law<sup>229</sup> had a concurrent application was canvassed. The argument was that any claim under the Trade Practices Act 1974 (Cth) was unaffected by s360(1) of the Companies (Victoria) Code.

If this argument was successful, members who had subscribed in reliance on misleading or deceptive statements would be able to recover damages despite the fact that they maintained their character as members of the company and the company was now in liquidation. Ordinarily such shareholders would rank behind creditors and, therefore, if the payment of creditors exhausted the assets of the company, they would not be able to recover their losses in a liquidation.<sup>230</sup>

The majority of the High Court (Mason CJ, Deane, Dawson and Toohey JJ [McHugh J dissenting]) rejected the argument that the Trade Practices Act had a concurrent operation with the winding up provisions of the Companies (Victoria) Code based on Brennan J's side wind argument. After examining s360 Companies (Victoria) Code which 'does not, in terms, preclude an action under s. 52 [TPA]'<sup>231</sup> and stating their opinion that '[c]learly, the Trade Practices Act is not concerned to regulate the position as between members of a company and its creditors,'<sup>232</sup> the Court made the following finding:

The Trade Practices Act is unquestionably a piece of innovative legislation. But it is not to be seen as eliminating, "by a side-wind", the detailed provisions established for more than a hundred years to govern the winding up of a company [citation omitted].<sup>233</sup>

The situation in respect of s52 TPA and s995 CL is slightly different. *Fraser v NRMA Holdings Ltd*<sup>234</sup> is authority for the proposition that s52 TPA does have a concurrent operation to s995 CL. However, in that case the finding of concurrent liability was limited to the facts of the case and only in respect of an application for an injunction. This is a critical factor because an application for an injunction under the Corporations Law for a breach of s995 CL is not subject to any defences, as is the case for an injunction application under the

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228. Above n 222.

229. Section 360 Companies (Victoria) Code.

230. 'Section 360 [Companies (Victoria) Code] imposes an obligation on members to contribute to the payment of all the liabilities of a company in liquidation. Paragraph (e) limits that obligation to the amount unpaid on the members' shares. Paragraph (k) subordinates sums due to a member in his or her capacity as a member to sums due to non-members . . . [However] it should be noted that s. 360(1)(k) provides that a sum due to a member in his or her capacity as a member may be taken into account for the purposes of the final adjustment of the rights of contributors amongst themselves. To that extent the member with a claim against the company occupies a preferred position to other members.': *Webb v Distributors (Aust) Pty Ltd v The State of Victoria* above n 222, 1,184–5.

231. Ibid 1,185.

232. Ibid 1,186.

233. Ibid.

234. Above n 221.

Trade Practices Act for a breach of s52 TPA.<sup>235</sup> Therefore, in the case of an application for an injunction for a breach of either s995 CL or s52 TPA, 'the relevant proscription is expressed in identical terms . . . [and] the issues for determination would have been substantially the same.'<sup>236</sup>

Thus no support is provided on the facts of this case for the assertion that s52 TPA would be permitted to eliminate, by a 'side-wind', the careful balance created by the prospectus liability provisions. In fact, support for the proposition that s52 TPA should be read down so as not to provide for civil liability in circumstances where the defences in ss1007–1011 CL would provide a defence was provided with the following statement:

It was submitted that applicants should not be able to avoid an unfavourable construction of s995 [CL] in connection with a dealing in securities by resorting to s52 [TPA]. With that submission we agree and we do not understand anything said by the learned trial judge to suggest otherwise. As Brennan J said in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 225; 42 ALR 1:

Section 52 operates in a milieu of the external legal order, so that the character of conduct which falls for consideration under s52 is to be determined by reference to the external legal order as it exists when the conduct is engaged in.

That observation is equally applicable to s995 [CL].<sup>237</sup>

By relying on this obiter from *Fraser v NRMA Holdings Ltd*<sup>238</sup> and the cases in which the operation of s52 TPA has been curtailed so as to not destroy an established regime of detailed provisions<sup>239</sup> it is arguable that strict liability will not lie under s52 in respect of a defective statutory prospectus.<sup>240</sup> Such an interpretation is also in step with international practice in the securities arena. For example, it is consistent with the way in which the general securities law misstatement rule (Securities and Exchange Commission Rule 10b-5)<sup>241</sup> has been read down in the United States.

235. Corporations Law Simplification Task Force, above n 223, 8, 24 and 32.

236. *Fraser v NRMA Holdings Ltd*, above n 221, 600.

237. *Ibid* 599.

238. *Ibid*.

239. Above n 222.

240. This argument was acknowledged by the Corporations Law Simplification Task Force, above n 223, 32: 'Although the court in *Fraser v NRMA* stated that an unfavourable interpretation of section 995 [CL] could not be avoided by reliance on section 52 [TPA], it is not clear whether the action would have failed if it had been for damages rather than for an injunction.' For a consideration of the 'side-wind' argument in this context see: Michael Gillooly, 'Misleading or Deceptive Conduct Under Section 995 Corporations Law' (July 1995) *Centre for Commercial and Resources Law Misleading or Deceptive Conduct Conference* 31–36; Brenda Marshall, 'Section 52 of the Trade Practices Act and the External Legal Order: Lessons from the NRMA Case' (1996) 4 *Trade Practices Law Journal* 126, 140–3 (note that the author assumes that *Fraser v NRMA Holdings Ltd* involved an action for damages to which the due diligence defences could apply, when in fact injunctive and declaratory relief, which are not subject to due diligence defences under the Corporations Law, were sought; see p142); Vicky Priskich, 'Webb Distributors Revisited: The Interaction Between the Principle of Preservation of Share Capital in Winding up to Claims for Misleading and Deceptive Conduct' (1998) 16 *Company and Securities Law Journal* 35, 42–44; Michael Legg, 'Misleading and Deceptive Conduct in Prospectuses' (1996) 14 *Company and Securities Law Journal* 47, 49–52.

241. Promulgated under the Securities Exchange Act 1934 (US).

Rule 10b-5(2) (US) provides that it is unlawful ‘to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.’ This provision has been read down to require the mental element of ‘scienter’, that is, an intention to defraud or possibly a reckless disregard. When considering the argument that negligence should be sufficient, the United States Supreme Court said:

Such extension [to a negligence standard] would allow causes of action covered by ss11, 12(2) and 15 to be brought instead under s10(b) and thereby *nullify the effectiveness of the carefully drawn procedural restrictions on these express actions* [emphasis added].<sup>242</sup>

This argument finds a close parallel to the side-wind argument discussed above in the context of Australian securities regulation.

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242. *Ernst and Ernst v Hochfelder et al* 425 US 185 (1975); quoted in Greg Golding, ‘The CLERP Fundraising Proposals’ (18 February 1998) *Corporations Law Reform Conference* 19.

## Chapter 9

# Defences to Civil Liability under the Corporations Law

Liability for a defective prospectus arising out of a civil action under s1005 CL is subject to the defences in ss1007–1011 CL. These provisions provide defences for each of the categories of persons listed in s1006 CL and any person who was engaged in the proscribed conduct by authorising or causing the issue of the prospectus. Defences are provided according to the level of involvement in the preparation of the prospectus required of persons who fall within each of the categories.

The requirements of these defences must be considered before any fundraising activity relying on a statutory prospectus is undertaken. This is because a clear understanding of the circumstances in which the defences apply is necessary in order to develop a process that results in a level of risk for each person involved in the issue of the prospectus that is sufficiently low to justify raising funds using a statutory prospectus. The process by which the risk of civil liability is minimised is commonly described as ‘due diligence’.

### Knowledge of the Defect — s1007 CL

A defence is provided under s1007 CL for persons who authorised or caused the issue of a prospectus (such persons would be those who engaged in a contravention relating to the issue of a defective prospectus) and all persons who are deemed to be involved in such a contravention by virtue of being within one of the classes specified in the s1006(2) CL list. The defence states that such persons will not be liable to a person who ‘subscribed for the securities to which the prospectus relates’ for loss resulting from a defective prospectus. Therefore, knowledge of the defect will be fatal to a civil action under s1005 CL brought by a subscriber against a defendant who falls within one of the categories in the s1006(2) CL list.

As noted in the discussion relating to the ambit of s1005 CL above,<sup>243</sup> subscribers would not seem to be the only persons who can suffer loss as a direct result of a defective prospectus. Therefore, it may be that this defence is too narrow to prevent recovery by all persons with knowledge of the defect in the prospectus. However, that should not concern issuers because, as was discussed above,<sup>244</sup> recovery should be unavailable due to a lack of causation.

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243. See discussion above in Chapter 5 under the *Causation* heading at n 58.

244. See discussion above in Chapter 5 under the *Multiple Causes* heading at n 62.

## Non-consenting Directors — s1008 CL

Persons who were directors at the time of the issue of the prospectus and persons who authorised or caused themselves to be named in the prospectus, and are named in the prospectus as a director, or as having agreed to become a director, are deemed to be involved in a contravention involving the issue of a prospectus under ss1006(2)(b) and (c) CL and consequently have the benefit of this defence. The common factor for all persons who fall within the s1006(2)(c) CL category is that they are all named in the prospectus, either as directors or proposed directors. The purpose of naming directors is to lend credence to the prospectus. This defence applies in respect of liability under s1005 CL for a defective prospectus (whether due to a false or misleading statement or omission).

A person in either of these categories has a defence if the prospectus was issued without their knowledge or consent and reasonable public notice of this fact is given as soon as practicable after becoming aware of the issue of the prospectus.<sup>245</sup> A defence is also available to a person in either category if they withdraw their consent to the issue of the prospectus (on becoming aware of the defect) and give reasonable public notice of the withdrawal including reasons. This option is available for withdrawals after the issue of the prospectus but prior to the allotment or issue of securities under the prospectus.

In addition, a proposed director who is named in the prospectus under s1006(2)(c) CL has a defence by withdrawing consent to become a director before the issue of the prospectus as long as the prospectus was issued without that person's authority or consent.<sup>246</sup> There is no need for public notice in respect of this defence. This is appropriate policy because such a person has no involvement in the issue of the prospectus and the link with the issuer has been broken. The requirement in s1021(13) CL for all directors and all persons named in the prospectus as proposed directors to sign the prospectus will mean that this defence will usually be unavailable (except, for example, in a case where the director's signature has been forged).

When considering who has deemed liability under ss1006(2)(b) and (c) CL and, consequently, the benefit of a number of defences, including s1008 CL, it is necessary to examine the extended definition of 'director' in s60 CL. This provision extends beyond directors who have been validly appointed and includes *de facto* directors and shadow directors.<sup>247</sup>

A *de facto* director is caught within the subgroup of s60(1)(a) CL which includes 'a person occupying or acting in the position of director of the body, by whatever name called and whether or not validly appointed to occupy, or duly authorised to act in, the position.' Even though a 'de facto director' has not been appointed, he or she acts as a director, whether through a nominee or directly.

245. Another option is given in s1008(1)(3) CL in relation to the time in which public notice must be given. This option is as soon as practicable after the prospectus was issued. However, this would appear to add nothing to the first option, that is, as soon as practicable after the person became aware after the issue of the prospectus. This is because the second option will also cover the case where the person knew at the time the prospectus was issued and so gave notice as soon as practicable after the prospectus was issued.

246. Subsection 1008(2) CL.

247. Pearlie Koh, 'Shadow Director, Shadow Director, Who Art Thou' (1996) 14 *Company and Securities Law Journal* 340; H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (8th ed, 1997) 294–5.

In addition, shadow directors falling within the s60(1)(b) CL subgroup of ‘a person in accordance with whose directions or instructions the directors of the body are accustomed to act’, will be ‘directors’ for the purposes of the Corporations Law. The purpose of this provision is to ensure that persons who behave like directors cannot escape liability for acts done in that role by arguing a lack of authority.

### **Directors’ Defences for Statements of Experts and Official Persons and for the Remainder of the Prospectus — s1008A CL**

‘Directors’, as defined in ss1006(2)(b) and (c), also have 3 separate defences that relate to distinct parts of the defective prospectus.

The first applies to defective statements (encompassing both false or misleading statements and omissions) in what purports to be an expert’s statement, in a statement based on an expert’s statement, or in a copy or extract from a report or valuation of an expert. This defence is available if:

- it is a fair representation or a fair copy or extract of the expert’s actual statement, report or valuation; and
- the director has made such inquiries as were reasonable, had reasonable grounds to believe and did believe until the time of allotment or issue of the securities, that the expert was competent, had consented to the inclusion of the information in the prospectus as required by s1032 CL and had not withdrawn that consent.

This defence has been criticised for not having a requirement that the director actually believe in the truth of the statement<sup>248</sup> or, to put it another way, the director should not believe that there were any untrue statements or material omissions<sup>249</sup> in the material provided by the expert. Clearly it would be inappropriate for the defence to apply when there is knowledge of the defect. However, it may be that the requirement for reasonable grounds to believe and an actual belief in the competency of the expert could not be satisfied if the director knew that the report was in fact defective.

‘Experts’ are defined in s9 CL as ‘a person whose profession or reputation gives authority to a statement made by him or her in relation to that matter.’ However, this defence requires not just the statement be that of an expert, but that consent has been duly given by the expert. This consent provides an important balance to the defence because it excuses the director who has taken due care in selecting an expert, but results in the expert taking responsibility for and having residual liability for their actions (subject to appropriate defences).

There is United States authority for the proposition that when considering statements ‘purporting to be made on the authority of an expert’<sup>250</sup> (ie the ‘expertised portion’<sup>251</sup> of the prospectus) it is not correct to say that the entire prospectus is ‘expertised’ because it is

248. Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 98.

249. *Escott v BarChris Construction Corporation*, 283 F Supp 643 (1968) 683.

250. *Ibid.*

251. *Ibid.*

prepared by a lawyer. Only portions of the prospectus ‘purporting to be made’<sup>252</sup> on the authority of the expert are expertised for the purpose of the defence. There is sufficient similarity between the statutory defences in s11 Securities Act 1933 (US) and s1008A(2) CL, which relates to a statement that purports to be, or to be based on, a statement made by an expert, as both require a level of directness in order for a statement to be expertised. The need for a direct link between the statement and the expert is reinforced by the link between ss1008A(2) and 1032 CL which requires consent to the specific statements of the expert made throughout the prospectus.<sup>253</sup>

The level of care that must be exhibited by the director in selecting the expert is ‘such inquiries (if any) as were reasonable’ and ‘reasonable grounds to believe’ as well as an actual belief that the expert was competent, until the securities are allotted or issued. These are also elements of the third defence and will be discussed in the context of due diligence inquiries (below).

The second defence applies to defective statements made by official persons or contained in what purports to be a public official document. In this case liability will not attach if it was a fair representation of the official’s statement or a correct and fair extract from a public official document. This case differs from that of experts as liability cannot be transferred to ‘the Crown in right of the Commonwealth or a state or territory, because its consent would not attract liability in an action under s1005 [CL] (s17(2) of the Corporations Act 1989 (Cth) and s15(2) of the Corporations Acts of the states).’<sup>254</sup> Even without the availability of another party to accept liability of the public official statements, it remains appropriate to relieve directors of responsibility for such statements as there would appear to be no public policy benefits in transferring responsibility for defective public official statements to directors.

The third defence, in s1008A(4), applies to the remainder of the prospectus. That is, the portions that are not expertised, or derived from a public official document or a statement made by a public official. This defence requires the director to have:

- made such inquiries (if any) as were reasonable;
- reasonable grounds to believe; and
- an actual belief,

that the defective statement was true and not misleading and that there were no material omissions from the defective statement. The accepted method of achieving the requisite belief is known as ‘due diligence’. (Due diligence inquiries are discussed below.)

This defence needs to be read with the following definitions of a ‘defective statement’ from s1008A(1) CL, that is:

- a false or misleading statement in the prospectus; or
- an omission from a statement in the prospectus.

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252. Ibid.

253. See Australian Securities and Investments Commission, *Practice Note 55 Prospectuses — Citing Experts and Statement of Interests* (23 January 1995, last updated 17 June 1996) paras 28–9 highlighting the obligation to refer specifically to the expert’s statement.

254. Ibid, para 35.



The reference to ‘material omissions from the defective statement’ and ‘an omission from a statement in the prospectus’ may imply a narrower treatment of omissions than the usual ‘omission from the prospectus’. If this is the correct interpretation, although a director is liable ‘in respect of conduct being the issue of a prospectus in relation to securities of a corporation . . . from which there is a material omission,’<sup>255</sup> this defence is of more limited application and applies only if the omission is from a particular statement already found in the prospectus.

Therefore, if an area of required information is completely missing from the prospectus, and it cannot be said that any particular statement in the prospectus is inadequate due to the omission, then it will not fall within this omissions defence. However, finding a link to a statement in a prospectus may not prove to be a practical problem, particularly in the context of the lengthy prospectuses currently favoured in Australia.

### **Defences for Experts and Advisers (other than underwriters and the like) — s1009 CL**

This provision provides defences for persons in three of the s1006(2) CL categories:

- experts who have consented under s1032 CL to the inclusion of their statements in the prospectus (‘experts’) — s1006(2)(e) CL;
- persons named with consent as auditor, banker, or solicitor of the corporation or for the issue (‘advisers’) — s1006(2)(g) CL; and
- persons named in the prospectus with consent as having performed a professional, advisory or other function for the corporation or the issue, other than those named in s1006(2)(e), (g) or (f) CL (‘advisers’). For completeness, s1006(2)(f) CL includes persons named in the prospectus with consent as a stockbroker, sharebroker or underwriter of the corporation or the issue.

Section 1009 CL commences by stating the maximum extent of liability of experts and advisers (sub-s(2))<sup>256</sup> before stating a variety of defences that apply in respect of that liability (sub-s(3) and (4)). These defences for experts and advisers are very similar although they cover different ground due to the differences in responsibilities.

These different responsibilities are expressed in sub-s(2) with reference to the maximum extent of possible liability. Experts will only be liable for false or misleading statements or omissions from their experts statements (this includes not just statements purporting to be made by them but also statements based on such statements — both types require consent under s1032 CL). Advisers will be responsible for omissions from the prospectus of any material matter for which the person is responsible in their purported capacity as an adviser.

255. Subsection 1006(1) CL.

256. Subsection 1009(2) CL is not expressed as a defence but as the ambit of possible liability for experts and advisers. Therefore, as a matter of construction, it would appear that a plaintiff taking action against a person falling within s1009(2) CL would have the onus of proving the elements of s1009(2) CL before the onus returns to the defendant to prove any of the defences that follow: Ford, Austin and Ramsay, above n 247, 912.

The extent to which an adviser is responsible for false or misleading statements in the prospectus is less clear. The lack of clarity results from advisers' and experts' responsibility for false or misleading statements being rolled up into a single paragraph. This does not recognise the fact that while the statements of experts will on their face purport to be made by the expert, that is not the case with the information for which the adviser is responsible (in a back-room sense) but which will not be attributed to any particular source in the prospectus. Indeed, if that information was actually attributed to the adviser they would necessarily become an expert as their consent would be required under s1032 CL.

Thus, advisers are liable only in respect of omissions (as described above)<sup>257</sup> and:

a false or misleading statement in the prospectus purporting to be made by the person as a person referred to in that paragraph, or to be based on a statement made by the person as a person referred to in that paragraph.<sup>258</sup>

As discussed above, the prospectus should not contain a statement 'purporting to be made by a solicitor' (or other of the persons within the adviser categories) or a statement 'purporting to be based on a statement made by a solicitor' (or other adviser) unless that person has consented under s1032 CL. This is because a solicitor (or other adviser) would fall within the definition of an expert in s9 CL.

The use of the word 'purporting' in both s1009(2)(a) CL and in s1032 CL implies an attribution of the statement to the maker. However, this would seem to be at odds with the role of the adviser who is not expertising portions of the prospectus, but is nevertheless responsible for its preparation. This role is recognised in s1009(2)(b) CL which stipulates that advisers will be responsible for omissions from the portion of the prospectus for which the adviser is responsible in that person's advisory capacity and provides an appropriate breadth of liability from a public policy viewpoint.

The literal reading of s1009(2)(a) CL in relation to the conduct of advisers who are not also experts would appear to produce an absurd result as such an adviser would not be liable for any false or misleading statements in the prospectus even though they appear in a portion of the prospectus for which the adviser is responsible in their advisory capacity. However, liability will result from any omissions from the portion of the prospectus for which the adviser is responsible. Therefore, it may be that s1009(2)(a) CL will be given a broad reading that attaches liability to the adviser for false or misleading statements for which they are responsible, even though those statements do not purport to be made by the adviser in an advisory capacity, nor purport to be based on a statement made by the adviser in an advisory capacity.

Once liability is established under s1009(2) CL, there are a number of defences available to experts and advisers. These defences can be described as withdrawal defences or due diligence defences and they bear a striking similarity to the withdrawal defences in s1008 CL and the due diligence defence in s1008A CL for directors.

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257. Paragraph 1009(2)(b) CL.

258. Paragraph 1009(2)(a) CL.

The withdrawal defences in s1009(3)(b) CL for experts and in s1009(4)(a) CL for advisers are in identical terms (and very similar to the s1008(4) CL defence for directors).<sup>259</sup> This defence is available if the expert or adviser withdraws their consent (in writing) to the issue of the prospectus (on becoming aware of the defect) and gives reasonable public notice of the withdrawal including reasons. This option is available for withdrawals after the lodgment of the prospectus but prior to the allotment or issue of securities under the prospectus.

There is a second withdrawal defence for experts which is less onerous than, but has some similarity to, the withdrawal defence for proposed directors under s1008(2) CL. The defence relieves experts who withdraw their s1032 CL consent (in writing) before the prospectus was lodged. This defence has an interrelationship with s1032 CL which requires that experts provide consents which have not been withdrawn prior to the issue of the prospectus. There is no similar defence for advisers. This may be because advisers are not liable under s1006 CL unless they are named with consent. Thus a withdrawal of consent would mean that such a person is not named with consent and not liable under s1006 CL.

Due diligence defences are also provided for both experts<sup>260</sup> and advisers<sup>261</sup> who must have made such inquiries (if any) as are reasonable, had reasonable grounds for the relevant belief and actually hold that belief. (Due diligence inquiries are discussed below.) The belief required of each of the categories differs due to their different responsibilities. Expert's beliefs are limited to their statements (including those based on their statements) and therefore it is sufficient if they believed the false or misleading statement to be true and not misleading, or that there were no material omissions from their expert's statements.

The defence for false or misleading statements of advisers is expressed in the same terms as the equivalent defence for experts and applies to statements made by the adviser. However, the defences for omissions are necessarily expressed more broadly as an adviser's liability for omissions is not limited to the statements that the adviser actually makes but extends to all material matters for which the person was responsible in that person's advisory capacity.

The due diligence defences for both experts and advisers also contain an obligation additional to the due diligence requirements for directors under s1008A(4) CL. The additional requirement is that an expert or adviser must be competent to make the statements for which they are responsible and an adviser must, in respect of omissions from the portion of the prospectus for which the adviser is responsible, have been competent to act in that advisory capacity.

### **Persons Named in Part Only of the Prospectus — s1010 CL**

Subsection 1010(1) CL provides a defence to the three categories of professionals who are liable due to being named, with consent, in the prospectus. They are:

259. The differences relate to the time that the defences commence (after issue of the prospectus for directors but after lodgment for experts and advisers) and there is an additional requirement for experts and advisers for their notice to be 'in writing'.

260. Paragraph 1009(3)(c) CL.

261. Paragraphs 1009(4)(b) and (c) CL.

- a stockbroker, sharebroker, or underwriter of the corporation or to the issuer (s1006(2)(f) CL);
- an auditor, banker or solicitor of the corporation or to the issuer (s1006(2)(g) CL); and
- a person who has performed or is performing in a professional, advisory or other capacity not mentioned in paragraph (e), (f) or (g). For completeness, paragraph (e) relates to s1032 CL experts.

The defence in s1010(1) CL applies when the professional is named in part only of the prospectus and provides a defence when the defect (whether a statement or omission) was not in that part of the prospectus. In addition, these professionals have a defence in the case of a statement that was not included in (or substantially in) the form and context that the person had agreed to.

These defences apply broadly in the case of a false or misleading statement in, or an omission from, the prospectus. In order to take advantage of these defences, s1010(2) CL requires the prospectus to include an express statement that the professional was only involved in the preparation of that part.

It is in order to meet this requirement and rely on the s1010(1) CL defence that prospectuses often contain statements naming the professional in the corporate directory only and stating that the professional was only involved in the preparation of that part. In order for this defence to be used in this way it would seem necessary for the professional's involvement to have actually been limited in the way described.<sup>262</sup> Otherwise, the prospectus will contain a false statement which at the very least will entitle ASIC to refuse registration<sup>263</sup> or issue a stop order<sup>264</sup> in addition to the possibility of civil<sup>265</sup> or criminal action.<sup>266</sup>

An identical defence is provided in ss1010(3) and (4) CL for the more amorphous class of persons who have authorised or caused the issue of part only of the prospectus.

The policy rationale for this defence seems confused. For the majority of the professionals who fall within the specified classes and for persons who authorise or cause the issue of part only of the prospectus, the policy of the defence, limiting responsibility to the portion for which the professional was responsible, is appropriate. However, this rationale breaks down where there is an expectation that the professional will have a role in ensuring the integrity of the entire prospectus.

This is a role that is expected of the lead underwriter due to the special role of the underwriter in pricing the offer and the expertise that an underwriter should bring when considering the kind of information that investors and their professional advisers would reasonably require and reasonably expect to be included in the prospectus. In addition, regard should be had to the significant reliance that is placed on the reputation of the underwriter by investors.<sup>267</sup>

262. Companies and Securities Advisory Committee, above n 248, 100; and see Greg Golding, 'Underwriters Liability in Australian Securities Offerings' (1993) 11 *Company and Securities Law Journal* 401, 421.

263. Section 1020 CL.

264. Section 1033 CL.

265. Sections 1005, 1324 and 1325 CL.

266. Section 996 CL.

267. Gregory Herder, 'Corporate Finance Theory and the Australian Prospectus Legislation' (1993) 6 *Corporate and Business Law Journal* 181, 202.

This understanding of the role of the underwriter is evident in the grouping of underwriters with the other persons with primary liability for the prospectus in s1011 CL<sup>268</sup> and is also a clear part of the fundraising landscape in the United States.<sup>269</sup> Therefore, for the purposes of the s1010 defence, it would seem more appropriate to differentiate lead underwriters from other finance professionals found in the s1006(2)(f) CL category for whom a lesser role in the preparation of the prospectus is acceptable.<sup>270</sup>

## **Defences for the Persons Primarily Responsible for the Preparation of the Prospectus — s1011 CL**

The defence for persons with primary responsibility for the correctness of the prospectus is provided in s1011 CL. This provision extends a defence to: the corporation; a promoter; a stockbroker, sharebroker or underwriter of the corporation or to the issue who is named with consent; and a person who authorised or caused the issue of the prospectus.

Of the categories of persons with a defence under s1011 CL, two require clarification because they do not fall within any professional occupation. They are: a person who authorised or caused the issue of the prospectus; and a promoter.

The meaning of ‘authorised or caused the issue’ has been discussed above, and it is likely that it would include a director who signs off on the prospectus under s1021(13) CL. However, it is uncertain whether it would extend further in relation to underwriters or advisers who participate in the due diligence committee.<sup>271</sup> In any case, this will be a question of fact depending on the actual level of involvement and control.

‘Promoter’, is defined in the Corporations Law as follows:

in relation to a prospectus issued by or in connection with a body corporate, means a promoter of the body who was a party to the preparation of the prospectus or of any relevant portion of the prospectus, but does not include a person merely because of the person acting in the proper performance of the functions attaching to the person’s professional capacity or to the person’s business relationship with a promoter of the body.<sup>272</sup>

The above is really more of a limitation than a defence, which is clear from the use of the language: “‘*promoter*’ . . . means a promoter . . . who’. Therefore, in order for a person who would ordinarily be considered to be a promoter to fall within this class for the purposes of prospectus liability, the promoter must have been a party to the preparation of the prospectus (or at least a part of it). In addition, it provides a circumstance, which alone, is insufficient to cause a person to become a promoter — that is, by fulfilling professional functions or due to a business relationship with the promoter.

268. Companies and Securities Advisory Committee, above n 248, 66; see also Kerry Bennett, ‘Due Diligence and Liability Under the Corporations Law’ (12 March 1991) *IIR Seminar*.

269. *Escott v BarChris Construction Corporation*, above n 249, 686–7: this case involved an action under s11 Securities Act 1933 (US) which, like s1006 CL, extends liability to a wide range of potential defendants.

270. Golding, above n 262, 421.

271. See discussion above in Chapter 6 under the *Authorise or Cause the Issue* heading.

272. Section 9 CL.

Thus the question remains, who would ordinarily be considered a promoter? Assistance in answering this question is available from the High Court in *Tracy v Mandalay Proprietary Limited*<sup>273</sup> where the following statement was made by the Court:

As used in connection with companies the term 'promoter' involves the idea of exertion for the purpose of getting up and starting a company (of what is called 'floating' it) and also the idea of some duty towards the company imposed by or arising from the position which the so-called promoter assumes towards it. It is now clearly settled that persons who get up and form a company have duties towards it before it comes into existence . . . Moreover, it is in our opinion an entire mistake to suppose that after a company is registered its directors are the only persons who are in such a position towards it as to be under fiduciary relations to it. A person not a director may be a promoter of a company which is already incorporated, *but the capital of which has not been taken up, and which is not yet in a position to perform the obligations imposed upon it by its creators* [citations omitted, original emphasis] . . .

But it is not only the persons who take an active part in the formation of a company and the raising of the necessary share capital to enable it to carry on business who are promoters. It is apparent from the passage cited that persons who leave it to others to get up the company upon the understanding that they also will profit from the operation may become promoters.<sup>274</sup>

Thus, relying on the views of the High Court in *Tracy v Mandalay Proprietary Limited*<sup>275</sup> combined with the s9 CL definition, in the prospectus context, which requires the company to already be formed,<sup>276</sup> a promoter should include persons who are involved in or profit from the formation and initial capital raising so long as they were a party to the preparation of at least a portion of the prospectus.

This defence applies to a false or misleading statement in, or omission from, the prospectus<sup>277</sup> that was:

- due to a reasonable mistake;
- due to reasonable reliance on information supplied by another person; or
- due to the act or default of another person, to an accident or to some other cause beyond the defendant's control where the defendant has taken reasonable precautions and exercised due diligence to ensure that all statements to be included in the prospectus were true and not misleading and that there were no material omissions from the prospectus.

In the context of this defence 'another person' is defined not to include a person who was a servant, agent or, in the case of a body corporate, director, of the defendant when the prospectus was issued. This defence replicates s85(1) TPA which provides a defence in the case of a criminal prosecution based on a breach of a provision of Part V TPA (ie the Part

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273. (1953) 88 CLR 215.

274. *Ibid* 241–2.

275. *Ibid*.

276. Section 1019 CL.

277. Even though 'the prospectus' is not specifically referred to in the opening of s1011 CL it should be implied. This is clearly appropriate as s1011 CL is referenced back to the persons in s1006(2) CL and the principle contravenors in respect of a defective prospectus. In addition, the final paragraph of s1011 CL provides a link back to the prospectus, as does s1006(2) CL. The 'drafting quirk' in the opening words of s1011 CL has been recognised and it has been recommended that s1011(1) CL be narrowed so as to only apply 'in respect of a false or misleading statement in or a material omission from a prospectus': Companies and Securities Advisory Committee, above n 248, 101.

dealing with consumer protection). The repetition of language and concepts from the Trade Practices Act 1974 (Cth) means that once again cases decided under that Act will form the basis for divining the likely interpretation of the like provision in the Corporations Law.

### *Reasonable mistake*

The first defence in s1011(1) CL applies in the case of reasonable mistake. This defence is derived from the criminal law defence of ‘honest and reasonable mistake’<sup>278</sup> which has been described as a ‘middle course between imposing absolute liability and requiring proof of guilty knowledge or intention.’<sup>279</sup> In considering the section in the Trade Practices Act 1974 (Cth) context the word ‘mistake’ has been examined with reference to its ordinary meaning, ‘[a] misconception of the meaning of something; hence, an error or fault in thought or action [and] . . . an unintended failure to perform correctly and effectively a task intended to be duly performed [citations omitted].’<sup>280</sup> In addition it has been suggested that ‘mistake’ refers to a ‘casual and isolated error in respect of a particular matter’ and not a ‘chronically defective system’.<sup>281</sup> Of course, not only must there be a ‘mistake’ in order to satisfy this defence, the mistake must also be ‘reasonable’.

In the context of s85 TPA the reasonable mistake defence has been rejected in a case where meat varieties were mixed (so as to not conform with the description used when sold) on a total of 20 days. This could not be described as a casual and isolated error.<sup>282</sup> The defence has also been rejected where goods were advertised as solid pine after their construction had changed from solid pine to a mixture of pine and particle board. This occurred in circumstances where there appeared to be no attempt to verify the advertised features of the product — which were readily ascertainable.<sup>283</sup> In reliance on this case it has been suggested that, ‘the “reasonable mistake” defence would not often be available in circumstances where the misstatement was readily verifiable by the company.’<sup>284</sup>

278. *Adams v Eta Foods Ltd* (1987) 78 ALR 611, 616–7; referring to Trade Practices Act Review Committee, *Report* (August 1976); see discussion at n 129 above.

279. *He Kaw Teh v The Queen* (1985) 157 CLR 523, 533; quoted in *Adams v Eta Foods Ltd*, above n 278, 617. It should be noted that this defence relates to ‘an honest and reasonable mistake as to the existence of facts, which, if true would have made his act innocent’ and not to a mistake of law: *He Kaw Teh v The Queen*, 533. For a discussion of ‘mistake of fact’ and ‘mistake of law’ in the prospectus context see: Greg Golding, ‘Prospectus Misstatement Liability in the 1990s: Where Does the Director Really Stand (Pt 2)’ (1997) 7 *Australian Journal of Corporate Law* 299, 311–3 and in particular at 312: ‘If the director is fully aware of the facts underlying the legal advice and in good faith relies on the legal opinion [for example, that disclosure of a certain matter in a prospectus is not required] it is likely that the belief will be characterised as a mistake of law. On the other hand, if all the elements in the legal reasoning are not available to the director it will be easier to argue mixed issues of fact and law are involved, entitling the director to raise the argument of mistake of fact.’

280. *Doolan v Waltons Ltd* (1981) 39 ALR 408.

281. *Brown v Riverstone Meat Co Pty Ltd* (1985) 60 ALR 595, 605.

282. *Ibid.*

283. *Doolan v Waltons Ltd*, above n 280, 414 where it was said that it was not a mistake, and even if it were, it was not a reasonable mistake.

284. Bob Austin and Norman O’Byrne, ‘Due Diligence Procedures to Protect Directors’ (March 1993) *New Prospectus Laws IIR Conference* 12–13; and Ford, Austin and Ramsay, above n 247, 915.

The defence was, however, made out in a case where beef pies were found to contain mutton. In this case there was reasonable reliance on a reliable supplier to supply what had been contracted for, and the defendant conducted a number of checks on the product upon receipt. However, the defendant did not check for meat species which was a reasonable omission in the circumstances (this was considered with reference to industry practice and available technology at the time).<sup>285</sup> In reliance upon this case it has been suggested that:

reliance on a representation by another party which results in the defendant making a mistake may be reasonable where the representation relates to something not within the defendant's area of expertise, provided that the defendant has conducted adequate due diligence within its sphere of responsibility.<sup>286</sup>

This defence, with its overtones of *mens rea* and intention which has been drawn from the sphere of criminal law, sits oddly as a defence to civil liability in the context of a regime concerned with taking reasonable steps to ensure the integrity of the prospectus, that is, concepts of negligence.<sup>287</sup> The need for the mistake to be 'reasonable' will take us some way in the right direction, however, this requirement has not been interpreted as requiring due diligence to be undertaken:

The taking of reasonable precautions and exercise of due diligence to avoid the contravention in question no longer is attached as a specific component in each defence provided for by s85(1) [TPA]. It is now attached as an element in the defence provided for in para (c). It is not attached to paras (a) and (b). They have their own elements. In particular, both mistake in para (a) and reliance on information in (b) must be reasonable. No doubt reasonableness is an objective matter, having regard, however, to the circumstances of the case . . .

But in my view it is not necessarily fatal to a defence of reasonable mistake within the meaning of para (a) that the defendant cannot show that he took reasonable precautions and exercised due diligence to avoid the contravention. The question, more directly, is whether the contravention is due to a reasonable mistake.<sup>288</sup>

The above quote refers to the three defences under s85(1) TPA. The paragraphs referred to ((a), (b) and (c)) equate to paragraphs (a), (b) and (c) in s1011(1) CL. In the current drafting of both s85 TPA and s1011 CL the due diligence requirement attaches only to paragraph (c), however, prior to 1977 the due diligence requirement attached to all three defences (what are now paragraphs (a), (b) and (c) of s85(1)) in s85 TPA. Amendments were made in 1977 to remove the due diligence obligation from the reasonable mistake (paragraph (a)) and reasonable reliance (paragraph (b)) defences due to concerns that the obligation was too onerous and it was this version of s85(1) TPA that was translated into s1011 CL. This recommendation was made in the report of the Trade Practices Act Review Committee 1976 (the Swanson Committee).

However, it should be remembered that the Swanson Committee recommendation was made in the context of a defence to criminal prosecution and the concerns do not necessarily

285. *Adams v Eta Foods Ltd*, above n 278, particularly 626–7.

286. *Ford, Austin and Ramsay*, above n 247, 915.

287. *Golding*, above n 262, 411–2.

288. *Adams v Eta Foods Ltd*, above n 278, 620.



hold true when considering a defence to civil liability available to the persons who are principally responsible for the integrity of the prospectus. The inapplicability of the Swanson Committee's concerns in the prospectus regime was accepted by the Companies and Securities Advisory Committee (the Lonergan Committee) which agreed that each of the three s1011 CL defences should be subject to the due diligence obligation.<sup>289</sup>

### *Reasonable reliance*

The application of this defence is likely to be fairly narrow due to the categories of persons who are excluded from the phrase 'another person' for the purpose of the defence. Thus, in order to establish this defence it is necessary for the defendant to establish reasonable reliance on another person who is not a servant, agent or director of the defendant. The committee structure of due diligence, which appears to be the norm in Australia,<sup>290</sup> will further limit the availability of this defence if it creates a relationship of mutual agency between the members.<sup>291</sup>

It has been suggested that in order to establish 'reasonable reliance': it would be necessary to establish the expertise or appropriateness of the third party to undertake the inquiry; the advice relied on must be within the area of expertise of the third party; and a level of independent verification may be necessary. These requirements are based on 'United States material in relation to the permissible extent of reliance on counsel for non-expertised portions of the prospectus.'<sup>292</sup> As to when reasonable reliance will not be established, the Trade Practices Act 1974 (Cth) cases show that when there was a failure to police a system set up to check the correctness of promotional material provided by the other party, and that system was a responsible and prudent requirement, 'reasonable' reliance could not be shown.<sup>293</sup>

The 'reasonable reliance' defence can also be seen to be at odds with the formulation of the director's defence for expertised and non-expertised portions of the prospectus in s1008A which permits the transference of liability to experts in circumstances where it is reasonable to do so. In addition, in relation to the non-expertised portions of the prospectus the s1008A defence does not prohibit the delegation of inquiries, which is a necessary feature of modern corporate life, but concentrates on the need for reasonable inquiries, reasonable grounds to believe, and an actual belief in the correctness of the prospectus.<sup>294</sup>

289. Companies and Securities Advisory Committee, above n 248, 101.

290. Golding, above n 279, 190–2; Stephen Minns and Greg Golding, 'Prospectus Due Diligence — A Focussed Approach' (1993) 11 *Company and Securities Law Journal* 542; Alistair Hood and Dimity Boswell, 'Due Diligence Reviews For Fund-raising Under the Australian Corporations Law', Gordon Walker, Brent Fisse and Ian Ramsay (eds), *Securities Regulation in Australia and New Zealand* (1998) 327–51; Austin and O'Bryan, above n 284, 8–12; R M A Mangioni and J P Hambrook, 'Fundraising', *Australian Corporations Law — Principles and Practice Looseleaf Volume 2* (1997) para 7.4.0163.

291. Ford, Austin and Ramsay, above n 247, 915; Austin and O'Bryan, above n 284, 13; Golding, above n 262, 419.

292. Golding, above n 262, 418.

293. *Videon v Barry Burroughs Pty Ltd* (1981) 37 ALR 365.

294. Golding, above n 262, 418; Golding, above n 279, 316.

The Lonergan Committee agreed that the effect of the limitation preventing reliance on the broadly defined ‘another person’ was that the only defence actually available to the corporation would be ‘reasonable mistake’ in s1011(1)(a). This would result because ‘every person involved in the preparation of the prospectus can be seen to be an “agent” of the corporation.’<sup>295</sup> It was suggested that ‘amendment of the definition of “another person” in s1011(2) may be the way to achieve this.’<sup>296</sup>

### *Acts of another, accident and causes beyond your control*

The third defence in s1011 applies in three separate circumstances. They are when the defect (whether a false or misleading statement in, or omission from, the prospectus) is due to:

- the act or default of another person;
- an accident; or
- some other cause beyond the defendant’s control.

In addition, in each of these three cases it is necessary that the defendant took reasonable precautions and exercised due diligence to ensure that all statements to be included in the prospectus were true and not misleading and that there were no material omissions from the prospectus. (This ‘due diligence’ requirement is discussed below.)

The problems associated in proving that the defect was due to the act or default of another person, due to the limitations on who will be considered to be another person,<sup>297</sup> have been examined above.<sup>298</sup> The ‘accident’ concept has been judicially examined in the context of the Trade Practices Act 1974 (Cth) using concepts of ‘unforeseen contingency; a disaster . . . a happening that is not expected, foreseen or intended; an unpleasant and unintended happening, sometimes resulting from negligence, that results in injury, loss, damage, etc . . . an unlooked-for mishap, or an untoward event which is not expected or designed [citations omitted].’<sup>299</sup>

Again, the policy of these defences appears questionable — but for the opposite reason to the concerns expressed about the reasonable mistake and reasonable reliance defences. In the case of the s1011(1)(c) defences a defendant must prove that reasonable precautions have been taken and due diligence exercised in order to ensure that there are no defects in the prospectus.

In the prospectus context it is unclear why, in addition to establishing due diligence under s1011(1), there is any value in further limiting the availability of the defence to where the defect was ‘due to the act or default of another person, to an accident or to some other cause beyond the defendant’s control.’<sup>300</sup> This is because it should be recognised that investment in securities ‘involves the voluntary assumption of risk for reward’ and that ‘it is not apparent what practical economic purpose is achieved by, in effect, requiring business

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295. Companies and Securities Advisory Committee, above n 248, 101.

296. *Ibid.*

297. Subsection 1011(2) CL.

298. See discussion above in Chapter 9 under the *Reasonable Reliance* heading.

299. *Doolan v Waltons*, above n 280, 414.

300. Paragraph 1011(1)(c) CL.

to take steps beyond what are reasonable to ensure proper disclosure.<sup>301</sup> These additional requirements would seem out of kilter with a negligence based system that excuses defects ‘which could not have been avoided even by making reasonable inquiries and exercising due diligence.’<sup>302</sup>

In addition, it is difficult to see how concepts of due diligence (which imply an absence of negligence) and accident or causes beyond the defendant’s control (which may result from negligence) marry. The effect of the interaction of the two concepts has been described in the following way in one of the leading textbooks:

Where a defect in a prospectus is the result of some negligence within the corporation’s management not unearthed by the due diligence inquiry, it seems reasonable to argue that it is a defect beyond the defendant’s control, provided that reasonable systems are in place to prevent and uncover negligence.<sup>303</sup>

### **Due Diligence Inquiries — ss1008A, 1009 and 1011 CL**

The standard of inquiry that is used to describe the due diligence obligation in ss1008A and 1009 CL is that the defendant:

after making such inquiries (if any) as were reasonable, had reasonable grounds to believe, and did believe until the time of the allotment or issue of the securities . . .<sup>304</sup>

However, the language used in s1011 CL to describe this obligation is that the defendant ‘took reasonable precautions and exercised due diligence.’<sup>305</sup>

In the absence of decisions considering the due diligence requirements of the Corporations Law there are a number lines of authority that provide assistance in understanding the possible extent of the obligation. They include cases on the provisions from which s1011 CL was derived and United States authorities relating to s11 Securities Act 1933 (US).

The leading statement in the Trade Practices Act 1974 (Cth) (s85(1) TPA is virtually identical to s1011(1) CL) context highlights the need to have a proper system laid down to guard against contraventions and for that system to be adequately supervised to ensure that it is properly carried out. However, the mere fact that an error occurs does not necessarily establish that the system is defective and the defence unavailable, as it must be recognised that the best systems may break down due to human error.<sup>306</sup>

Similar language is also used in s10(1) of the Environmental Offences and Penalties Act (NSW) to describe the due diligence defence. It has been said in relation to that provision that:

301. Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 14.

302. *Ibid* 2.

303. Ford, Austin and Ramsay, above n 247, 916.

304. See ss 1008A(2), 1008A(4), 1009(3), and 1009(4) CL.

305. See s1011(1) CL.

306. *Universal Telecasters (Qld) Ltd v Guthrie* (1977–8) 18 ALR 531, 534; referred to in *Videon v Barry Burroughs Pty Ltd*, above n 293, 388.

[d]ue diligence, of course depends upon the circumstances of the case, but contemplates a mind concentrated on the likely risks. The requirements are not satisfied by precautions merely as a general matter in the business of the corporation, unless also designed to 'prevent the contravention'.

Whether the defendant took the precautions that ought to have been taken must always be a question of fact and, in my opinion, must be decided objectively according to the standard of a reasonable man in the circumstances. It would be no answer for such person to say that he did his best given his particular abilities, resources and circumstances. This particularly applies to activities requiring experience and acquired skill for proper execution.<sup>307</sup>

In addition, the House of Lords has identified the following five components of a properly conducted due diligence review:

- compiling a detailed and adequate system;
- selecting suitable persons to carry out each part of the system;
- giving adequate instructions to each person involved as to how the system is to operate;
- checking that the instructions are understood and observed;
- providing adequate and proper supervision to ensure that the system is followed.<sup>308</sup>

Returning to the words used in ss1008A and 1009, similar language is used to provide the due diligence defence under s11(b)(3)(A) of the Securities Act 1933 (US), that is, that 'he had, after reasonable investigation,<sup>309</sup> reasonable ground to believe and did believe, at the time such part of the registration statement became effective.'<sup>310</sup> Unlike the Corporations Law, the statute itself specifies the standard of reasonableness required by this test as, 'that required of a prudent man in the management of his own property.'<sup>311</sup>

In the United States the most definitive analysis of the due diligence defence was in *Escott v BarChris Construction Corporation*<sup>312</sup> ('BarChris') in which the directors of the issuing corporation as well as the underwriting syndicate and the auditor were found liable for material misstatements in the registration statement (which is equivalent to the prospectus). The effect of this case on a consideration of due diligence is that the standard of care will be examined with reference to a 'sliding scale depending upon the defendant's knowledge, expertise, status with regard to the issuer, its affiliates or underwriters, and the degree of the defendant's actual participation in the registration process and in preparing the registration materials.'<sup>313</sup>

In *BarChris* the standard of care of each of the persons responsible for the registration statement (ie the prospectus) was examined. The result was that the standard of care expected of 'insiders' was higher than that required for 'outsiders' — this differentiation

307. *State Pollution Control Commission v Kelly* (1991) 5 ACSR 607; and quoted by Companies and Securities Advisory Committee, above n 248, 72.

308. Hood and Boswell, above n 290, 333; referring to *Tesco Supermarkets v Natrass* (1972) AC 153.

309. Contrast 'reasonable investigation' in s11(b)(3)(A) Securities Act 1933 (US) with 'reasonable inquiries (if any)' in ss1008A(2), 1008A(4) and 1009(3) CL.

310. Louis Loss and Joel Seligman, *Securities Regulation* (3rd ed 1989) 4256.

311. *Ibid* 4257; s11(c) Securities Act 1933 (US).

312. 283 F Supp 643 (1968); and for an analysis of this decision: Greg Golding, 'Where does the Director Really Stand (Pt1)' (1997) 7 *Australian Journal of Corporate Law* 177, 198–205.

313. Thomas Hazen, *The Law of Securities Regulation* (3rd ed 1996) 349.

extended to inside (ie executive) directors and outside (ie non-executive) directors. In addition, special skills, such as accounting or legal skills, also affected the standard of care on this sliding scale of 'reasonableness'. Thus an outside director who is also a lawyer and as such has an intimate knowledge of the transaction may be treated as an inside director.<sup>314</sup>

In relation to the persons found liable in *BarChris* a number of insiders were considered to have known of the deficiencies in the prospectus. The remainder of the persons found liable were generally found not to have conducted sufficient independent investigation or, where inquiries were conducted, not to have followed up to verify questionable disclosures.<sup>315</sup>

The need for verification by the underwriters was particularly emphasised in light of the reliance placed by investors on the reputation of the underwriter:<sup>316</sup>

In order to make the underwriters' participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company's officers or on the company's counsel. A prudent man in the management of his own property would not rely on them.<sup>317</sup>

The use of 'reasonableness' to provide a sliding scale of investigation needed to establish the due diligence defence was closely followed in *Feit v Leasco Data Processing Equipment Corporation*<sup>318</sup> where it was stated that what is sufficient to amount to a reasonable investigation 'will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data.'<sup>319</sup> In this case the underwriter was found to have satisfied the due diligence defence and it was recognised that the defective information supplied by the company could not be independently verified.

This later case also summarised a number of the ramifications flowing from *BarChris* with reference to a number of commentaries published since *BarChris*. For example, the role of the individual participant, their expertise and their access to the pertinent information and data affects the extent to which the participant must play an adverse role. That is, the extent to which they must independently verify information in order to satisfy the obligation of 'reasonable verification'.<sup>320</sup> This would appear to underpin the expectations of the Court in *BarChris* that the underwriter would play an adversarial role and verify information provided by officers of the company.

It was also noted in *Feit v Leasco Data Processing Equipment Corporation*<sup>321</sup> that in *BarChris* the only question of verification arose in respect of information provided to outsiders by insiders (because the executive directors were found to have known about the

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314. *Feit v Leasco Data Processing Equipment Corporation*, 332 F Supp 544 (1971) 575–6; and see Golding, above n 312, 204.

315. Golding, above n 312, 341–8.

316. *BarChris*, above n 249, 696.

317. *Ibid* 697.

318. Above n 314, 544.

319. *Ibid* 577.

320. *Ibid*.

321. *Ibid*.

misrepresentation) and it was stressed that the same obligation for reasonable investigation or verification would apply equally to insiders.<sup>322</sup>

The extent of liability for inside directors with an intimate knowledge of the corporation was also re-examined and it was stated that their level of investigation will need to be more complete as they have a greater knowledge of the facts supporting or contradicting the inclusion of the information in the registration statement.<sup>323</sup>

It was also suggested that:

*BarChris* imposes such stringent requirements of knowledge of corporate affairs on inside directors that one is led to the conclusion that liability will lie in practically all cases of misrepresentation. Their liability approaches that of the issuer [who has no due diligence defence under s11 Securities Act of 1933 (US)] as guarantor of the accuracy of the prospectus.<sup>324</sup>

In *BarChris* the Court considered the extent to which a defence would arise in relation to the expertised portions of the prospectus,<sup>325</sup> which broadly equates to the formulation in s1008A CL. The Court rejected the argument that the whole prospectus could be said to be expertised due to the involvement of a lawyer who had examined the entire document. The 'expertised' portion of the registration was limited to the audited accounts prepared by the independent director. Reliance on the expert was available to those who relied on the information supplied by a national accounting firm due to confidence in the firm and having no reasonable grounds to think otherwise. However, those with knowledge of the accounts could not shut their eyes to the facts within their area of responsibility and, as a result, the treasurer and chief financial officer and the controller (a person familiar with the company's books as its financial officer) could not rely on the expert.<sup>326</sup>

In relation to the remainder of the registration statement (the non-expertised portion) it is recognised in the United States that:

a fiduciary need not individually perform every duty imposed upon him, but may delegate to others the performance of acts which it is unreasonable to require that the fiduciary shall personally perform, especially where the character of the acts involves professional skill or facilities not possessed by the fiduciary himself.<sup>327</sup>

In *BarChris*, when examining the non-expertised portion of the prospectus, the Court relied on the old United Kingdom decision of *Adams v Thrift*<sup>328</sup> as authority for the proposition that 'a director who knew nothing about the prospectus and did not even read it, but who relied on the statement of the company's managing director that it was "all right" was liable for the untrue statements.<sup>329</sup> The case of *Adams v Thrift*<sup>330</sup> is of importance when

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322. Ibid.

323. Ibid 578.

324. Ibid.

325. Paragraph 11(b)(3)(c) Securities Act 1933 (US).

326. Loss and Seligman, above n 310, 4259–61; Hazen, above n 313, 341–3.

327. Loss and Seligman, above n 310, 4258.

328. [1915] 1 Ch 557.

329. Above n 249, 688.

330. Above n 328.

considering the extent to which due diligence inquiries can be delegated as it considers what is necessary to establish the second element in the due diligence defence in ss1008A and 1009, that is, reasonable grounds for belief.<sup>331</sup> It was considered in this case that the belief should be examined with reference to the reasonable man and that ‘such a man might reasonably believe in the truth of the statements verified by competent and independent agents, instructed not by him individually, but by or on behalf of a board of directors of whom he was one.’<sup>332</sup>

This case is also authority for the proposition that investigations made when deciding to become a director do not provide reasonable grounds for belief in the prospectus. More importantly, as was discussed in *BarChris*,<sup>333</sup> the uncorroborated statements of vendors and promoters are not sufficient to establish reasonable grounds (clearly the self interest of such persons would prevent their unverified statements being sufficient to establish a reasonable belief). Similarly, a statement that another director had thoroughly examined the matter was insufficient to corroborate the statements of the promoter. In addition, where circumstances provide ‘[a]n accumulation of incidents calculated at least to put any business man on inquiry and on his guard, if not to create an atmosphere of suspicion in his mind’<sup>334</sup> the failure to follow up such matters and ‘an attitude of almost childlike credulity’<sup>335</sup> will mean that no reasonable belief could be held.

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331. See also *Stevens v Hoare* (1904) 20 TLR 407, 409 in considering whether a director must make all inquiries personally in order to establish reasonable grounds for belief it was said: ‘If so he would be bound to do a great deal more than the most industrious and prudent man of business could think of doing, or in most cases would be able to do in the conduct of his own affairs . . . I am of the opinion that the defendant had reasonable grounds for believing the statement of the prospectus to be true.’; and discussed in *Golding*, above n 312, 193. It is also interesting to note the similarity of the description of the standard of reasonableness used in this case, that is, the ‘industrious and prudent man of business in the conduct of his own affairs’ and the United States formulation of ‘a prudent man in the management of his own property’.

332. Above n 328, 565.

333. Above n 249, 688.

334. *Ibid* 570.

335. *Ibid* 571.

# Chapter 10

## Additional Civil Remedies

In addition to the civil remedy under s1005 CL, additional remedies can be found in ss1325 and 1324 CL and injunctions are available under s1324 CL. These remedies are discretionary and therefore the conduct of both the plaintiff and the defendant, 'including the general blameworthiness of what was done'<sup>336</sup> will be relevant to the Court when deciding whether to exercise these powers. It is also possible, in limited circumstances, for ASIC to begin and conduct proceedings on behalf of aggrieved persons.

### Injunctions

An injunction under s1324(1) may be granted against a person who has, is, or is proposing, to engage in conduct that would amount to a contravention, an attempt at a contravention, or involvement (or attempted involvement) in a contravention. Such an injunction can be granted to restrain the person from engaging in the conduct or, if the Court thinks it desirable, to require the person to do any act or thing. In addition, a mandatory injunction, requiring an act or thing to be done, may be granted under s1324(2) for a refusal or failure (actual or threatened) to do an act or thing required by the Corporations Law. Failure to comply with an injunction is a contempt under s1327 and can be punished by either or both a fine and imprisonment.<sup>337</sup>

Injunctions are available on the application of a more limited class under s1324 CL than under s80 TPA. This is because under s80 TPA 'any person' may apply for an injunction, whereas under s1324 CL an injunction is available on the application of ASIC or a person whose interests have been, are, or would be, affected by the conduct.

In relation to an injunction under the Trade Practices Act 1974 (Cth) it has been suggested that:

Perhaps because their effect is to reduce the prospect of the TPA and its state, territory and New Zealand equivalents from being contravened and, hence, directly and immediately to further the public interest in a marketplace free of conduct proscribed by the statutes, the Acts impose very few limits on the range of persons who may obtain these remedies.<sup>338</sup>

However, in considering the requirement for standing under the precursor to the Corporations Law, which expresses the standing requirement in the same terms, it has been

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336. *Australian Securities Commission v Sackley* (1991) 4 ACSR 739, 747.

337. J B Kluver, 'ASC Enforcement', *Australian Corporations Law — Principles and Practice Looseleaf Volume 2* (1997) para 15.2.0055.

338. Colin Lockhart, *The Law of Misleading or Deceptive Conduct* (1998) 166.



held that ‘the interests referred to...are interests of any person (which includes a corporation) which go beyond the mere interests of a member of the public.’<sup>339</sup>

In the corporate context the injunction has been shown to be a powerful weapon in what is known as ‘spoiling’ litigation, particularly in the case of applications under the Trade Practices Act 1974 (Cth) where there is no need to show standing at all. In this context injunctions have been used by disaffected directors to thwart a corporate restructure and in an attempt by a target to derail a takeover.<sup>340</sup>

## Damages and Other Orders

In addition to the injunction power, s1324(10) CL contains an incidental provision that allows a Court to grant damages either in addition to or in substitution for damages. This remedy is only available in circumstances where the Court has the power to grant an injunction.

In addition, a broad power that permits the Court to make such order or orders as it thinks appropriate is found in s1325 CL. An order may be granted under s1325(1) or (2) CL if a person has suffered, or is likely to suffer, loss or damage because of the conduct of another person that was engaged in, in contravention of Part 7.11 or Part 7.12 CL. This order may provide compensation in whole or in part for the loss or damage, or prevent or reduce the loss or damage, and may be granted against the person engaged in the contravention or a person who was involved in the contravention.

This power applies in a proceeding issued under, or for a contravention of the fundraising or liability provisions (Part 7.12 or Part 7.11 CL) where the Court finds that loss has been suffered or is likely to be suffered (whether or not it grants an injunction),<sup>341</sup> or on the application of the person who has suffered or is likely to suffer loss or on the application of ASIC on behalf of such a person or persons.<sup>342</sup> An application by ASIC on behalf of such person can also flow from proceedings instituted under s1324 CL for an injunction. In order for ASIC to make an application on behalf of such persons, s1325(3) CL requires ASIC to have the written consent of the persons on whose behalf the application is made.

Section 1325 CL is based on s87 TPA.<sup>343</sup> Where an action has not been commenced under another provision the availability of s1325(2) CL has been questioned. This is because the similarly worded s87(1A) TPA was held not to be available unless an action

339. *Broken Hill Proprietary Co Ltd v Bell Resources Ltd* (1984) 8 ACLR 609, 613; see also: Michael Gillooly, ‘Misleading or Deceptive Conduct Under Section 995 Corporations Law’ (July 1995) *Centre for Commercial and Resources Law Misleading or Deceptive Conduct Conference* 37–8.

340. *Fraser v NRMA Holdings Ltd* (1995) 15 ACSR 590; *Pancontinental Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463.

341. Subsection 1325(1) CL.

342. Subsection 1325(2) CL.

343. Corporations Bill 1988 (Cth) 960, para 3956.

has been commenced under another provision.<sup>344</sup> However, there is a strong argument that this authority is not relevant to s1325(2) CL as the intention to create a separate cause of action can be implied from the existence of a limitation period in sub-s(4), which refers to when the 'cause of action arose', for applications under sub-s(2).<sup>345</sup>

The orders available to the Court under s1325(1) and (2) CL include the orders listed in sub-s(5). These orders are available to 'compensate . . . in whole or in part for the damage or . . . prevent or reduce the loss or damage.'<sup>346</sup> The orders listed in s1325(5) CL (broadly) allow:

- a declaration that the contract is void (including void ab initio or from a specified date);
- a variation of a contract or arrangement;
- the refusal to enforce any or all provisions of a contract;
- a direction to refund money or return property;
- a direction to pay the amount of loss or damage; and
- a direction to supply specified services (at the contravenor's own expense).

Of these remedies, the power to declare a contract void ab initio is of particular interest. This is because of the uncertainty surrounding a member's ability to recover against the company, particularly if the company is in liquidation.<sup>347</sup> However, the availability of this remedy is likely to be very limited due to the following statement made in the context of the equivalent provision of the Trade Practices Act 1974 (Cth):

Furthermore, in *Trade Practices Commission v Milreis Pty Ltd*, Brennan J. and Deane J., as members of the Federal Court made it clear that s87(2)(a) [TPA] is not to be understood as conferring a power to declare void a contract that which was valid at its inception, other than through the operation of some other provision of the Trade Practices Act or by reason of some alteration in circumstances.<sup>348</sup>

In *Trade Practices Commission v Milreis* the example given was in relation to a contract that initially had the protection of s45 TPA as not substantially lessening competition. That protection could be lost (resulting in a change of circumstances) as a result of a party to the contract increasing its market share thereby making available the possibility of declaring the contract void ab initio.<sup>349</sup>

344. *Sent v Jet Corporation of Australia Pty. Ltd.* (1986) 160 CLR 541 where it was found that s87(1A) TPA did not create a separate cause of action. This defect has since been remedied by the enactment of s87(1C) TPA, which specifically states that subsection (1A) provides a separate cause of action, and s87(1CA) TPA which specifies a limitation period for actions brought under s87(1A) TPA.

345. Gillooly, above n 339, 38–40.

346. Subsections 1325(1) and (2) CL.

347. See *Webb Distributors (Aust) Pty Ltd v The State of Victoria* (1993) 11 ACLC 1,178; and *Houldsworth v City of Glasgow Bank and Liquidators* (1880) 5 App Cas 317; see also Vicky Priskich, 'Webb Distributors Revisited: The Interaction Between the Principle of Preservation of Share Capital in Winding up to Claims for Misleading and Deceptive Conduct' (1998) 16 *Company and Securities Law Journal* 35.

348. *Webb Distributors (Aust) Pty Ltd v The State of Victoria*, above n 347, 1,186.

349. (1977) 14 ALR 623, 645–6.

## Civil Proceedings Begun and Conducted by ASIC

An additional power under which ASIC can take civil action on behalf of aggrieved persons is found in s50 Australian Securities and Investments Commission Act 1989 (Cth) (ASIC Act). This provision allows ASIC to begin and conduct civil proceedings when it is in the public interest to do so.

In order to take action under this provision ASIC must become aware of the misconduct in the course of an investigation. In addition, if the aggrieved person is not a company, ASIC must obtain the person's written consent. Consent of a company is not a prerequisite to commencing an action in the company's name. It is also not necessary for ASIC to consider the lack of consent of a company's directors when deciding to commence an action in the company's name.<sup>350</sup>

It is, therefore, possible for ASIC to bring a class action on behalf of investors<sup>351</sup> when the public interest test is satisfied. An example given by ASIC of a circumstance in which it may be in the public interest for ASIC to bring proceedings is where 'the affairs of a corporation were being conducted in a manner oppressive to minority shareholders, and those minority shareholders had insufficient resources to bring appropriate proceedings.'<sup>352</sup> However, ASIC has indicated a general unwillingness to commence civil proceedings 'where there is a potential plaintiff with sufficient funds to bring those proceedings, but is not prepared to do so.'<sup>353</sup>

Care should be taken by aggrieved persons (the nominal plaintiff) when giving consent to an action under s50 ASIC Act. This is because this provision does not appear to give ASIC the ability to defend cross-claims brought by the defendant against the nominal plaintiff. Therefore it is likely that the nominal plaintiff will have the responsibility for defending cross-claims.<sup>354</sup>

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350. *Australian Securities Commission v Deloitte Touche Tohmatsu* (1996) 138 ALR 655, 687 where the Full Court of the Federal Court rejected the argument that the ASC was bound to take the rule in *Foss v Harbottle* into account when deciding whether to take action under s50 of what was then the Australian Securities Commission Act 1989 (Cth) (and is now the ASIC Act).

351. Robert Baxt and HAJ Ford and Ashley Black, *Securities Industry Law* (5th ed, 1996) 12.

352. Australian Securities and Investments Commission, *Policy Statement 4 Intervention*, para 4; and considered in *Australian Securities Commission v Deloitte Touche Tohmatsu*, above n 350, 687.

353. Australian Securities and Investments Commission, above n 352; Dougal Richardson, 'Section 50 of the Australian Securities Commission Act 1989: White Knight or White Elephant?' (1994) 12 *Company and Securities Law Journal* 418, 422 and also at 437 for a discussion of instances in which actions under s50 ASIC Act have been commenced.

354. Richardson, above n 353, 435.

# Chapter 11

## CLERP Proposals to Reform the Liability Provisions

### Why Rewrite the Liability Provisions?

There have been numerous calls for changes to the liability provisions of the Corporations Law due to their complexity and the inconsistent policy that they implement.<sup>355</sup> Proposals for a streamlined liability regime implementing a clear and consistent policy have received widespread support.<sup>356</sup> The degree of uncertainty that currently exists in the liability provisions has been amply demonstrated above and is exacerbated by the fact that the applicable provisions do not implement a consistent policy.

Some of the key problems that have been highlighted include:

- the uncertain interaction between s52 TPA (and the equivalent provisions of the State and Territory Fair Trading Acts) and the code for prospectus liability in Part 7.11 CL;
- the uncertain interaction between s995 CL and the defences to civil liability in Part 7.11 CL;
- the defences do not provide complete coverage as persons who are involved in a contravention by virtue of s79 CL, who do not fall within one of the s1006(2) categories and are not persons who caused or authorised the issue of the prospectus, will not have the benefit of any defences;
- the s1007 CL defence for all persons who have deemed liability under s1006(2) is too narrow because it only applies in respect of claims of subscribers under the prospectus, however, the cause of action in respect of a defective prospectus in s1005 CL is potentially available to a wider class of persons;

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355. Greg Golding, 'Prospectus Misstatement Liability in the 1990s: Where Does the Director Really Stand (Pt 2)' (1997) 7 *Australian Journal of Corporate Law* 299; Greg Golding, 'Underwriters Liability in Australian Securities Offerings' (November 1993) *Company and Securities Law Journal* 401, 401; Michael Gillooly, 'Misleading or Deceptive Conduct Under Section 995 Corporations Law' (July 1995) *Centre for Commercial and Resources Law Misleading or Deceptive Conduct Conference*; Bob Baxt, 'The Float that Sank' (December 1994) *Charter* 22.

356. There has been widespread industry support for this project, see for example: Investment Funds Association of Australia Limited, *IFA Submission on the CLERP Fundraising Proposals — Proposals for Reform: Paper No. 2* (November 1997) 5; Securities Institute of Australia, 'Corporate Law Economic Reform Program — Fundraising', *Letter to the Honourable Ian Campbell* (1 July 1997) 5; Australian Institute of Company Directors, *Corporate Law Economic Reform Program — Fundraising — Submission to Treasury* (May 1997) 3–4; Australian Stock Exchange Limited, *Submission to the Corporate Law Economic Reform Program* (November 1997) 11; Law Council of Australia Corporations Law Committee, *Corporate Law Economic Reform Program — Comments on Fundraising Reform Paper* (November 1997).

- the defence relating to reliance by directors and proposed directors on defective experts' statements in s1008A CL should be subject to an additional requirement for an actual belief in the truth of the statement (ie there should be no defence for a person who knows that the statement is defective);
- the directors and proposed directors defence in s1008A(4) CL for omissions is inadequate, as it provides a defence for omissions from a statement but not for a matter that is completely omitted from the prospectus;
- the limitation on liability for s1006(2)(g) and (h) CL advisers in s1009(2)(a) CL is misconceived (liability is limited to false or misleading statements in the prospectus purportedly made by the person or to be based on a statement by the person). This is because the involvement of advisers in the preparation of a prospectus is much broader than that of s1032 experts, and will often include responsibility for material included in the prospectus without any particular statement being linked to the adviser;
- the class of persons to whom the defence in s1010 CL applies is too broad. The defence allows liability to be limited to a specified part of the prospectus and applies to various advisers and professionals involved in the preparation of the prospectus including the lead underwriter who would ordinarily be expected to have a role in ensuring the integrity of the entire prospectus;
- the defence in s1011(1) CL appears, on its face, to have too broad an operation. The defence should be limited to false or misleading statements in, or omissions from, a prospectus;
- the policy of the defences in ss1011(a) and (b) CL for reasonable mistake and reasonable reliance is confused and introduces criminal law concepts of intention and *mens rea*, without any obligation to undertake due diligence inquiries. This sits oddly in a negligence based regime for civil liability; and
- the defence in s1011(c) CL for acts of another, accident and causes beyond one's control seems unnecessarily narrow in light of the availability of a due diligence defence for the corporation, the promoter, the underwriter, stockbroker or sharebroker, and persons who authorised or caused the issue of the prospectus.

The CLERP reform proposals purport to be based on a consistent policy which acknowledges the function of allocating and pricing risk inherent in investing, while encouraging a high standard of conduct.<sup>357</sup> The proposals also concentrate deemed liability on a core group who are responsible for the prospectus as a whole and limit the liability of others to their own statements or statements based on their statements. These features of the proposals, combined with the rationalisation and clarification of the liability provisions, should lead to greater certainty and reduced costs for fundraisers.

However, the suggested benefits will only be realised if the CLERP Bill delivers clearly drafted liability provisions coupled with a consistent policy of civil liability subject to defences based on concepts of due diligence. At the margins some of the reform proposals may not quite deliver the promised consistent policy. (The proposed reforms and the CLERP Bill are discussed in greater detail below.)

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357. See discussion above in Chapter 4 under *The Public Policy of Legislative Liability* heading, particularly at n 46.

## Summary of the Proposed CLERP Reforms

There are 6 CLERP proposals to reform the liability provisions. In addition, some of the other proposals, such as the introduction of profile statements and offer information statements have liability consequences because a liability regime must be introduced to apply to the new forms of disclosure document. (The six liability reforms are summarised below.)

### *Overlap between the Trade Practices Act and the Corporations Law*

The central proposal for the reform of the liability provisions is to remove the overlap of the Trade Practices Act 1974 (Cth) and the Fair Trading legislation of the States and Territories for securities dealings. Instead '[t]he liability rules for securities dealings will be contained in the Corporations Law.'<sup>358</sup>

### *Persons liable for all statements in the prospectus*

Primary liability for the prospectus will be borne by the corporation, its directors and the underwriters to the issue. These persons will have the benefit of a uniform defence.<sup>359</sup>

### *Promoters*

Liability under the Corporations Law for a defective prospectus will not be extended directly to promoters or persons who authorise or cause the issue of the prospectus. Persons who currently fall into these categories will only face liability for a defective prospectus if they are liable in another capacity.<sup>360</sup>

### *Professional advisers and experts*

Professional advisers and experts will be liable only for misleading statements attributed to them in the prospectus and not in relation to all parts of the prospectus on which they have advised or assisted.<sup>361</sup> Consent from the adviser or expert will be required before a statement may be attributed to them.<sup>362</sup>

### *Uniform defence*

A uniform defence based on due diligence inquiries will be introduced for each of the categories of persons who are liable for a defective prospectus, that is, the corporation, directors, underwriters, experts and advisers. The defence will require reasonable inquiries

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358. Corporate Law Economic Reform Program, *Policy Reforms* (17 March 1998), 8.

359. *Ibid* 9.

360. *Ibid*.

361. *Ibid*; see also Corporate Law Economic Reform Program, *Proposals for Reform: Paper No. 2, Fundraising* (8 October 1997), 47.

362. Corporate Law Economic Reform Program, above n 358, 9.

to be undertaken, and a reasonable belief to be held that the prospectus was not misleading. It will also be possible to rely upon other persons (such as professional advisers and experts) where that is reasonable.<sup>363</sup>

### *Forward-looking statements*

Liability for forecasts and other forward looking statements will remain the same, that is, they will continue to be subject to a requirement that they be based on reasonable grounds. At present the maker of the statement also has the evidential onus of proving that the forecast is based on reasonable grounds. Under the reform proposal the onus of proof will be reversed and returned to the usual situation under the law where the plaintiff must make out a prima facie case.

### **A Single Prohibition**

The first of the significant changes under the CLERP reform proposals is the introduction of a single prohibition in s728(1) CLERP Bill for conduct involving the offer of securities under a disclosure document that contains a misleading or deceptive statement or from which there is an omission (I will refer to such a document generally as a 'defective' disclosure document).<sup>364</sup> The single prohibition has universal application to each of the 'disclosure documents' available under the CLERP Bill, that is, it applies equally to an offer made pursuant to: a prospectus, offer information statement or profile statement.

### *Removal of overlap*

Under the proposed changes the misleading or deceptive conduct prohibition in the Trade Practices Act 1974 (Cth) and the State and Territory Fair Trading Acts will no longer apply to a statutory prospectus or other disclosure document.<sup>365</sup> There has been a great deal of public debate about the issue.<sup>366</sup> However, the changes in the CLERP Bill are more extensive than many expected upon reading the words of the proposed reform:

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363. Ibid.

364. Section 728(1) of the CLERP Bill replaces ss996 and 995 CL in respect of a defective prospectus. Section 996 will be repealed and s995 narrowed so as not to apply to misleading or deceptive conduct in respect of securities: see CLERP Bill Schedule 3, Part 1, items 60 and 57.

365. This will be achieved by inserting a new s51B TPA to exclude the operations of Part 5, Division 1 of the Trade Practices Act (which includes s52) in respect of dealings in securities. In addition, the CLERP Bill itself will exclude the operation of the State and Territory Fair Trading Acts in respect of dealings in securities: see Schedule 3, Part 1, items 59 and 24.

366. As well as the support of the organisations described at n 356 above, there has also been public disagreement from the Australian Competition and Consumer Commission (ACCC) and the Australian Consumers' Association (ACA) to the proposal to remove the application of s52 TPA so that prospectus disclosures will be subject to due diligence defences: Geoffrey Hone, 'Fundraising and Prospectuses — The CLERP Proposals' (1996) 16(4) *Companies and Securities Law Journal* 311, 318; and see 'Corporations Law Simplification Task Force', *ACCC Journal No.2* (1995/96) 42 where it was stated: '[the ACCC] believes there is no reason that dealings in securities should be treated more leniently than other

The liability rules for securities dealings will be contained in the Corporations Law. Section 52 [TPA] and associated consumer protection provisions of the Trade Practices Act (and the Fair Trading legislation of the States and Territories) should not apply to dealings in securities.<sup>367</sup>

In addition, the debate that preceded these reforms, and that occurred upon the release of these reforms centred on whether it was appropriate to have strict liability for misleading or deceptive statements where there is a positive duty to disclose such as in a prospectus.<sup>368</sup> That debate centred on the application of s52 TPA and ss995 and 996 CL.

After extensive consultation on this issue,<sup>369</sup> a paper was released in March 1997 by the Simplification Task Force which recommended that:

conduct in relation to fundraising, takeovers and other dealings in securities be governed by the Corporations Law and not by the provisions in Part V of the Trade Practices Act (which include section 52), nor by the equivalent provisions in the Fair Trading Act of each State and Territory.<sup>370</sup>

However, this broad recommendation was clarified by the following statement:

The essential effect of the proposed amendments of the Trade Practices Act would be limited. The existing liability to compensate for loss that arises from misleading or deceptive statements in a prospectus or takeover document which could not have been avoided even by making reasonable inquiries and exercising due diligence would be removed.<sup>371</sup>

One element of these recommendations has already occurred, that is, the transfer of the consumer protection elements of the Trade Practices Act to the securities regulator. This occurred via amendments made by the Financial Sector Reform (Consequential Amendments) Act 1998 (Cth) which commenced on 1 July 1998. These amendments have not yet been reflected in State legislation and so, as is the case for the Trade Practices Act, there are constitutional limits on their ambit.

Under these amendments s51AA TPA (unconscionable conduct) and Part 5 TPA (consumer protection provisions) were expressed not to apply to financial services.<sup>372</sup> Equivalent provisions in relation to s51AA TPA and Part 5 Division 1 (consumer protection, unfair practices) were inserted into the ASIC Act.<sup>373</sup> These new provisions include the general civil prohibition against misleading or deceptive conduct<sup>374</sup> (the equivalent of s52

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forms of commercial conduct, and that the proposal [to remove the operation of s52 TPA for fundraising] is not in the interest of small investors.' For a similar view see Law Council of Australia Consumer Law Committee of the General Practice Section, *Submission on Corporate Law Economic Reform Program Proposals for Reform Paper No. 2 — Fundraising* (November 1997).

367. Corporate Law Economic Reform Program, above n 358, 8.

368. *Ibid.*

369. Corporations Law Simplification Task Force, *Fundraising — Trade Practices Act, s52 and Securities Dealings* (November 1995) 4.

370. *Ibid* 2.

371. *Ibid.*

372. Sections 51AAB and 51AF TPA.

373. Part 2, Division 2, Subdivision C — Unconscionable Conduct; and Subdivision D — Consumer Protection.

374. Section 12DA ASIC Act.



TPA) and more general consumer protection provisions<sup>375</sup> including prohibitions against harassment and coercion<sup>376</sup> bait advertising<sup>377</sup> and pyramid selling.<sup>378</sup>

This transfer of responsibility is limited to financial services which are defined to mean, 'a service that (a) consists of providing a financial product, or (b) is otherwise supplied in relation to a financial product.' Financial product is further defined to cover the entirety of ASIC's new portfolio of responsibilities, that is, bank deposit products, securities, futures contracts, insurance contracts, superannuation interests and retirement savings accounts. The definition specifically excludes foreign exchange contracts.<sup>379</sup> It is important to note that despite the transfer of consumer protection provisions for financial services to ASIC from the ACCC, there is provision for both ASIC and the ACCC to delegate their consumer protection functions and powers to each other. The delegation powers are found in s102 ASIC Act and s26 TPA. This means that investigations involving financial services and other products can be delegated to one agency if this will provide more efficient and cost effective regulation.

The steps which remain for the CLERP process are: firstly to mirror the Trade Practices Act 1974 (Cth) changes in the Fair Trading Acts of the States and Territories and to incorporate those changes into the national scheme laws (which will remove the constitutional limitation); and secondly to remove strict liability for misleading or deceptive conduct in respect of mandatory disclosure documents including prospectuses.

This could be achieved in either of two ways. One way would be by adding defences to s12DA ASIC Act. The alternative would be to specify that s12DA does not operate in relation to misleading or deceptive conduct in respect of a disclosure document (and provide a single prohibition for misleading or deceptive conduct subject to due diligence defences in the Corporations Law). The model chosen for the CLERP Bill is the second, that is s728 CLERP Bill will operate to the exclusion of s12DA ASIC Act. However, the breadth of the exclusion proposed in the CLERP Bill has been the subject of a number of objections.<sup>380</sup>

Under the CLERP Bill a new s12DAA will be inserted in the ASIC Act which will exclude Part 2, Division 2, Subdivision D (consumer protection) from dealings in securities.<sup>381</sup> This will leave s995 to regulate securities dealings other than conduct that contravenes s728 (defective disclosure documents).<sup>382</sup> In addition, the provisions of the Fair Trading Acts of the States and Territories will be completely excluded in relation to all

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375. With both civil and criminal liability.

376. Section 12 DJ ASIC Act.

377. Section 12DG ASIC Act.

378. Section 12DK ASIC Act.

379. Section 12BA ASIC Act and s4(1) TPA.

380. See Australian Competition and Consumer Commission, *Submission to Joint Committee on Corporations and Securities — Corporate Law Economic Reform Bill* (May 1998); and The Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, *Submission on CLERP — Fundraising* (November 1997) 3. See also Commercial Law Association, 'Recommendations Corporate Law Economic Reform' (1998) 12(1) *Commercial Law Quarterly* 7 which expressed the concern that there should be no regulatory gap.

381. CLERP Bill, Schedule 4, item 1.

382. CLERP Bill, Schedule 3, Part 1, item 57. Defective takeover documents are also excluded from the ambit of s995(2) CL under this provision.

dealings in securities. These amendments open up a regulatory gap in relation to dealings in securities generally because, not only has the general misleading or deceptive prohibition been excluded in respect of disclosure documents, but a raft of consumer protection provisions have also been excluded in respect of disclosure documents and in respect of dealings in securities generally.

These provisions are currently found in Part 2, Division 2, Subdivision B of the ASIC Act with the general prohibition against misleading or deceptive conduct. While these provisions may add no extra protection in respect of a prospectus or other disclosure document, they are potentially relevant in the context of securities dealings generally. Therefore, it seems inappropriate for s995 to apply to securities conduct generally (that is, securities conduct other than a defective disclosure document) to the exclusion of the additional protections found in the ASIC Act.

This exclusion is described as follows in the Explanatory Memorandum to the CLERP Bill:

Actions for damages or injunctions for misleading or deceptive conduct in connection with a disclosure document will no longer be available under section 995 [CL] (Bill Schedule 3, Part 1, item 57). Instead, Division 1 of Part 6D.3 will provide a self-contained liability regime for misstatements and omissions from disclosure documents.

Similarly, the misleading and deceptive conduct provisions of the Australian Securities and Investments Commission Act will no longer apply to securities dealings (Bill Schedule 4, Part 1, item 1). This will ensure that there is no overlap between the Corporations Law and the Australian Securities and Investments Commission Act in relation to securities dealings. One of the main effects of this change would be to provide a self-contained liability regime in the [Corporations] Law for dealings in securities.<sup>383</sup>

Even though the CLERP proposals suggest that '[t]he liability rules for securities dealings should be contained in the Corporations Law',<sup>384</sup> this recommendation was made in the context of a discussion about the inappropriateness of strict liability where there is a mandatory disclosure obligation. There has been no public discussion about whether the consumer protection provisions available for dealings in securities should be reduced or rationalised.<sup>385</sup> Similarly, both the report of the Simplification Task Force and the Financial System Inquiry limit their discussion to the undesirable effects of strict liability under s52 TPA and no suggestion is made that the other consumer protection provisions of the Trade Practices Act 1974 (Cth) are inappropriate in the context of dealings in securities generally.<sup>386</sup>

Not surprisingly, the ACCC does not support the proposal to exempt all dealings in securities from the entire raft of consumer protections found in Part V, Division 1 TPA and summarises its position as follows:

The ACCC is seriously concerned that . . . [the proposed amendments] will severely limit the effectiveness of consumer protection in the financial services sector. The proposals are not

383. Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) 59.

384. Corporate Law Economic Reform Program, above n 361, 43.

385. Ibid 40–3.

386. Simplification Task Force, above n 369; Financial System Inquiry, *Final Report* (March 1997).

consistent with the FSI [Financial System Inquiry] recommendations, and [are] unnecessary and inappropriate. The ACCC reiterates its earlier comments that the relevant policy objectives can most simply and effectively be met by:

- providing that a due diligence defence be available in any action brought under s.52 or comparable legislation in relation to a statement contained in or omitted from a prospectus, takeover document or superannuation statement;
- implementing an operating agreement between ASIC and the ACCC to resolve jurisdictional issues.<sup>387</sup>

No benefits have been identified to justify the removal of the entire raft of consumer protections (other than s12DA ASIC Act) from dealings in securities. Nor have any problems been demonstrated in relation to their application to dealings in securities. For these reasons, it is my submission that the only limitation that should be contained in the CLERP Bill is in respect of misleading or deceptive conduct in s995 CL, s12DA ASIC Act and the equivalent provisions of the Fair Trading Acts of the States and Territories as they apply to disclosure documents (remembering that Part 5 of the TPA including s52 no longer applies to financial services). At the very least, a detailed analysis of how the removal of the entire raft of consumer protection provisions would affect consumer protection in securities dealings should be undertaken before making a final decision about whether to proceed with these amendments.

### *The formulation of the prohibition*

More generally, the single prohibition in s728(1) CLERP Bill has a number of benefits over the existing law. The CLERP Bill makes it clear that this is the only prohibition that needs to be considered and the links between the prohibition, the cause of action and the defences are clear. It is also clear from s728(1)(b) CLERP Bill that omissions will be examined with reference to the appropriate disclosure standard. Finally, the interaction of the supplementary prospectus provisions is clarified by prohibiting offers from being made using the prospectus if a new circumstance that would require disclosure under the mandatory disclosure obligation arises.<sup>388</sup>

The ‘misleading or deceptive’ formulation of s995 CL and s52 TPA has been used in s728(1) CLERP Bill in preference to the s996 formulation of ‘false or misleading’. As discussed above in Chapter 6 under the *Similarities Between ss995 and 996 CL* heading, in the context of disclosure in a prospectus there is unlikely to be any difference between a provision that proscribes misleading or deceptive conduct, and a provision that proscribes false or misleading statements.

A conscious decision has been made not to include a materiality requirement in the formulation of the prohibition. This is so as to not reduce the level of protection available to investors as a result of the removal of the ambit of s52 TPA (as that section does not expressly include a materiality requirement).<sup>389</sup> However, as discussed above in Chapter 6,

387. Australian Competition and Consumer Commission, above n 380, 17.

388. Subsection 728(1)(c) CLERP Bill.

389. Corporate Law Economic Reform Program, *Commentary on Draft Provisions* (17 March 1998) 13.

under the *Misleading or Deceptive Conduct* — s995 CL, *Materiality* heading, in the securities context s52 TPA has been read to include a requirement for materiality.

From a policy perspective it is difficult to see why it would be appropriate for an immaterial defect to constitute a breach of s728(1) CLERP Bill and thereby open the way to the possibility of civil liability. Therefore, it is to be hoped (and it would be reasonable to expect) that s728(1) CLERP Bill will be interpreted in the same way in this respect as the section it is attempting to emulate. Of course, even if materiality is not implied, in a civil action it would be difficult to prove that the loss complained of resulted from an immaterial defect.

## Reversal of Onus of Proof for Forecasts

Under the CLERP Bill s765 CL will be replaced with s728(2). The new provision, like s765 CL, provides that a statement about a future matter will be deemed to be misleading unless the maker has reasonable grounds, but it does not place the onus on the maker of the statement to show reasonable grounds. This proposal, like the proposal for a single prohibition for defective prospectuses has received widespread industry support.<sup>390</sup> The arguments put forward for this proposal relate primarily to the savings that will flow from protecting issuers from liability when they use 'legitimate forecasting'.<sup>391</sup>

However, this support has not been universal and a number of bodies have put forward persuasive reasons as to why the reverse onus should be maintained. The argument has been clearly expressed by the ACCC:

The ACCC . . . has concerns that this amendment will decrease the reliability of information for investors.

It will always be prudent for legitimate traders to have reasonable grounds for making any statements about the products or services they offer, including statement about the future. A reversed onus of proof will not change the compliance burden for these operators. The main beneficiaries of a deletion of the reversed onus of proof will be unethical operators, as the risks of getting caught for a contravention will be greatly decreased.

Representations about future matters are notoriously difficult to prove, as the relevant information is likely to be solely within the hands of the person making the representation. Similarly it is difficult to prove that a person did not have reasonable grounds for making a future statement. The reversed onus of proof overcomes these difficulties by requiring the issuer to bring forward the material used in making a forecast. Without it, the obligations with respect to future representations will be effectively unenforceable, and investors will not be able to confidently rely on the information provided by issuers.

390. Investment Funds Association of Australia Limited, above n 356, 3; Securities Institute of Australia, above n 356, 3; Australian Institute of Company Directors, above n 356, 6–7; Australian Stock Exchange Limited, above n 356, 5; Commercial Law Association, above n 380, 7; Law Council of Australia Corporations Law Committee, above n 356, 5. See also Golding, above n 242, 22–37.

391. Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) 57.

*A reversed onus of proof does not make issuers liable for legitimate forecasting; issuers will only be liable for forecasting that has no reasonable basis for support [emphasis added].*<sup>392</sup>

As has been discussed above in Chapter 6 under the *State of Mind* heading, a forecast in a prospectus will convey the implications that the maker of the statement had a particular state of mind when the statement was made and that there was a reasonable basis for that state of mind. Therefore, a forecast will be misleading if the maker of the forecast does not have reasonable grounds for making it. This means that s728(2) CLERP Bill will do no more than restate the general law if the reversal of the onus of proof element is removed.

However, despite the concerns expressed above, the significance of the loss of the reverse onus of proof in the prospectus context is questionable. This is because, as has been discussed above in Chapter 6 under the *State of Mind* heading,<sup>393</sup> the obligation to include information about the assumptions and the method of calculation should provide sufficient evidence about the reasonableness (or otherwise) of the forecast.<sup>394</sup> Therefore, although at first glance the removal of the reverse onus of proof from s765 CL would appear to make it extremely difficult for investors to allege that a forecast is misleading or deceptive, the inclusion in the prospectus of the assumptions made when preparing the forecast should provide sufficient evidence of the reasonableness (or lack thereof) of the belief, no matter who has the onus of proof.

This view is consistent with a comment made by the Lonergan Committee in the context of their recommendation to remove the reverse onus of proof for s765 CL:

The Sub-Committee recognises that reversing the onus of proof in s765 CL may cause problems for plaintiffs as they may have difficulty ascertaining the basis for a particular forecast because this information might be known only to those associated with the promotion of the prospectus. In cases where a plaintiff has truly suffered loss or damage however it is likely that valid arguments could be raised to support a case that the forecasts included in the prospectus were not based on reasonable grounds (particularly if the assumptions used to generate the forecasts were disclosed in the prospectus).<sup>395</sup>

## Right to Compensation

The right to compensation under s729(1) CLERP Bill is drafted much more narrowly than s1005 CL in that its availability is limited to the conduct prohibited by s728(1) CLERP Bill, that is, the offer of securities under a defective disclosure document. In fact the breadth of s729(1) CLERP Bill is even more limited than it appears on its face because it is further circumscribed by the definitions. First, 'disclosure document' is defined as a

392. Australian Competition and Consumer Commission, above n 380, 19. See also The Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, above n 380, 2; and the Law Council of Australia Consumer Law Committee, above n 366.

393. See discussion above in Chapter 6 under the *State of Mind* heading.

394. Australian Securities and Investments Commission, *Practice Note 67 Financial Forecasts in Prospectuses* (4 August 1998) para 19: 'A prospectus must disclose specifically the assumptions used to compile a financial forecast that materially affect the forecast outcome . . . The assumptions must give a reasonable basis for a forecast.'

395. Companies and Securities Advisory Committee, *Prospectus Law Reform Sub-Committee Report* (March 1992) 34.

prospectus, profile statement, or offer information statement for the offer, and then each of these documents is further defined as the document that is lodged with ASIC.<sup>396</sup>

Therefore, a document that makes an offer of securities, but is not lodged with ASIC will not be a disclosure document and will not be subject to s729(1) CLERP Bill. Similarly, an offer that is made orally without the benefit of any document will not be subject to s729(1) CLERP Bill. However, the more general right to compensation in s1005 CL will continue to operate in respect of contraventions of the liability provisions in Part 7.11 CL including misleading or deceptive conduct that does not relate to a disclosure document (under s995 CL).<sup>397</sup> For the same reasons as were discussed above in Chapter 6 under the *Similarities Between ss995 and 996 CL* heading, the prohibition in s995 CL is likely to operate in virtually the same way as s996 CL (and now s728(1) CLERP Bill) when there is a statutory disclosure obligation, even though s995 CL is not expressed on its face to apply to omissions from that disclosure obligation.

Like s1005 CL, causation remains an element of s729(1) CLERP Bill, although the words 'by the conduct' from s1005 CL have been substituted with 'because an offer of securities under a disclosure document contravenes subsection 728(1)'. The use of the phrase 'because an offer' in s729(1) CLERP Bill may be narrower than 'by the conduct' in s1005CL and imply a need for the loss to flow directly from the offer that is made using the defective document.

Little assistance can be gleaned on this point from the Explanatory Memorandum which simply states:

It will no longer be necessary in civil actions under the Law to establish that the misleading or deceptive statement, omission or new matter was material (Bill subsection 728(1)). However, in place of a materiality element, recovery of damages will depend on establishing that loss has been suffered as a result of the misleading or deceptive statement, omission or new matter (Bill subsection 729(1)).<sup>398</sup>

If that is the correct interpretation, it would seem to remove any possibility of recovery under s729(1) CLERP Bill using the fraud on the market doctrine which is discussed above in Chapter 5 under the *Causation* heading. Such a limitation would benefit persons who are involved in the fundraising activity by limiting the class of possible plaintiffs to subscribers (or in certain circumstances purchasers)<sup>399</sup> under the prospectus. However, it would also have the unfortunate result of preventing recovery under this provision for plaintiffs who would ordinarily be considered to be sufficiently direct and proximate to be able to sustain the cause of action, for example, when there is an intention to use the disclosure document to inform and encourage trading on the secondary market.<sup>400</sup>

It is interesting to note that for persons who acquire securities as a result of an offer accompanied by a profile statement, an action relating to a defect in the underlying prospectus will be available because the requirement for causation will be satisfied by deemed

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396. CLERP Bill, Schedule 3, Part 1, items 7, 19, 17 and 16.

397. CLERP Bill, Schedule 3, Part 1, items 62 and 57.

398. Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) 60.

399. Disclosure under a prospectus will be required for some secondary sales under the CLERP Bill (s707).

400. *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All ER 774.

reliance on the prospectus under s730(2) CLERP Bill. However, deemed reliance may provide a two edged sword.

For example, if the profile statement contains a defective statement and it is corrected in the prospectus, will the fact that a person who subscribed pursuant to the profile statement has relied on the profile and is deemed to have relied on the prospectus mean that the offeror and others involved in the contravention will be able to argue that the defect in the profile has been cured by the prospectus, even though the investor has not actually seen the prospectus? In my submission, the answer should be no and this could be argued by analogy with s52 TPA authority relating to the impact of disclaimers on pre-contractual misrepresentation.

In this context it has been held that:

A disclaimer or qualification will frequently have little or no effect on the impact of a misrepresentation. A man may tell a lie loudly while murmuring the truth inaudibly, unconvincingly, or so blandly that it is not likely to receive any hearing. Much the same may be true of a disclaimer which is so inconspicuous, or very general, or apparently merely formal.<sup>401</sup>

However, this problem could very easily be remedied by simply limiting the application of the deeming provision to actions in respect of a defective prospectus.

As is the case with s1005 CL, liability under any other law is expressly preserved in s729(4) CLERP Bill and the limitation period for bringing an action in s729(3) CLERP Bill is within 6 years after the day on which the cause of action arose.

## Persons Liable for the Disclosure Statement

The table following s729(1) CLERP Bill lists the persons who will be liable under s728(1) CLERP Bill and the extent of their liability. Under the table the person who has the capacity, or who agrees, to issue or transfer the securities if the offer is accepted (the offeror),<sup>402</sup> the directors of the offeror, proposed directors named with their consent and underwriters other than subunderwriters have deemed liability for the entire prospectus. In addition, persons named with consent as making a statement included in the disclosure statement, or on which such a statement is based, are deemed to be liable for those statements. Finally, liability is extended to persons who contravene s728(1) CLERP Bill and others involved in the contravention. Although this final category is included in the table in respect of which liability is deemed 'even if the person did not commit, and was not involved in, the contravention',<sup>403</sup> it cannot be accurately described as deemed liability because liability only extends to the actual contravention that the person committed or was involved in.

The categories of persons with deemed liability in the s729(1) CLERP Bill table has been substantially pared down from the s1006 CL list by removing promoters and all

401. Warren Pengilly, "But you Can't do That Any More!" — The Effect of Section 52 on Common Negotiating Techniques' (1993) 1 *Trade Practices Law Journal* 113, 123; quoting *Lezam Pty Ltd v Seabridge Australia Pty Ltd* (1992) ATPR 41-171, 40,356.

402. CLERP Bill s700(3).

403. Subsection 729(1) CLERP Bill.

advisers other than the lead underwriter. The exclusion of sub-underwriters, stockbrokers and sharebrokers from the list of persons with deemed liability for a defective prospectus recognises that their involvement in the offer and the preparation of the prospectus is much more limited than that of a lead underwriter and accords with a recommendation made by the Australian Stock Exchange Limited (ASX). The ASX recommendation suggested that not all underwriters should be liable for the entire prospectus and that there should be a differentiation between underwriters depending on their actual level of involvement (as is presently possible under s1010 CL).<sup>404</sup>

Under s729(1) CLERP Bill, persons who are named in the prospectus with consent as having made a statement that is included in the disclosure document, or on which statements are based, are the only advisers, professionals or experts who will be deemed to be liable for the defective prospectus and their liability is limited to those statements but no more. This is effectively a reiteration of liability for s1032 CL experts from s1006(2)(e) CL. This provision marries with the positive obligation for such 'experts' to consent to the inclusion of their statements (and those based on their statements) in the disclosure document. Therefore it will not be possible to use the reputation of an expert to help sell the offer unless that expert accepts liability for their statements by consenting to be named in the disclosure document.

It is important that persons who are actually 'engaged' in the contravention (ie primary participants) and persons 'involved in the contravention' (ie s79 CL accessories) are also included in this list because recovery in respect of a breach of s728(1) CLERP Bill is limited to the categories of persons listed in the table. In addition, the extent of each category's liability is also listed in the table and persons engaged or involved in a contravention are made liable for that contravention. This means that, despite the narrowing of the list, persons who are actually responsible for misconduct remain liable for that conduct. This should overcome any limitations resulting from the narrowness of the categories of deemed liability.

In addition, reliance on this general category may mean that the liability of promoters is substantially unchanged, despite the removal of promoters from the list of persons deemed to be responsible for the prospectus. This is because, in order for a promoter to fall within s1006(2)(d) CL it is necessary to have been a party to the preparation of the prospectus or of any relevant part of the prospectus.<sup>405</sup> Therefore, if the promoter has been a party to the preparation of the prospectus (which is a prerequisite for a promoter to fall within s1006(2)(d) CL) then the promoter is likely to have actually contravened, or at least been involved in the contravention of the prohibition in s728(1) CLERP Bill against offering securities under a defective disclosure document. As a result, such promoters will face liability despite the removal of the 'promoter' category from the s729(1) CLERP Bill table.

404. Australian Stock Exchange Limited, above n 356. But see discussion above in Chapter 9 under the *Persons Named in Part Only of the Prospectus — s1010* heading.

405. Section 9 CL and see discussion of promoters above in Chapter 9 under the *Defences for the Persons Primarily Responsible for the Preparation of the Prospectus — s1011 CL* heading.



The removal of ‘promoters’ from the list of persons with deemed liability for the entire prospectus has nevertheless been greeted unfavourably by a number of industry bodies.<sup>406</sup> The arguments for continuing liability for promoters are based primarily on their role in selling the offer, the benefits they receive from the sale and their knowledge about what is being sold:

The deletion of the promoter as a statutory defendant is striking — promoters’ nondisclosure was precisely the reason why mandatory disclosure was first introduced in the UK and the USA. In particular, promoters often know more information than anyone else about the true value of assets sold to a company. Hoping to pick that up through a fiduciary duty with confusing remedial consequences seems a strange contradiction of the posited need for law reform.<sup>407</sup>

However, the use of the ‘person who contravenes subsection 728(1)’ category is complicated by the definition of a person who offers securities in s700(3) CLERP Bill as ‘the person who has the capacity, or agrees, to issue or transfer the securities if the offer is accepted’, and the fact that s728(1) CLERP Bill prohibits the ‘offer’ of securities using a defective disclosure statement. Thus, it may be that a promoter could not be said to be responsible for the contravention as a promoter does not make an ‘offer’ of the securities as defined in s700(3) CLERP Bill.

The argument that follows is that a promoter could not be liable under s729 CLERP Bill as a principal offender for a breach of s728(1) because the prohibition in s728(1) relates to the ‘offer’ of securities and a promoter is unlikely to be an offeror within the very narrow definition in s700(3) CLERP Bill. However, this would not prevent the promoter from facing liability as an accessory (that is, a person involved in the contravention). As has been discussed above, liability for an accessory is less onerous as it must be shown that the accessory had knowledge of the essential elements of the offence.

## Due Diligence Defence for Prospectuses

The due diligence defence to civil liability under s729 CLERP Bill, for a breach of s728(1) CLERP Bill, is provided by s731 CLERP Bill.<sup>408</sup> The inconsistency in the current law whereby there are no defences available for s79 CL accessories is overcome by expressing the provision to apply to all persons who are subject to liability.

406. The Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, above n 380, 3; Law Council of Australia Corporations Law Committee, above n 356, 6; Law Council of Australia Consumer Law Committee, above n 366.

407. Michael Whincop, ‘Token Economics? One View of the CLERP Fundraising Reforms’, *Butterworths Corporation Law Bulletin* (5 November 1997) 22, 347.

408. In fact, ss731-733 CLERP Bill provide identical defences to both civil and criminal liability. The only difference between the extent of civil and criminal liability is found in s728(3) which limits criminal liability for a defective prospectus to the situation where the defect is both material and adverse. However, as has been discussed above in Chapter 6, civil recovery will also not be possible unless the defect is material and adverse despite the fact that the Corporations Law does not restate those principles. It is interesting to note that no criminal defence linked to the state of mind of the defendant is provided.

This defence picks up the due diligence test used in s1008A(4) CL and requires:

- all inquiries (if any) that were reasonable in the circumstances; and
- a belief on reasonable grounds (which incorporates the two concepts of reasonable belief and actual belief) that the statement was not defective or that there was no omission from the prospectus in relation to that matter.

Of the differences between this formulation and the current formulation in s1008A(4) CL, it is submitted that despite changing ‘such inquiries’ to ‘all inquiries’ and adding the phrase ‘in all the circumstances’ the due diligence obligation is unlikely to be any different. This is because ‘all’ would seem to be encompassed by ‘such’ and ‘in all the circumstances’ should be implicit.

Like s1008A(4) the due diligence defence for omissions in s731(2) CLERP Bill is not expressed broadly but is limited to ‘an omission from a prospectus in relation to a particular matter’ where reasonable inquiries have been made resulting in a reasonable belief that ‘there was no material omission from the prospectus in relation to that matter.’ As was discussed above in Chapter 9 under the *Directors’ Defences for Statements of Experts and Official Persons and for the Remainder of the Prospectus — s1008A CL* heading<sup>409</sup> the reference to ‘that matter’ may imply that the broad ‘matter’ from which there is an omission must at least have been canvassed in the prospectus.

Finally, the use of ‘if any’ has been carried over from s1008A(4) into s731. The use of these words has been criticised by some commentators as implying that in some cases no investigation will be necessary. These commentators argue that the words ‘if any’ are inappropriate because the very basis for a due diligence defence is the fact that inquiries are carried out.<sup>410</sup>

## Reasonable Belief Defence for OISs and Profile Statements

The defence for offer information statements and profile prospectuses is subject to a lower standard of inquiry. This has been done by removing the obligation to make inquiries. The effect is that the defence for profile statements and offer information statements in s732 CLERP Bill requires no more than a lack of knowledge of the defect.

In the context of the offer information statement this reduced requirement would seem appropriate because higher risk is the accepted trade off (coupled with warnings) in order to facilitate limited capital raising by small and medium enterprises. In the case of profile statements the aim is to provide simplified disclosure but without sacrificing accuracy. As a result, the reduced obligation seems less appropriate.<sup>411</sup>

However, the fact that the profile statement can only exist as an adjunct to the full prospectus for which due diligence must be undertaken, should reduce the risk that a piece of information needed to prevent the profile statement from being defective will not be discovered and therefore receive the benefit of the lack of knowledge defence. In addition, the fact

409. See discussion above at about n 255.

410. Golding, above n 355, 302.

411. Australian Competition and Consumer Commission, above n 380, 20.

that investors also have the benefit of deemed reliance on the full prospectus, will mean that they will have a cause of action in respect of the full prospectus if due diligence should have uncovered the defect.

## General Defences for All Disclosure Documents

### *Reasonable reliance on another*

A defence for reasonable reliance on information provided by another is provided by s733(1) CLERP Bill and is in similar terms to s1011(1)(b) CL. For the reasons discussed above in Chapter 9 under the *Reasonable Reliance* heading, it is difficult to see why the reasonable reliance formulation was selected in preference to the defence for expertised portions of the prospectus in s1008A CL. As has been discussed above, the policy of the s1008A CL defence permits the transfer of liability to an expert with their consent.

This defence would work equally well in the context of the CLERP Bill where the liability of experts, professionals and advisers is limited to the statements in the prospectus for which they accept responsibility. Of course, if the s1008A(3) CL defence replaced s733(1) it would also be necessary to insert a provision equivalent to s1008A(3) to give a defence for reliance on statements by official persons and the use of extracts from public official documents. As discussed above in Chapter 9 under the *Directors' Defences for Statements of Experts and Official Persons and for the Remainder of the Prospectus — s1008A CL* heading, there would appear to be no public policy benefits in transferring responsibility for defective public official statements to directors (and liability will not attach to the Crown in any event).

The CLERP Bill takes a more liberal approach:

Because all aspects of a disclosure document will not necessarily be within the expertise of all persons who may be potentially liable, a person who places reasonable reliance on information provided by someone else will also have a defence to any liability that arises from statements or omissions in relation to that information (Bill subsection 733(1)).<sup>412</sup>

However, this approach has the disadvantage of removing liability from the persons with principal responsibility for the prospectus when they rely on others, without moving the liability to the person responsible for the advice. This may leave a gap in the Corporations Law liability regime for investors who subscribe on the basis of a defective prospectus when the defect is the fault of an adviser upon whom it was reasonable for reliance to be placed. Although it may be that the gap will be filled, at least to some extent, because s729(1) CLERP Bill makes a person who actually contravenes or is involved in the contravention of s728(1) CLERP Bill, actually liable for that contravention. Therefore, an adviser may be liable as a person involved in the contravention if they have knowledge of the essential elements of the contravention.

The s733(1) CLERP Bill defence does have one advantage over s1008A CL in that an interpretative provision is included in s733(2) CLERP Bill to clarify the circumstances in

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412. Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) 61.

which an adviser does not become an agent. Subsection 733(2) states that 'a person is not the agent of the body or individual merely because they perform a particular professional or advisory function for the body or individual.' It is suggested in the Explanatory Memorandum to the CLERP Bill that:

a director of a fundraising body . . . [will not be precluded from] relying on information supplied by the fundraising body's employees as those persons are not employees of the director. A person will be able to rely on someone who performs a particular advisory or professional function provided they are not an agent for some other reason (Bill subsection 733(2)).<sup>413</sup>

It has been suggested that the s733(1) CLERP Bill defence should be expanded to permit reliance on employees and agents but, with respect, that is confusing the appropriate policy of permitting the delegation of due diligence inquiries and the inappropriate policy of giving a person a defence when they rely on themselves and get it wrong.<sup>414</sup> This point has been discussed above in Chapter 9 under the *Due Diligence Inquiries — ss1008A, 1009 and 1011* heading and is specifically highlighted in the Explanatory Memorandum to the CLERP Bill:

Although the body will not be able to rely on information supplied by its employees for the purpose of establishing a subsection 733(1) defence, it will be able to carry out due diligence through its officers and employees for the purpose of establishing a defence under Bill section 731.<sup>415</sup>

### *Withdrawal of consent*

A further defence is provided in s733(3) CLERP Bill for all the persons from whom consent is required for liability to attach. Such persons (proposed directors, underwriters, and experts/advisers/professionals to whom statements are attributed in the prospectus) are provided with a defence if they publicly withdrew their consent to be named in the prospectus in the way they were named. It is not necessary for this defence to extend to directors because a director has the power to prevent the lodgment of a prospectus. This is because s720 requires the consent of every director to the lodgment of the prospectus. After lodgment, directors are also the persons with control over decisions relating to the prospectus, including its withdrawal or the issue of a supplementary prospectus.

The s733(3) CLERP Bill defence is similar to the various withdrawal defences available under ss1008 and 1009 CL but without the detailed machinery as to when the withdrawal must occur and, in the case of experts and advisers, the form that the withdrawal must take. It would be desirable to increase the clarity of this provision by providing the latest time that withdrawal can be publicised in order to take advantage of this defence. Options to consider are: before lodgment of the prospectus; before the issue of the prospectus; or before allotment of the securities.

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413. Ibid.

414. Australian Institute of Company Directors, above n 356, 8; and see Corporate Law Economic Reform Program, *Commentary on Draft Provisions* (17 March 1998) 14–15.

415. Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) 61; see also Corporate Law Economic Reform Program, above n 414, 14–15.

In my submission it would be acceptable to provide a defence if the consent is publicly withdrawn before the allotment of securities. This is because, in the case of a prospectus that contains an invitation to treat (which is the usual case), applicants are able to withdraw their application at any time prior to their acceptance. Allotment would ordinarily be the act that indicates that the offer has been accepted. Therefore, if the consent is publicly withdrawn prior to allotment, applicants who were concerned about that withdrawal would have the option to withdraw their application. However, even without a provision to this effect, it would seem reasonable to assume that the ‘public withdrawal’ would need to occur before the cause of action arose, that is, before the plaintiff subscribed on the basis of the defective disclosure document.

### **Unawareness of new matter**

The final defence in s733(4) CLERP Bill appears aimed at limiting due diligence inquiries to the period up until the prospectus is lodged, after which due diligence inquiries are not required to discover ‘new circumstances’. However, if ‘new circumstances’ are discovered they must be disclosed. This is consistent with the ambit of the supplementary prospectus obligation in the current law (ss1023A — 1024 CL) and with the defence to criminal prosecution in s996 CL which limits the due diligence requirement to the period up to the issue of the prospectus. However, it may be less onerous than the current position under s1008A(4) CL which applies to the period up to allotment or issue of the securities.<sup>416</sup>

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416. Section 1008A(4) CL ... the person is not liable if it is proved that he or she, after making such inquiries (if any) as were reasonable, had reasonable grounds to believe, and did believe, until the time of the allotment or issue of the securities: (a) ... that the defective statement was true and not misleading; or (b) ... that there were no material omissions from the defective statement.

# Chapter 12

## Conclusion

The above analysis demonstrates that more work should be done to fine tune the drafting as well as some policy aspects of the CLERP Bill. Problems that have been identified include:

- the lack of machinery contained in the s733 withdrawal defence, particularly in relation to the period during which the withdrawal can be made;
- the restrictive effect of the s700(3) definition of ‘offeror’ on the application of the prohibition in s728(1) to ‘a person who contravenes . . . subsection 728(1)’. It is arguable that it limits this category of persons liable to persons who fall within the ‘offeror’ definition in s700(3);
- the possibility that the deemed liability provision for profile prospectuses in s729(2) may also result in constructive notice of information from the prospectus that corrects a deficiency in the profile statement, even though the investor has never seen the full prospectus;
- the limitation of the right to compensation beyond the ordinary requirements to show sufficient proximity and directness, as a result of the language ‘because an offer . . . under a disclosure document contravenes subsection 728(1)’, appears unduly strict when compared to the current formulation of ‘by conduct of another person’; and
- the choice of the s1011(1)(b) CL reliance test in preference to the s1008A(3) CL test which only provides relief where the liability is shifted to the person on whom reliance has been placed leaves the potential for a regulatory gap in respect of advisers who do not exercise due diligence in providing their advice.

In addition, two significant policy concerns have been examined. Firstly, the policy behind the proposal to remove the reverse onus of proof for forecasts has been considered and found wanting. Secondly, and more importantly, the removal of a raft of consumer protection provisions (other than s12DA ASIC Act which is equivalent to s52 TPA) without providing any reasons or analysis is disturbing and should, in my submission, not occur unless cogent reasons for their removal can be established.

However, even with the problems that have been identified (and which may yet be remedied) the benefits likely to flow from the simple and cohesive structure proposed by the CLERP Bill are significant. The above analysis of the existing liability provisions is far from definitive, not only because of the lack of case law interpreting the current provisions, but also because they have not been drafted with a cohesive regulatory policy in mind.

The provisions of the CLERP Bill benefit not just from simpler modern drafting techniques but, more importantly, from being considered together as a means of implementing

a clear policy. Leaving aside the question of whether that policy is pitched at the right level, the result is a set of provisions with a clear interaction. It is inevitable that the edges of their application will be grey, however, the advantages of the radically simplified proposals are likely to be substantial.<sup>417</sup>

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417. For a contrary view about the general benefits of a review of the liability provisions see Law Council of Australia Corporations Law Committee, *Corporate Law Economic Reform Program — Comments on Fundraising Reform Paper* (November 1997) 6 where it was stated: 'In light of the fact that, as far as we are aware, not one company director has been made liable for a misstatement in a prospectus or been successfully prosecuted in relation to a prospectus since the introduction of the Corporations Law on 1 January 1991, the focus on liability is inappropriate.'

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