IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA290/2019
[2019] NZCA 404

BETWEEN	ERIC MESERVE HOUGHTON Appellant
AND	TIMOTHY ERNEST CORBETT SAUNDERS, SAMUEL JOHN MAGILL, JOHN MICHAEL FEENEY, CRAIG EDGEWORTH HORROCKS, PETER DAVID HUNTER, PETER THOMAS AND JOAN WITHERS First Respondents
	CREDIT SUISSE PRIVATE EQUITY INCORPORATED Second Respondent
	CREDIT SUISSE FIRST BOSTON ASIAN MERCHANT PARTNERS LP Third Respondent

Hearing:	26 August 2019
Court:	French, Collins and Wild JJ
Counsel:	C R Carruthers QC and PAB Mills for Appellant A R Galbraith QC, D J Cooper and M C Harris for First Respondents other than S Magill and J Withers T C Weston QC for First Respondent S Magill B D Gray QC and A E Ferguson for First Respondent J Withers JBM Smith QC, A S Olney and C J Curran for Second and Third Respondents
Judgment:	2 September 2019 at 3 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant is to pay each of the separately represented respondents costs for a standard appeal on a band A basis with usual disbursements.

C We certify for second counsel for each of those separately represented respondents.

REASONS OF THE COURT

(Given by Wild J)

Introduction

[1] This is an interlocutory appeal in the "Feltex" litigation. It is against a judgment of Dobson J delivered on 15 May, dismissing Mr Houghton's application that any defence relying on s 63 Securities Act 1978 be struck out.[1]

Background

[2] Feltex Carpets Limited was floated to the public in May 2004. By September 2006, the company had collapsed financially and was put into receivership and then liquidation.

[3] Representing some 3,000 subscribers for shares in the public offer, Mr Houghton sues the directors of Feltex and the promoters of the issue claiming compensation. Mr Houghton's fourth amended statement of claim, filed on 14 March 2014, pleads four causes of action. The second of these is directed against Mr Magill alone (he was Feltex's only executive director). The others allege breach of s 9 Fair Trading Act 1986, breach of s 56 Securities Act (the Act), and negligence. This application focuses on the claim under the Act. In that cause, Mr Houghton alleges the respondents are liable for making, in the prospectus, an untrue statement in the Company's forecast of its revenue in the 2004 financial year.

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1 *Houghton v Saunders* [2019] NZHC 1061.

[4] Over a decade has passed since Mr Houghton filed his statement of claim. In 2012 the High Court, with the parties' agreement, directed that the case be split into two stages for hearing.[2]

[5] Stage one of the litigation has travelled to the Supreme Court. In a judgment delivered on 15 August 2018, the Supreme Court held the defence in s 56(3)(c) of the Act was not available to the respondent directors.[3] Although the availability of relief under s 63 of the Act was not in issue at stage one of the litigation, the Supreme Court did make some comments about its availability. We will revert to those.

[6] The availability of relief under s 63 became an issue when the respondents sought to include it in the issues for determination in stage two. Those issues were settled by Dobson J in a hearing last February.

[7] Mr Houghton then applied, on 27 February 2019, to strike out the s 63 defence (effectively, to have its availability removed from the list of issues). The judgment under appeal dismissed that application.

[8] There is urgency in delivering this judgment because the stage two hearing is scheduled to commence before Dobson J on 4 November 2019. We are conscious that Mr Houghton may, in the interim, seek leave to take this matter to the Supreme Court.

The two provisions

[9] The strike out application is based on the following parts of ss 56 and 63 of the Act:

> **56 Civil liability for misstatements in advertisement or registered prospectus**
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> (1) Subject to the provisions of this section, the following persons shall be liable to pay compensation to all persons who subscribe for any securities on the faith of an advertisement or registered prospectus which contains any untrue statement for the loss or damage they may have sustained by reason of such untrue statement, that is to say:
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> …

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2 *Houghton v Saunders* [2012] NZHC 1828, [2012] NZCCLR 31.
3 *Houghton v Saunders* [2018] NZSC 74.

(c) in the case of a registered prospectus, every person who has signed the prospectus as a director of the issuer or on whose behalf the prospectus has been so signed, or who has authorised himself or herself to be named and is named in the prospectus as a director of the issuer or has agreed to become a director either immediately or after an interval of time:

(d) every promoter of the securities.

…

(3) No person shall be liable under subsection (1) in respect of any untrue statement included in an advertisement or registered prospectus, as the case may be, if he or she proves that—

…

(c) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he or she had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true;

…

63 Power of court to grant relief in certain cases

(1) If in any proceedings against any person for negligence, default, breach of duty, or breach of trust in connection with—

(a) an offer to the public …

…

it appears to the court hearing the case that the person is or may be liable in respect of the negligence, default, breach of duty, or breach of trust, but that he or she has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he or she ought fairly to be excused for the negligence, default, breach of duty, or breach of trust, the court may relieve him or her either wholly or partly from his or her liability, on such terms as the court may think fit.

Mr Houghton's argument

[10] In his written submissions for the appellant, Mr Carruthers QC advanced three crisp arguments. As he developed these, they synthesised into two:

(a) as a matter of law, Mr Houghton's claim for compensation under s 56 is not a proceeding against the respondents "for negligence, default,

breach of duty, or breach of trust" in connection with the Feltex offer to the public. It therefore does not come within the ambit of s 63 and relief under that section is not available to the respondents; and

(b) as a matter of fact, even if relief under s 63 was available to the respondents, the Supreme Court's judgment precludes the respondents from that relief.

[11] This second argument relies on the following part of the Supreme Court's judgment:[4]

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

Mr Houghton argues that the words we have emphasised preclude any possibility of the respondents obtaining relief under s 63. Because the Supreme Court has held the respondent directors did not have "reasonable grounds" for believing the statement was true, it is not possible for them now to argue they "acted honestly and reasonably" in relation to that statement. As a matter of fact, a person who lacks reasonable grounds for belief in the truth of a statement cannot also be considered to have acted reasonably and honestly. Lacking reasonable grounds for belief is by definition dishonest and unreasonable.

[12] We will term these, respectively, the legal and factual arguments. For the different reasons that follow, neither of these arguments can succeed.

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4 *Houghton v Saunders*, above n 3, at [291] (emphasis added) (footnote omitted).

The legal argument

[13] Mr Carruthers began by outlining what he said was the structure of the relevant provisions in Part 2 of the Act. Sections 55–57A deal with civil liability, ss 58–60 with criminal liability, and ss 61–65 with a third and different category of liability. Mr Carruthers' written submissions categorised this as "liability for special relationships".

[14] Mr Carruthers described s 56 as a completely self contained provision. Section 56(1) imposes liability on the respondents. Section 56(3)(c) provides the defence which the Supreme Court has held is not available to the respondent directors. Moving to ss 61–65, Mr Carruthers argued that the relief from liability for "negligence, default, breach of duty, or breach of trust" available under s 63 can only refer to liability arising under ss 61–62 because those sections employ exactly the same language (or, in the case of s 62, just the words "liability for breach of trust").

[15] The flaw in this argument was pointed out by counsel for the respondents: ss 61–62 do not impose liability. They prohibit certain insurance covers and permit other covers. Any indemnity given in breach of s 61 is void: s 61(2). And s 62 voids certain liability exempting provisions in deeds or contracts relating to debt or participatory securities.

[16] Confronted with this, Mr Carruthers submitted that relief under s 63 is available for a contravention of the prohibitions in ss 61 and 62. But, as the Court pointed out to Mr Carruthers, that would mean that s 63 would relieve people who had either issued, or been issued with, void insurance, or entered into a deed or contract containing void provisions. Relief under s 63 is simply not needed by such people. The legal consequence of insurances, and deeds and contracts, that contravene ss 61 and 62 respectively is that they are void.

[17] Mr Carruthers' argument faces the further difficulty that s 63 applies to "any proceedings against any person for negligence, default, breach of duty, or breach of trust …". Sections 61–62 are not concerned with proceedings. Rather, their subject matter is as outlined in [15] above.

[18] It follows that we do not accept that the relevant sections of the Act can be compartmentalised and construed in the manner suggested by Mr Carruthers.

[19] What then is the ambit of s 63? In particular, does it encompass a claim for compensation under s 56(1)? In our view it does. First, the words in s 63 "*any* proceedings against any person for negligence, default, breach of duty, or breach of trust …" are wide. The emphasis is ours. In *Deputy Commissioner of Taxation v Dick*,[5] Spigelman CJ described those same words in s 1318 of the Corporations Act 2001 (Cth) as involving "interrelated, overlapping expressions intended to cover a wide field within the context of civil proceedings".[6]

[20] Mr Carruthers submitted that the respondents' action in issuing the prospectus when they knew it contained an untrue statement was not within the wording of s 63. He said it could only come within the concepts of "default" or "breach of duty" and it was neither. A positive act rather than an omission was involved. Further, he argued that liability on the respondents under s 56(1) arose, not through their act or omission, but by virtue of their office as directors and promoters. Certainly, s 56 imposes liability only on those persons in the categories described in s 56(1)(a)–(d). But that liability is imposed on those persons because of their involvement in the issue of a prospectus containing an untrue statement. So liability depends both on office and conduct, be it act or omission.

[21] We agree with counsel for the respondents that s 34(1) of the Act imposes a duty not to distribute a prospectus if it is false or misleading. It provides:

> **34 Restrictions on distribution of prospectuses**
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> (1) No registered prospectus shall be distributed by or on behalf of an issuer,—
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> …
>
> (b) If it is false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances (whether or not it became so misleading as a result of a change in circumstances occurring after the date of the prospectus).

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5 *Deputy Commissioner of Taxation v Dick* [2007] NSWCA 190, (2007) 67 ATR 762.
6 At [15].

[22] It follows that Mr Houghton's claim for compensation under s 56 is a claim arising out of a "breach of duty", within the terms of s 63. We consider the claim is also within s 63 because it is for "default" on the respondents' part. The wide definitions of 'breach of duty' and 'default' in *Black's Law Dictionary*[7] and *Stroud's Judicial Dictionary of Words and Phrases*,[8] referred to by Mr Smith QC, support that view. In particular, *Stroud* defines 'default' in this way:

> "Default" has been described as a large and loose word and in the most general sense means failing … and is a relative term, like negligence, and means not doing what is reasonable under the circumstances having regard to the relations which you occupy towards the other persons interested in the transaction …
>
> (Citations omitted.)

[23] We also accept the submission by respondents' counsel that there is a sequential relationship between s 56 and s 63. Section 56(1) imposes liability. If the s 56(3) defence is available it removes that liability – "no person shall be liable …". Section 63 is engaged only if the s 56(3) defence is either not available or not successful. That is the view Richardson J took in *Fleming v Securities Commission*.[9] Having referred to the civil and criminal liability imposed by ss 56–58, and the effect of ss 61 and 62, the Judge stated:

> It is in that context that s 63 empowers the High Court to grant relief … In my view it is apparent from the statutory context that s 63 is directed to relief from the civil liability imposed or recognised in the preceding sections.

[24] As Dobson J observed:

> [19] Those comments treat s 63 as a provision that has potential application after civil liability has been made out. There would be no point in creating the discretion if the identical test was to apply to cases in which a director was not exempt from liability for untrue statements pursuant to s 56(3)(c).

[25] In addition to the sequential operation of ss 56 and 63, there are other differences standing in the way of the appellant's attempt to equate the operation of the two provisions. First, as we have pointed out, if the s 56(3) defence succeeds,

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7 *Black's Law Dictionary* (10th ed, Thomson Reuters, 2009) at 226 and 507.

8 *Stroud's Judicial Dictionary of Words and Phrases* (9th ed, Sweet and Maxwell, 2016) at 294 and 622.

9 *Fleming v Securities Commission* [1995] 2 NZLR 514 at 527–528.

liability is removed. But s 63 does not have the same effect. As Santow JA explained in *Dick* of the Australian equivalent of s 63:[10]

> [T]here is a consistent theme that the court should have power to relieve, in order that penal provisions or quasi penal provisions should not operate unfairly or harshly. Relief so extended does not strictly speaking exonerate the person in question by removing the breach; rather it operates as a dispensing power excusing the contravenor. "Exonerate" used in this s1318 context has therefore the sense of taking a burden from a person who has committed a breach. It does not mean that the breach is deemed never to have occurred. Rather the person concerned seeks to satisfy the court that "having regard to all the circumstances of the case" he or she "ought fairly to be excused" so as to receive dispensation.

[26] We agree with the conclusion Dobson J reached on this first point:

> [25] This distinct character of the discretion exemplifies the distinction to be drawn between the function of s 56 as establishing liability subject to exemptions, and, if liability is made out, the prospect of discretionary relief from that liability by application of s 63.

[27] Second, and again we have pointed this out, the s 56(3) defence is a complete one: it removes liability. On the other hand, the relief available under s 63 may be partial and it may be conditional — "the court may relieve him or her either wholly or partly from his or her liability, on such terms as the Court may think fit".

[28] Third, a person may seek relief under s 63 in advance, in anticipation of the imposition of liability: s 63(2). Not so under s 56(3).

[29] Fourth, the Australian equivalent of s 63 has been held to be wide enough to enable the Court to allocate liability between defendants. In *AWA Ltd v Daniels trading as Deloitte Haskins & Sells* Rogers CJ held the provision:[11]

> [was] appropriate to operate as a provision for the proper allocation of fault. … The expression "having regard to all the circumstances of the case" in s 1318 is all-embracing and it is not clear to me what advantage to the proper administration of the law is to be had from denying full scope for its operation.

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10 *Deputy Commission of Taxation v Dick*, above n 5, at [78].

11 *AWA Ltd v Daniels trading as Deloitte Haskins & Sells* (1992) 7 ACSR 759 (NSWSC) at 856.

[30] What the Chief Justice had in mind is the ability to distribute liability by wholly relieving some defendants, partially (and to varying extents) relieving others, and refusing relief to the remaining defendants. There is not that liability in s 56(3).

[31] Mr Gray QC advanced a further powerful argument against Mr Carruthers' argument on the relationship between ss 56 and 63. If the wording "negligence, default, breach of duty or breach of trust" in s 63(1), which is also the wording of s 61(1), does not encompass a claim for compensation under s 56(1), then the result would be that insurance covering liability under s 56(1) would not be prohibited. In other words, while insurance indemnifying a director for liability for negligence (to take one example) was prohibited, the same would not be true of cover indemnifying for liability for an untrue statement in a prospectus.

[32] That outcome does not accord with the purpose of s 61. Mr Carruthers was unable to identify any policy reason why the legislature would choose to exclude s 56 claims in that way, other than to suggest it would not be the only anomaly in the Act. But it is a well established principle of interpretation that Courts should try and avoid an interpretation that results in an illogical outcome.

[33] Dobson J considered the respondents' position that relief under s 63 remains available to them was also supported by the Supreme Court's judgment. We agree. As the Judge noted,[12] there was limited consideration of s 63(1) before him in the High Court, none in this Court, and no argument about s 63 before the Supreme Court. Mr Galbraith QC informed us that the Supreme Court, in a minute issued about a week after the hearing, requested copies of the submissions in the courts below. With the benefit of that material, the Supreme Court said this:[13]

> [283] Section 63(1) was discussed only briefly in the decision of Dobson J. He simply noted that if it were found that the due diligence defence under s 56(3) was unavailable, he was not in a position to make any findings of any distinguishable circumstances in which any of the defendants would nonetheless be entitled to some measure of relief under s 63(1).[14] He said the matter would need to be reargued if the application of s 63(1) became an issue. Section 63(1) was not referred to by the Court of Appeal and was not the subject of argument in this Court. We will confine our attention to

12 Houghton v Saunders, above n 1, at [32].
13 *Houghton v Saunders*, above n 3.
14 *Houghton v Saunders* [2014] NZHC 2229, [2015] 2 NZLR 74 at [557].

> s 56(3)(c), but we note that Dobson J's observation that, if any of the respondents were found to be liable under s 56(1) and unable to avail themselves of the defence under s 56(3)(c), then the availability or unavailability of relief under s 63(1) would need to be reargued.[15]
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> …
>
> [292] The unavailability of the s 56(3)(c) defence does not prevent any respondent found to be in breach of the Securities Act from arguing that s 63(1) should be applied to relieve them from liability. As mentioned earlier, we did not hear argument on the application of that section and, if a decision needs to be made about its application, it will have to be made at the stage 2 hearing.[16]

[34] Mr Carruthers is justified in emphasising that the availability to the respondents of relief under s 63 was not argued before the Supreme Court. However, the passages we have set out lend no support to his argument that there is equivalence between s 56(3)(c) and s 63(1), so that the Supreme Court's decision that the defence in the former is not available to the respondents must mean that relief under the latter is not available either. On the contrary, those passages suggest that the Supreme Court considered that relief under s 63(1) was still open to the respondents, and was a matter for argument in the current (stage two) phase of this litigation.

[35] For all those reasons we conclude that the legal argument is wrong.

Factual argument

[36] Mr Carruthers' second, factual, argument does not meet the strike out threshold.[17] A person who does not believe in the truth of a statement may nevertheless be held to have acted honestly and reasonably in making it, or permitting it to be made. The phrases "reasonable grounds to believe" in s 56(3)(c) and "acted honestly and reasonably" in s 63(1) are not necessarily co-extensive. And the passages in the judgment of the Supreme Court which we have set out cannot be interpreted as saying they are. We have in mind particularly the comment in the passage set out

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15 The respondents specifically maintained the "defences" under s 56(3)(c) and s 63 if they were found to be otherwise liable under s 56.

16 In a footnote at the end of its [292], the Supreme Court referred back to its [283].

17 *Couch v Attorney-General* [2008] NZSC 45, [2008] 3 NZLR 725 at [3].

in [11] above that the directors "may be able to establish that they believed [the revenue forecast] was untrue only to an immaterial extent".[18]

[37] Although the respondents may face an uphill battle, it is arguable they may, on the facts, be able to make out a case for relief under s 63(1). For that reason strike out of the s 63 issue is inappropriate.

Result

[38] For the reasons we have given this appeal is dismissed.

[39] The appellant is to pay costs to each of the separately represented respondents for a standard appeal on a band A basis with usual disbursements. We certify for two counsel for each of those separately represented respondents.

Solicitors:
Antony Hamel, Dunedin for Appellant
Gilbert Walker, Auckland for First Respondents
Wilson Harle, Auckland for First Respondent J Withers
Russell McVeagh, Wellington for Second and Third Respondents

[18] *Houghton v Saunders*, above n 3, at [291].