

Capital Holders

Other Remedies for Capital Holders

Misrepresentation in Prospectus

When a shareholder buys shares in a company on the basis of the prospectus, they may have a remedy if there was a misrepresentation in the prospectus.

There are a number of remedies which overlap, and there is a certain lack of clarity in the law in this area, largely because it's been a common law development and concerns two different areas of law - contract and tort.

[A] Civil Remedies

1) Rescission of the acquiring contract (most important)

- Rescission is where the innocent party is put back in the position they were in before the misrepresentation, e.g. the share certificate and monies returned.
- There are three types of misrepresentation - negligent, innocent and fraudulent
- Can only be exercised against the other party to the contract - there is a difference if the other party to the contract is the company or a private individual
- Subject to the requirement that the other party was responsible for the misrepresentation. In other words, may read a company prospectus, but may buy shares from another source
- Alternatively, the prospectus may be issued by an *issuing house*, in which case that action will lie against that *issuing house* and would be impossible to rescind the contract if it has gone into receivership or liquidation
- What about the expected profits (dividends) on the shares? - under contract law, can only recover the cost of the shares - to recover the dividends, etc., will have to sue in the law of tort

2) *Can the plaintiff recover damages as well as rescission?*

The amount of money recoverable is directly related to the degree of misrepresentation. There has also to be a degree of reasonable expectation. There is also the possibility that:

3) *Damages from persons other than the party to the contract?*

There may be circumstances where the plaintiff is unable to claim rescission of the contract, here, the plaintiff would be unable to have any remedy against the company. There is a potential liability in respect of directors of a company, due to the fact that the directors will have authorised the prospectus. So, there is a potential liability if statements contained in the prospectus are false. If the directors know that the statements are untrue, there may be action under the tort of deceit.

4) *Can the plaintiff proceed against anyone else responsible for misstatements in the prospectus?*

Ref. Hedley Byrne v Heller - a person may be liable for negligent misstatements provided that there is a sufficient degree of proximity

No definitive definition of what constitutes sufficient proximity. To a certain extent, this has been limited by the courts because of the fear of floodgate argument.

Therefore, the courts have generally tried to restrict the operation of this proximity rule. Therefore liability will rise within the immediate circle of distribution of the prospectus, and is less likely where the prospectus is distributed by, for example, a national newspaper.

Specifically to Hedley Byrne v Heller, similar to the tort of deceit - not just those who have subscribed to the shares / debentures - but, potentially those who have obtained shares in the open market. There may be possible actions under the Misrepresentation Act 1967, s.2(1).

Generally speaking, directors can be liable under the act as well.

[B] Criminal Liabilities

Financial Services Act 1986, s.47(1) - it will be an offence for anybody who is involved in business to knowingly supply false particulars. In other words, they have to:

- a) knowingly or recklessly (dishonestly or otherwise) to make a statement, promise or forecast, which is false, misleading or deceptive; or
- b) dishonesty to conceal material facts, provided in either case that this is done to induce, or reckless as to whether it induces, a person to enter or to offer to enter, an investment agreement, or to refrain from so doing, or to exercise, or refrain from exercising, rights conferred by the investment

By virtue of s.47(3), it will be a defence if the person concerned can prove that they reasonably believed that the actions / conduct would not create an impression that was misleading or false.

The maximum possible penalty is 7 years in prison, and there is a further offence committed if the published particulars are not copied to the Registrar of Companies.

The Financial Services Act 1968, s.202 is also of relevance. Where an offence is committed by a company, and this offence is proved to have been committed with the consent or connivance or is attributable to any neglect on the part of a director, manager, secretary or other similar officer of the company, that person as well as the company itself will be guilty of the criminal offence.

Also related to s.57 of the same Act - investment adverts can only be issued with the approval of authorised persons. If there is no such approval, then a criminal offence is committed.

Theft Act 1968, s.19 is also relevant - it provides that if a company officer or a person purporting to be a company officer publishes a statement which they know is or may be misleading with the intention of deceiving members or creditors, and offence will be committed. Again, punishment is up to 7 years imprisonment.

Came in as part of a common law case - Crown v Lord Kylsant (1932).

In this case, the issue of the prospectus said that a certain amount of dividends had been paid, whilst true that these dividends had been paid, it was omitted that this had only been possible because the company had drawn on secret reserves, and the omission was therefore also a misleading statement.