Statutory civil liabilities of corporate gatekeepers for defective prospectuses in Australia, the United States, the United Kingdom and Canada: a comparison

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Abstract
Securities regulation is largely the regulation of information asymmetry in relation to the selling of financial assets described as securities. This selling requires information concerning issuers and their securities to be disclosed to the investing public. Securities regulation seeks to regulate this disclosure in order to ensure a level playing field between issuers and their potential investors. The House of Lords in Peek v Gurney held in 1873 that the objective of a prospectus was to enable investors to make an informed investment decision. Most of the recent corporate failures in the United States between 2001 and 2002 such as Enron, WorldCom, Tyco, HealthSouth and Adelphia resulted from financial scandals in which issuers attempted to maximise the price of their securities by creating misimpressions about their financial health. Very recently, the Australian Securities and Investment Commission (ASIC) has expressed disappointment at "the significantly worse performance of auditors" found in an 18-month audit of auditors conducted by the regulator. This malpractice is sometimes a deliberate fabrication of material facts, while other times it is a product of recklessness or negligence on the part of persons involved in the preparation and issuance of disclosure documents. Such a practice has a perilous impact upon the integrity of, and investor confidence in, the market.

Keywords
united, states, kingdom, canada, comparison, liabilities, corporate, gatekeepers, defective, prospectuses, statutory, australia, civil

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The securities regulation is largely the regulation of information asymmetry in relation to the selling of financial assets described as securities. This selling requires information concerning issuers and their securities to be disclosed to the investing public. Securities regulation seeks to regulate this disclosure in order to ensure a level playing field between issuers and their potential investors. The House of Lords in *Peek v Gurney* held in 1873 that the objective of a prospectus was to enable investors to make informed investment decision.¹ Most of the recent corporate failures in the United States between 2001 and 2002 such as Enron, WorldCom, Tyco, HealthSouth and Adelphia resulted from financial scandals in which issuers attempted to maximise the price of their securities by creating misimpressions about their financial health.² Very recently, the Australian Securities and Investment Commission (ASIC) has expressed disappointment at ‘the significantly worse performance of auditors’ found in an 18-month audit of auditors conducted by the regulator.³ This malpractice is sometimes a deliberate fabrication of material facts, while other times it is a product of recklessness or negligence on the part of persons involved in the preparation and

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¹ (1873) 6 LR 377. See also *Scott v Dixon* (1859) 29 LJE 620 (QB).


issuance of disclosure documents. ⁴ Such a practice perilously impacts upon the integrity of, and investor confidence in, the market.

By virtue of possession of inside information, each of the gatekeepers such as auditors, lawyers and underwriters are able to serve as watchdog for the investing public. ⁵ The financial scandals occurred where ‘watchdogs failed to bark when the issuer’s disclosures obscured the less favourable underlying reality of its economic situation’. ⁶ Referring to the massive gatekeeper failures causing corporate collapses over the past decade in the US, John Coffee asserts that ‘the United States’ much vaunted system of corporate governance was suddenly compromised’. ⁷

Investors are expected to invest their savings in securities in reliance on the public disclosure made by the issuer. The issuer hires different gatekeepers in preparation for going public for raising funds. Although they are hired and accordingly paid by the issuer, they are ultimately intended to serve investors who are generally unfamiliar with the material information about the issuing entity and the individuals behind it. The issuer needs to win the confidence of the investing public in order to gain capital from them. Hence, the gatekeepers who are called ‘reputational intermediaries’ ⁸ between issuers and their potential investors are paid in a bid to convince the investing public for subscribing to offers made by their payers. A twomaster problem is thus apparent in the essential connection between the roles of these gatekeepers and the very purpose of convincing investors by disclosure.

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⁴ ‘Disclosure documents’, ‘registration statements’ and ‘prospectuses’ have some differences in their meanings which vary between jurisdictions. However they broadly represent the expression ‘disclosure in the primary share market’. Hence for convenience they will be used interchangeably in this study.

⁵ Fox (2008) above n2. The concept of ‘gatekeeper’ will be discussed at some length later in this article.

⁶ Ibid.


⁸ Id at 2.
Disclosure is believed to be the ‘Holy Grail’ of securities markets in that an information asymmetry obviously exists between issuers and their potential investors. Disclosure that bridges the gap is a mechanism employed by regulators to protect investors from the misfeasance of other market players, and it is a historically proven fact that investors are unable to protect themselves from the misfeasors.\(^9\) Hence the primary responsibility of these gatekeepers is to help create a level playing field by minimising, if not eliminating, the informational asymmetry between the two unequal players being the issuer and their potential investors. In order to facilitate a fair-play between them, provisions governing disclosures around the world commonly require ‘full, fair, accurate and timely’ disclosure of material or price sensitive information about issuers and the shares to be offered. To this end, two of the three objectives of securities regulation recognised by the International Organisation of Securities Commissions (IOSCO) include: protecting investors, and ensuring market fairness, efficiency and transparency.\(^{10}\) Consistently, securities regulators all over the world are explicitly biased towards the weaker party, the subscribers to the issue, in recognition of the fact that the development of a securities market essentially requires investor protection.\(^{11}\) The regulatory role in relation to public offerings is therefore concerned


with the proper disclosure by issuers.

The corporate disclosure in the primary share market involves participation of a group of individuals comprised of, amongst others, directors and the so called gatekeepers. They are together called the ‘IPO Coalition’. The importance of the roles of gatekeepers is perhaps best evident from the fact that ‘[h]alf of the $50 billion of new securities offered during the decade following World War I proved to be worthless’. Gatekeepers were largely responsible for the recent corporate debacles in the developed world. Given the scale of the deceitful public issues of securities, it has been argued that ‘[t]he flotation of such as mass of essentially fraudulent securities was made possible because of the complete abandonment ... of... standard of fair, honest, and prudent dealing....’ In such a situation, the accountability of wrongdoing through liability for ‘defective disclosure’ is believed to be an effective measure to combat the wrongdoings. In support of this view, Milton Cohen observes that ‘the liability provisions have had the in terrorem effect of creating an extraordinarily high sense of care and responsibility in the preparation of registration


16 For the purposes of this article, a ‘defective disclosure’ or ‘defective prospectus’ means a disclosure document which contains untrue or misleading or deceptive statement or omits to state a relevant material fact.
statements'.

This article examines the statutory provisions concerning the liabilities of auditors, lawyers and underwriters for defective disclosures that are issued by corporations in raising share capital from the public in Australia, the US, the UK and Canada. The statutory civil liability is particularly important where their liability under the common law tort of negligence is avoided by the strict requirements of proximity, foreseeability, causation and reliance more or less in all of these four jurisdictions. It concludes that statutory provisions concerning gatekeeper civil liability are ambiguous, although some of them in some instances apparently impose liability on auditors or underwriters but in most cases gatekeepers are not categorically named as persons who can be held liable for defective prospectuses, which may have resulted from difficulties in common law and ambiguities in statutory laws. Hence this article identifies the statutory ambiguities and recommends clarification of the existing statutory civil liability provisions for defective prospectuses by legislative amendments instead of waiting for their judicial interpretations in the future.

Role of Gatekeepers in Preparing Disclosure Documents and the Rationale for Their Liabilities

Auditors

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17 Cohen (1966) above n 9 at 1355.
19 For example, there are no suits against gatekeepers in Australia: G Golding, The Reform of Misstatement Liability in Australian Prospectus Laws, (2001) unpublished PhD dissertation, The University of Sydney, Australia p362. The present writer did not find any cases against them in Australia.
Generally, the auditors are the gatekeepers who are first hired for the disclosures in primary share markets and they ‘must observe inventory and confirm accounts receivable’ for their reports. The primary role of auditors is to ‘review, analyse, and determine the validity’ of the claims intended to be made by their clients in disclosures in the primary share market. More importantly, they are sometimes regarded as independent guarantors of truth and fairness in the financial disclosures. Compared to the role of lawyers, auditors engage in a back-up role in reviewing and testing the information contained in the disclosure document. Given their role in verifying the financial details of the issuer, it can be argued that the accuracy of disclosures in a prospectus largely depends on the role of the auditors who attach a due diligence certificate to the prospectus concerning the accuracy of the information in relation to the financial status of the issuer. Melissa Harrison argues that auditors usually have much influence over the contents of the disclosures that often mislead or defraud investors. Public reliance on auditors is clearly evident from the report that the investors significantly lost their confidence in auditors and accountants in the aftermath of the collapse of Enron. When an American company comes into play, a vast majority of 73 per cent Canadians expressed their concerns about protections and believed that an Enron-like scandal would occur there as well.

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Generally, auditors act behind the scene and the imposition of liability on them is reasonable because ‘they have an impact on the disclosure’s capacity to deceive’.

In appreciation of their crucial role in drafting fraudulent disclosure documents, the Court of Appeals for the Ninth Circuit in the US has suggested primary liability for auditors. Expressing a similar view, a district court in California pronounced that the simple involvement or participation in a fraudulent disclosure is sufficient for liability to be imposed. Law generally imposes monitoring responsibility on gatekeepers rather than merely a duty to report, as a result they are considered to be liable for primary violations of compliance with disclosure requirements. An academic investigation reveals that the extent of liability of auditors has positive impacts on the performance of their professional duties.

Accounting and economic literature is not something readily understandable to everyone especially to those who are investment illiterate. In each and every share market, there are numerous investors that have hardly any knowledge of investment and/or financial affluence, as a result they lack the ability to buy professional advice, nonetheless they are investors relying upon the professionals hired by the issuer of the shares. Such investors are vulnerable and they are retailers who provide constant liquidity to the market, and therefore their protection is imperative. Auditors, together with other professionals, bluff or defraud not only the investors but also the regulator. This is so because the regulator in a disclosure regime approves an IPO proposal believing that the disclosures in prospectuses are true, fair, accurate and complete, in

29 In Re ZZZZ Best Co Sec Litig 864 F Supp 960 (1994) at 970.
one word, flawless; even though the watchdogs may have their own mechanisms to verify the truth in the document. Taking into account the critical role of auditors in the preparation of defective disclosures and their damaging consequences on investors as well as on the market, it can be plausibly argued that personal liability be imposed on them in order to maintain public confidence and protect investors in the primary share market.

**Underwriters**

Basically, an underwriter plays the role of an intermediary between issuers and their investors. An underwriter, in exchange for a portion of the sale proceeds, assumes the inherent risk of the issuer’s failure to sell the offer in full.\(^{32}\) By taking the responsibility for the risk, they provide an implied guarantee that the shares being offered have been properly priced. It means all the public and private material information that may affect the value of the shares offered is reflected on the price. Unlike sophisticated investors, general investors known as ‘unsophisticated’ or even sometimes ‘amateur’ investors, rely on the agreement between the issuer and its underwriters with respect to the pricing of shares owing to the fact that they are unable to determine the fair price of the issue themselves. In practice, it is reasonable that investors rely on underwriters to verify the accuracy of the statements included in the disclosure and the soundness of the relevant offer.\(^{33}\) One commentator says that ‘underwriters face strong incentives to act as certifiers, if they can provide credible assurances that an issuer’s disclosures are truthful, investors will be willing to pay more for the issuer’s securities’.\(^{34}\) In return, the issuer will be willing to pay more to

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\(^{32}\) *In re WorldCom, Inc Sec Litig* 346 F 2d 628, 662 (SDNY 2004)

\(^{33}\) *Chris-Craft Industries Inc v Piper Aircraft Corp* 480 F 2nd 341 (1973) at 370.

the underwriter whose certification helped the former to raise more capital from the
market.\textsuperscript{35} Thus the underwriter takes the responsibility to ensure truth in corporate
disclosures,\textsuperscript{36} and they are expected to unearth exaggerations and puffy
statements made by the issuers.\textsuperscript{37} In this respect, the Second Circuit Court in the USA held in
\textit{Chris-Craft Indus. Inc v Piper Aircraft Corp} that the underwriters have a considerable
financial stake in the public issue, therefore they have ‘a special motive [to]
thoroughly ... investigate the issuer’s strengths and weaknesses. Prospective investors
look to the underwriter ... to pass on the soundness of the security and the correctness
of the registration statement and prospectus’.\textsuperscript{38}

In relation to the duty of underwriters, the Court in \textit{Feit v Leasco Data
Processing Equip Corp} held that:

\begin{quote}
Courts must be particularly scrupulous in examining the conduct of underwriters since they
are supposed to assume an opposing posture with respect to management.... In light of this
adverse position they must be expected to be alert to exaggerations and rosy outlooks and
chary of all assurances by the issuer. Their duty is to the investing public ... as well as to their
own self-interest and that duty cannot be taken lightly.\textsuperscript{39}
\end{quote}

The nature of responsibility assumed by underwriters requires them to exercise a
high degree of care in discharging their duties as an independent verifier of the
issuers’ representations.\textsuperscript{40} This is where the rationale for underwriter’s liability lies
and the imposition of liability on the underwriters has been emphasised to ensure the
integrity of the prospectus from the viewpoint of public confidence and investor
protection.\textsuperscript{41} It is said that the incentive for the gatekeepers to properly perform their
duties is not only the ‘carrot’ meaning the commission, but also the ‘stick’ of statutory

\begin{footnotesize}
\textsuperscript{35} Ben-Ishai (2007) above n 25 at 472.
\textsuperscript{36} \textit{Escott v Barchris Constr Corp} 283 F Supp 643, 697 (SDNY 1968).
\textsuperscript{37} \textit{Feit v Leasco Data Processing Equip Corp} 332 F Supp 544, 581 (SDNY 1971).
\textsuperscript{38} 480 F 2d 341, 370 (2d Cir 1973)
\textsuperscript{39} \textit{Feit v Leasco Data Processing Equip Corp} 332 F Supp 544, 581 (SDNY 1971).
\textsuperscript{40} \textit{Feit v Leasco Data Processing Equip Corp} 332 F Supp 544, 582 (SDNY 1971).
\textsuperscript{41} G Golding, ‘Underwriters’ Liability in Australian Securities Offerings’ (1993) 11 \textit{Company and
Securities Law Journal} 401 at 431.
\end{footnotesize}
liability. A lack of liability may be regarded as an encouragement to avoid compliance with the legal requirements. John Coffee identifies reduced exposure to litigation or reduced risk of liability as one of the main causes of the rash of financial scandals in the 1990s and the early 2000s. However, opponents of this liability argue that the stick may make the gatekeepers overly cautious and risk-averse and it may cause competent people to depart from this profession. Despite such disparagement on gatekeeper liability, securities regulators and courts alike favour their liability in the USA, which is evident even in a recent survey. The Southern District Court of New York in the WorldCom case observed that ‘the underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public’. The Court also held that ‘...underwriters’ reliance on audited financial statements may not be blind...[and] where “red flags” regarding the reliability of an audited financial statement emerge, mere reliance on an audit will not be sufficient to ward off liability’.

The foregoing shows that underwriters have a crucial role to play in reducing informational asymmetry and preventing issuers from wrongdoings. Failures in doing so may harm investors as well as markets by damaging investor confidence. Hence they should bear the responsibility for untrue and misleading disclosure by companies which hire and pay them explicitly to verify the claims made in their disclosures. Their implied certification of truth in the prospectus disclosure provided through

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47 In re WorldCom, Inc. Sec Litig. 364 F Supp 2d 628, at 672 (S D N Y 2004).
pricing of the offer attracts liability on the premise that general investors, if not others, are heavily reliant on their acceptance of the offer price. In other words, their certification works as solicitation for purchasing the shares covered in a given prospectus.

Lawyers

Lawyers are primarily responsible for the verification of legal requirements for disclosures in the primary share market. They provide opinion to the underwriter that the disclosures contain all material information in relation to the issue and the issuer. Regarding prospectuses, A Sommer said when he was a US-SEC Commissioner in 1974 that, a securities lawyer is not an advocate, but rather ‘the filed marshal who coordinate[s] the activities of others engaged in the registration process’. Senator John Corzine, the former CEO of investment giant Goldman Sachs, who played a major role in drafting s307 of the Sarbanes-Oxley Act 2002 (SOX) imposing whistle-blowing responsibility on lawyers, says that:

In our corporate world today... executives and accountants work day to day with lawyers. They give advice on almost each and every transaction. That means when executives and accountants have engaged in wrongdoing, there have been some folks at the scene of the crime – and generally they are the lawyers.

In respect of a lawyer’s role, Roman Tomasic observes that:

Corporate lawyers contributed to the 1980s 'decade of greed' by failing to speak out against frauds, misleading conduct and shady deals. Much corporate crime would not be possible without the support that professional advisors, such as corporate lawyers, provide to those who engage in fraudulent corporate behaviour.\(^{53}\)

Referring to the active role of lawyers in corporate scandals, Thomas Ross terms them as 'amoral technician' and 'hired guns'.\(^{54}\) The burden to ensure that the prospectus is prepared in compliance with law and its contents represent full and fair disclosure, squarely falls on the shoulders of lawyers hired by the issuer.\(^{55}\)

Lawyers, similar to the other professionals in share markets, are supposedly hired to bring special expertise to their immediate clients in the preparation of disclosure documents. However, unlike other gatekeepers, they have the authority to make certain legal decisions by which they can put pressure on their clients to accept their advice in order to comply with, and avoid breaching the relevant law.\(^{56}\) On the other hand, they provide opinions to the underwriter that the prospectus contains all material information in relation to the issue and issuer.\(^{57}\) One of the major functions of lawyers with respect to securities is to assess the public offer objectively and critically in order to determine 'whether the proposed transactions meet legal standards'.\(^{58}\) They often determine whether the executives of the issuer should sign the disclosure document, and provide advice on the compliance with the legal


\(^{57}\) Coffee (2003) above n 49 at 1296.

\(^{58}\) R C Crumpton, 'Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues' (2002) 58 The Business Lawyer 143 at 147.
requirements. Lawyers had contributed to the collapse of Enron by providing a cover of legitimacy of the misdeeds of the company.

It is said that lawyers, regardless of being an insider or outsider, are often considered to be ‘deal killers’ by the business community. They assume the leading role in the preparation of disclosures and in designing the deal to be offered to the public. Recognising the importance of the role of lawyers in preventing their clients from violating laws, courts in the United States on various occasions observed that lawyers should be held liable for inaccurate advice, or for defective prospectuses. More importantly, the SOX has expanded the liability of lawyers giving them the power to persuade, force, or even override their clients by withdrawing their supports and acting as a whistleblower.

Lawyers are reasonably believed to be the most learned individuals on an IPO coalition in respect of legal knowledge and the satisfaction of disclosure requirements. They are hired primarily for their legal knowledge. It may be true in some cases that the hirers are mala fide in choosing a particular lawyer with respect to getting undue favour, but the legal practitioner must have the professional integrity and responsibility to protect the society from deliberate misdeeds by others within the realm of their profession. They are meant to be trusted not only by the securities

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64 Breda v Sachnoff & Weaver Ltd 941 F2d 142 (2nd Cir, 1991).
regulator, but also by the investing public in respect of a public offer of shares. Christoph Pippel comments that ‘the lawyer who shies away from the obligation of providing candid and independent judgment, or even “spins” the law in favour of his client’s desires, fails more than his own conscience, he fails to fulfil his professional responsibility’.  

As discussed above, securities lawyers play an important role in the preparation of prospectuses, and they are logically trusted by potential victims of malpractice of their clients. Their failure to discharge responsibilities with reasonable care and due diligence may not only ruin many life savers, but also seriously harm the national and international economies in this age of globalisation. Having regard to professional roles and responsibilities, it is quite realistic to argue that they should be held liable for their failures to perform their duties in a proper manner in the interest of the protection of investor and maintenance of their confidence in the primary share market.

**Civil Liability of Gatekeepers for Defective Prospectuses in Australia, the USA, the UK and Canada**

**Australia - Statutory Provisions of Civil Liability for Defective Prospectuses**

Liabilities of gatekeepers are largely governed by statutes in the developed world perhaps due to the complexity of relevant common law provisions.  

Ben-Ishai observes that for common law remedies, the substantive and procedural requirements to be met are more onerous than their statutory equivalents.  

There is a scarcity of

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66 Pippel (2004) above n 52 at 133.

67 See *Derry v Peak* (1989) 14 App Cas 337 HL.

68 Ben-Ishai (2007) above n 25 at 446. See, for details of the common law requirements and the onus on the plaintiffs at some length at 446-47 in this article of Ben-Ishai.
cases concerning liability of gatekeepers for defective prospectuses in Australia.⁶⁹ Even if there are a few cases regarding prospectus liability, they are concerned with investor’s claim of damage or compensation against the issuers alone in exclusion of gatekeepers.⁷⁰ It demonstrates that investors prefer to recover their compensation from the issuing companies whose liabilities are clearly articulated in the statute, rather than from members of an IPO coalition, whose liabilities are somewhat ambiguous.⁷¹

The first major attempt to ascertain the scope of misstatement liability in Australia was made in 1970 in Mutual Life & Citizens Insurance Co Ltd v Evatt.⁷² In this case, the High Court of Australia set out the first legal test for the liability of professionals for misstatements. The High Court established three conditions for the existence of the duty to care of professionals when owed to third parties. The conditions are: (i) the professional realises or ought to realise that the third party will rely on his/her (professional) skill and judgment; (ii) the third party intends to act upon the information embodied in the statement; and (iii) the reliance of the third party is reasonable.⁷³ The third party in this leading case received information through a direct request as opposed to public disclosure. Hence it does not represent typical third-party claims based on misrepresentation as mentioned in Esanda Financial Corp

⁷¹ See, for examples of such cases, Cadence Asset Management Pty Ltd v Concept Sports Ltd & Others (2005) 56 ACSR 309; Sons of Gwalia Ltd v Margaretic (2007) 60 ACSR 292.
Lid v Peat Marwick Hungerford which is regarded as the most influential decision on
gatekeeper liability in Australia. 74

The High Court of Australia in Esanda Financial Corp Ltd v Peat Marwick
Hungerfords 75 significantly narrowed down the liability of gatekeepers. 76 This case
involves providing credit relied upon an audited account to a company which went
into liquidation. Then the creditors claimed that the auditors owed a duty of care to all
creditors of the liquidated company, because they (auditors) did foresee or ought to
have reasonably foreseen that creditors would rely on the accounts audited by them.
The Court unanimously held that in order to impose liability on auditors, two
requirements are to be satisfied. They are the foreseeableability of harm and the
relationship of proximity. They are difficult to prove for which the decision in effect
limits the scope of gatekeeper liability. Moreover, it concerned the creditors, rather
than shareholders whose claim might be even weaker as a residual claimant in the
event of liquidation. The case was lodged under the previous Corporations Law
(s1006) which was similar to its current equivalent s729 of the Corporations Act 2001
(Cth) (CA2001-Australia).

Presently Chapter 6D of the CA2001-Australia governs corporate fundraising
activities, which contains provisions concerning liabilities for defective disclosures in
the primary share market. Regarding misstatement in, or omission from, disclosure
document, s728 of the Act provides that:

(1) A person must not offer securities under a disclosure document if there is:
(a) a misleading or deceptive statement in: (i) the disclosure document; or
(ii) any application form that accompanies the disclosure document; or

74 See Esanda Fin Corp Ltd v Peat Marwick Hungerfords (1997) 188 CLR 241 at 255.
76 See for details, A Greinke, ‘Auditors’ Liability to Third Parties: The View of the High Court (1997)
(iii) any document that contains the offer if the offer is not in the disclosure document or the application form; or (b) an omission from the disclosure document of material required by section 710, 711, 712, 713, 714 or 715; ...

2) A person is taken to make a misleading statement about a future matter (including the doing of, or refusing to do, an act) if they do not have reasonable grounds for making the statement. This subsection does not limit the meaning of a reference to a misleading statement or a statement that is misleading in a material particular.

The phrase ‘disclosure document’ has been used in the above section. Section 9 of the CA2001-Australia provides that a ‘disclosure document’ for an offer of securities means: (a) prospectus for the offer; or (b) a profile statement for the offer, or (c) an offer information statement for the offer. Section 705 of the CA2001 offers further details about this disclosure document and adds another one called short-form prospectus. As stated in s705 - prospectus is the most comprehensive and standard full disclosure document; short-form prospectus contains basic information on the offer and an abridged version of all information already lodged with ASIC- this short form is issued to the public and investors can get copies of materials from ASIC; profile statement is a brief statement of the offer issued to the public with ASIC’s approval and the prospectus is lodged with the regulator; offer information statement is a genuine alternative to a prospectus and is approved to be issued to the public for an offer of AU$10 million or less.

The articulation of this section proscribing defective disclosures being issued as stated above seems unclear as to the person who would be liable for the contravention of this section or for the failure to comply with these requirements. First of all, this section needs clarification about the ‘person’ who offers securities, because it imposes prohibition only on those who make securities offers with defective disclosures. In this regard, s700(3) of the CA2001-Australia attempts to identify such persons by stating that for the purposes of the corporate fundraising in Australia ‘the person who offers securities is the person who has the capacity, or who agrees, to issue or transfer the securities if the offer is accepted’. If read as a whole, it appears that the
identification or description of the relevant persons is erroneous or at least vague on
two counts: firstly, its vagueness in specifying the persons who could be held liable;
and secondly, emphasis is on the issuance of shares in pursuance of the disclosure
document rather than the issuance of the disclosure itself. The vagueness as to the
person is evident in the shortcoming that it does not specify the persons who have the
capacity to issue or transfer the securities if the offer is accepted. Generally, company
directors who are typically involved in drafting the disclosure document have the
capacity to issue shares. Hence the directors may be conveniently caught under this
description of the persons mentioned in s728 (1) as stated above. But, as alluded to
earlier, a public offer of shares involves several distinct areas of activity which
commonly include promoters and directors of the issuing company, accountants/auditors, lawyers, underwriters, issue managers and bankers to the issue.
Professionals such as auditors, underwriters and lawyers may not have the capacity to
issue the shares at all. They are outsiders and hired to prepare the disclosure document
explicitly to comply with the legal requirements, and implicitly to convince the
potential investors about the truth in the claims made by the issuer in the prospectus.
Even they may not be regarded as officers of the company as decided in the old
British case *Re Great Wheal Polgooth Co.*77 In this case, they fall beyond the scope of
this category of persons having the capacity to issue shares, and thus arguably may
comfortably remain out of the hook despite their direct and significant involvement in
the drafting of the defective disclosure at least so far as prohibition and the statutory
meaning of offeror is concerned.

77 [1883] 53 L J Ch 42 at 42. It was held that ‘a solicitor is not an officer of the company... [and he or
she] is not to be treated as a promoter of the company’.
Emphasis given to the issuance of shares [read s728 (1) together with 700(3)] rather than to the preparation and issuance of the disclosure document itself, appears to be misplaced. It refers to the capacity to issue shares, whereas the contravention of law lies in the issuance of the disclosure documents to the public. Persons dealing with the preparation or drafting of the disclosure document may not necessarily be the same persons who will issue the shares once the offer is accepted. The releasing of disclosure documents to the public and the subsequent issuing of shares to the successful applicants or intended subscribers are two different phenomena even though one is related to the other. In terms of wrongdoing concerning prospectuses, the wrongness should be primarily attached to the drafting and then to the issuing of the defective disclosure to the public. Gatekeepers are involved in the drafting stage only. Once the document is prepared, it is the authority of the company or its board of directors, which has the authority to decide to go ahead with it immediately, or to delay the offer, or even bury it for ever in which case the application money held in a trust fund must be returned. The hired gatekeepers have nothing to say about the fate of the draft they prepared as long as they are properly paid.

Literally, no wrong is committed if the prospectus is not issued to the public because offering securities with a defective disclosure document is prohibited, and lodgement of such a document with the ASIC by itself is not prohibited under s728(1) and the offering is directly related to the issuance of shares as shown above. It is a popular proverb that prevention is better than cure. Hence the liability should be connected with the preparation and lodgment of the document with the regulator and issuance of the same document to the public. This liability should primarily aim to deter the persons from preparing and issuing defective disclosures to the public. Then
it will help restrain the ill intention or negligence surrounding a public offer before they harm the investors.

It can be argued that if a person does not have the capacity to issue shares, they can still be hooked up because of their agreement to issue or transfer shares as provided in s700(3). Gatekeepers in questions can arguably be held liable under this provision. To counter this contention, it can be said that those gatekeepers are not involved in the final process of issuing or transferring securities, and if the underlying shares are not eventually issued by the company for any reasons whatsoever despite the issuance of the prospectus to the public, the applicants/subscribers can get remedies only against the company or their directors. Such a failure cannot reasonably attract liability of gatekeepers who are the central concern of this article. The justification for linking the liability to the issuance or agreement to issue of shares based on defective disclosures is thus unclear. In order to make the prohibitions clear, persons could have been categorically identified by referring to their involvement in the drafting and/or issuance of the disclosure document itself.

Apart from s728 as discussed above, s729(1) of the CA2001-Australia sets out the liability for disclosure document by reference to the victim’s right to recover for loss or damage resulting from contravention. It reads as follows:

Right to compensation

A person who suffers loss or damage because an offer of securities under a disclosure document contravenes subsection 728(1) may recover the amount of the loss or damage from a person referred to in the following table if the loss or damage is one that the table makes the person liable for. This is so even if the person did not commit, and was not involved in, the contravention.

The Table referred to in s729 attempts to identify persons who can be held liable for defective disclosures. The Table of s729 is provided below.
**People liable on disclosure document under s729 of the CA2001-Australia**

<table>
<thead>
<tr>
<th>These people ...</th>
<th>are liable for loss or damage caused by...</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 the person making the offer</td>
<td>any contravention of subsection 728(1) in relation to the disclosure document</td>
</tr>
<tr>
<td>2 each director of the body making the offer if the offer is made by a body</td>
<td>any contravention of subsection 728(1) in relation to the disclosure document</td>
</tr>
<tr>
<td>3 a person named in the disclosure document with their consent as a proposed director of the body whose securities are being offered</td>
<td>any contravention of subsection 728(1) in relation to the disclosure document</td>
</tr>
<tr>
<td>4 an underwriter (but not a sub-underwriter) to the issue or sale named in the disclosure document with their consent</td>
<td>any contravention of subsection 728(1) in relation to the disclosure document</td>
</tr>
<tr>
<td>5 a person named in the disclosure document with their consent as having made a statement: (a) that is included in the disclosure document; or (b) on which a statement made in the disclosure document is based</td>
<td>the inclusion of the statement in the disclosure document</td>
</tr>
<tr>
<td>6 a person who contravenes, or is involved in the contravention of, subsection 728(1)</td>
<td>that contravention</td>
</tr>
</tbody>
</table>

The Federal Court of Australia in *Cadence Asset Management Pty Ltd v Concept Sports* in which shareholders claimed compensation against the issuer for a defective prospectus observes in *obiter dicta* that s729 imposes liability not only on the issuer and its directors and promoters, but also to stockbrokers, underwriters, auditors, bankers or solicitors. However, the present writer has not found any cases in which these gatekeepers have been held liable for defective prospectuses offering shares in Australia. Nonetheless, the above description of persons liable for a defective disclosure document offers a better understanding of the wrongdoers who should be held liable. However, it may not be free from ambiguity in that at the heading of the Table, the entire identification attempt relates to the ‘people’, but the descriptions

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underneath the heading brings into play the term ‘person’ instead. It is unclear as to why the word ‘people’ which generally refers to only human beings has been used to mean ‘persons’ which legally include both natural and artificial persons as contained in the Table. This creates confusions over whether only the natural persons or both individuals and corporations could be held liable. It might be pointless to use the word ‘people’ instead of persons in the legislation, if its special meaning for which it has been used is not clarified.

The Table looks widely encompassing persons who are involved in the preparation of disclosure documents for the purposes of civil liabilities. However there can still be ambiguity as discussed by Greg Golding. In his doctoral research Golding observes with respect to civil liability that ‘[t]he advisor who has consented to being named in an offering document will face potential primary civil liability for statements made by them ... or for statements ... which are based on a statement made by them... For other respects...potential accessory liability ....’ 79 But he raises concerns about the determination of reliance on the gatekeepers’ advice in making a disputed statement incorporated in the disclosure document. 80 Further, the Table is not succinct enough to distinguish between persons in group 5 and those in group 6.

Group 5 requires a person to make a statement which is either included in the disclosure with their consent, or a separate statement made and included based on ‘person’s statement. Group 6, on the other hand, is unrelated to any statements, but directly linked to the contravention of s728(1). This begs clarification as to who will be regarded as being one of those who either contravene or get involved in the contravention. Arguably, it can be simplified by adding to the present articulation of

79 Golding (2001) above n 19 at 361.
80 Id at 362
the provisions the names of major and common players typically engaged in the preparation of prospectuses, and thereby imposing liability on them for contravention of the compliance requirements. The current vague provisions, after embracing those names, can straightforwardly arrest the gatekeepers and at the same time can exist to blame anyone who may get involved beyond the widely recognised members of an IPO coalition. This revision can therefore facilitate its smooth enforcement. This would reasonably enhance the level of deterrent effects as well as facilitate its plain enforcement.

An unusual provision appears at the end of s729, which spells out that a person identified in the Table is liable 'even if the person did not commit, and was not involved in, the contravention'. This provision contradicts the stipulations made in the Table of s729, which makes a person liable only for a specific contravention of s728(1). Hence, it warrants clarification as to why a person will be held liable without having any involvement in the contravention of law. It may appear to be overregulation unless the true meaning of this clause is provided.

USA – Statutory Provisions of Civil Liability for Defective Prospectuses

The Securities Act 1933 (SA1933-US) is the primary legislation that imposes civil liability for defective disclosure in the USA. 81 Civil liabilities are stated in ss11, 12 and 15 of the SA1933-US. Section 11 deals with registered public offerings, whereas s12(1) is concerned with offerors or sellers of securities, who make the offer in breach of the registration and prospectus requirements. Section 12(2) imposes liability on those who offer or sell securities using a material misstatement regardless of whether

or not the offer is registered or exempted.\textsuperscript{82} Although s12 deals with selling or offering of securities or with misstatement in prospectuses for initial public offerings (IPOs) as held by the US Supreme Court in 1995 in \textit{Gustafson v Alloyd},\textsuperscript{83} it is concerned with the liability of sellers only. Broadly, issuing companies are the seller, however, underwriter can also be regarded as a seller for the purposes of s12 as will be discussed later in this section. Issuers’ liability falls beyond the scope of this article, therefore s12 will be discussed only with respect to gatekeepers at hand. On the other hand, s15 imposes civil liability on those who control the persons liable under ss11 and 12. The US Congress enacted this provision ‘to curb the possibility of corporations using nominal or ‘dummy’ directors who, at the command of those controlling them, would sign registration statements so that the control person could avoid liability’.\textsuperscript{84} Since the liability of directors of any kind falls beyond the purview of this study, s15 will not be looked at in this pursuit.

The liability imposed under s11 of the SA1933-US is considered to be the ‘most powerful incentive’ to ensure truth and accuracy in disclosures in the primary share market.\textsuperscript{85} Section 11 provides details about civil liability for any misstatements in the registration statement which include, amongst other things, prospectuses.\textsuperscript{86} It says that if a registration statement, when it became effective, ‘contained an untrue statement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading’, any person who acquired

\textsuperscript{82} For further details, see I. Loss and J Seligman, \textit{Fundamentals of Securities Regulation} (5\textsuperscript{th} ed, 2004) New York: Aspen Publishers at 1193.
\textsuperscript{84} I. Loss et al (2004) above n 82 at 772.
\textsuperscript{86} The term ‘registration statement’ has been defined in s2(8) of the SA1933-US, as being ‘the statement provided for in section 6, and includes any amendments thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference.’
relevant securities unknowingly of the untruth or omission is entitled to remedy either in law or in equity.

The Securities Act Rule 405 defines the term ‘material’ as ‘matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered.’ The court in *Escott v BarChris Construction Corp*, the first leading case on this matter, has provided an interpretation of this materiality for the purposes of s11, according to which the term ‘material’ refers to ‘a fact which if it had been correctly stated or disclosed would have deterred or tended to deter the average prudent investor from purchasing the securities in question.’

The section seems to be very wide and vague in respect of imposing liability on persons. Its ambiguities are apparent not only with regard to the persons liable, but also with respect to persons who are entitled to sue. The section uses ‘any persons acquiring such security’ which may mean that even the acquirer in the secondary market may be allowed to sue for damages. In practice until 1995, courts consistently applied this section to both primary and secondary markets as long as the shares were firmly linked with the registration statement. But, in contradiction to the broad approach, some lower courts interpreted it as applicable only to the primary market. This later approach has lately been rejected by the higher judiciary which has permitted its applicability to both segments of the securities market. This wider application is supportable in that the original purchasers may sell the securities with the profits soon after their purchase but before the discovery of the defects in the registration statement. In such a situation the wrongdoers will go off the hook and

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87 283 F Supp 643 (S D N Y, 1968).
88 See, for details, *Barnes v Ososky* 373 F 2d 269 (2nd Circuit).
89 See *Gould v Harris* 929 F Supp 353, 358 (C D Cal 1996).
90 See *Joseph v Wiles* 223, F 3d, 1155 (10 Cir 2000).
innocent purchasers of those securities on the secondary market will be unduly harmed.\textsuperscript{91} Perhaps because of its extensive coverage of persons to impose liability, its critics at the initial stage considered it a 'draconian measure' believing that it would wither the underwriting business in the country and commented that 'grass would grow in Wall Street'.\textsuperscript{92} The application of this section is limited to only the registered securities, the securities offered are required to be registered and are registered accordingly, and liabilities arise from the materially misleading and defective statements being incorporated in the registration document.\textsuperscript{93}

The remedy under this section is to recover loss or damage from the persons liable. In order to recover the loss suffered from the investment in securities covered by a given registration statement, the investor (plaintiff) is required to prove two things: firstly, there was a material misstatement or omission in the registration statement; and secondly, the investor lost money from that investment. There is a significant laxity in terms of reliance requirements. Claimant investors are not required to show that they received a copy of the registration statement, let alone they relied upon it in acquiring the shares.\textsuperscript{94} However, reliance on the misstatement or omission has to be proved by the plaintiff if he/she had purchased the shares after the issuer had published an earning statement of a period of at least 12 months of the effective date of the registration statement, nevertheless it does not require the plaintiff to read the registration statement as stated in s11(a) of the SA1933-US as held in \textit{Haralson v E F Hutton Group Inc.}\textsuperscript{95} The plaintiff is required to prove simply that 'any part of the registration statement, when such part became effective,

\textsuperscript{91} Ratner et al (2005) above n 85 at 88.
\textsuperscript{92} Quoted in Id at 85.
\textsuperscript{93} Loss et al (2004) above n82 at 1193.
\textsuperscript{94} Ratner et al (2005) above n 85 at 8
\textsuperscript{95} 919 F2d 1014, 1032 (5th Cir 1990).
contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading'. It does not require any scienter to be proved, because this liability applies to innocent or negligent material misstatements or omissions as well.⁹⁶

**Persons Liable under s11 of the SA1933-US**

Section 11(a) imposes liability on every person who signs the registration statement. The persons who are required to sign this document are stated in s6 of the same Act. They are: the issuer itself, the chief executive, financial and accounting officers, and a majority members of the board of directors. In addition, s11(b)-(e) imposes liability on: (b) all directors, (c) all prospective directors who consented to be director, (d) every accountant and expert who has consented to being named as either to have prepared or certified a part of the registration statement, and (e) every underwriter for their respective portions based on their underwriting agreement.⁹⁷ Although liability is generally joint and several, there are exceptions. Firstly, a person who has been named as having prepared or certified a certain part of the statement, that person is liable for misstatements, if there is any, only in that specific part. Secondly, each underwriter is responsible for the specific part of the whole offer that they have underwritten.⁹⁸ Their liability is subject to some statutory defences which will be discussed elsewhere. So underwriters can be obviously caught, but the liability of lawyers and auditors remain vague to some extent unless they are found to have prepared and certified certain parts of the registration statement.

**Civil Liability under s12 of the SA1933-US for Defective Prospectuses**

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⁹⁶ *Glenfed Inc Sec Litig* 11 F 3d 843, 850 (9th Cir 1993).
⁹⁸ Ibid.
Section 12 of the SA1933-US imposes civil liability on sellers for two wrongs: first, selling or offering securities without registration though the offer was required to be registered under s5; second, selling or offering by means of misstatement in a prospectus or oral communication. Section 12(a)(1) is mainly concerned with the selling or offering of securities in violation of registration requirements under s5 by using defective disclosures. The basic elements of this breach required to be established by the plaintiff are: (i) the defendant was a seller and (ii) the defendant failed to comply with the registration or prospectus requirements. The defendant bears the onus of proof if the offer was not required to be registered.\textsuperscript{99} A fundamental breach of this section occurs if the securities had not been registered before the offer. It clearly imposes liability on sellers of securities by simply saying that anyone who offers or sells securities in violation of the registration required under s5 of the same Act shall be liable. The purchaser can claim either recession of the investment contract if the securities are still held, or for damages where securities have already been transferred in the secondary market.\textsuperscript{100} There is a clear restriction on this liability that the purchaser from initial distribution is entitled to a remedy under this section, only if he/she was unaware of the untruth or omission in question at the time of purchase. This provision is ambiguous in that it does not define the persons who will be regarded as seller or offeror. Hence, the gatekeepers are not explicitly liable for their involvement in the preparation of defective disclosures. Judicial interpretations of the term ‘seller’ will be discussed shortly in this section.

\textsuperscript{100} Id at 1193
Section 12(a)(2) creates civil liability for misstatements in disclosure regarding 'all sales of securities, whether or not registered and whether or not the particular security or transaction is exempted from s5'.\footnote{Id at 1198.} The ambiguity in the scope of the application of s12(a)(2) has been clarified to some extent by the US Supreme Court in 1995 in \textit{Gustafson v Alloyd},\footnote{513 US 561 (1995).} by asserting that, s12(a)(2) applies only to initial public offerings made by a statutory prospectus, which is the central concern of this study. It means it is applicable to the primary market or initial transactions only, leaving the secondary market under s10(b) and Rule 10b-5 of the Securities Exchange Act 1934 (SEA1934-US). Hence the liabilities under both subsections (1) and (2) of s12 are directly relevant to this article and they both impose liability on sellers. The definition of 'seller' is the same under both s12(a)(1) and s12(a)(2) as the Court in \textit{Shaw v Digital Equipment Corp} relied on \textit{Pinter v Dahl}\footnote{486 US 622, 623 (1988).} in which by the Supreme Court interpreted s12(a)(1).\footnote{See Loss et al (2004) above n 82 at 1217.}

\textbf{Elements of an Action under s12(a)(1) of the SA1933-US}

The liability under this section is somewhat ambiguous because it provides that '[a]ny person who offers or sells a security in violation of section 5 ... shall be liable subject to subsection (b) to the person purchasing such security from him [or her]' because the liability is close to absolute.\footnote{Byrnes v Faulkner, Dawkins & Sullivan 550 F 2d 1303, 1303 (2\textsuperscript{nd} Cir 1977) as quoted in id at 1194.} The plaintiff is required to prove only two elements: firstly, that the defendant was an offeror or seller of the security in question; secondly, that the securities were sold in breach of s5 of the SA1933-US. Thus s12(a)(1) places liability primarily on the issuer, and where the issuer sells the securities to an underwriter for resale, judicial interpretation suggests that an underwriter as a seller of securities under a ‘firm commitment’ underwriting

\footnotesize{101 Id at 1198.} 
\footnotesize{102 513 US 561 (1995).} 
\footnotesize{103 486 US 622, 623 (1988).} 
\footnotesize{104 See Loss et al (2004) above n 82 at 1217.} 
\footnotesize{105 Byrnes v Faulkner, Dawkins & Sullivan 550 F 2d 1303, 1303 (2\textsuperscript{nd} Cir 1977) as quoted in id at 1194.}
agreement can be held liable under s12. In interpreting the meaning of ‘seller’ the First Circuit Court in Shaw v Digital Equipment Corp rejected the issuer’s status as seller by stating that the issuer in a firm commitment underwriting does not pass title to the security to its purchaser/investors, therefore, the officers of the issuer cannot be held liable as ‘seller’ under s12(a)(2): ‘unless they actively “solicited” the plaintiff’s purchase of securities to further their own financial motives, in the manner of a broker or vendor’s agent. Absent such solicitation, [the issuer] can be viewed as no more than a “seller’s seller”, whom plaintiffs would have no right to sue under Section 12(a)(2).”

The US Supreme Court in interpreting the meaning of ‘seller’ in Pinter v Dahl within the scope of s12(a)(1) held that:

“seller” is not limited to an owner who passes title, or other interest in a security, to the buyer for value, but extends to a broker or other person who successfully solicits a purchase of securities, so long as he [or she] is motivated at least in part by a desire to serve his [or her] own financial interests or those of the securities owner.

More specifically the Supreme Court further pronounced that the Congress did not intend to extend liability under s12(1) to ‘persons who merely participate in unlawful sales transactions but are only remotely related to the relevant aspects of the transactions, including accountants and lawyers simply performing their professional services.’

As the wording of s12 is silent about the liability of gatekeepers such as auditors and lawyers, some academic commentators in line with judicial interpretations positively

106 See Lone Star Ladies Inv Club v Schlotsky’s Inc 238 F 3d 363, 370 (5th Cir 2001); In re WorldCom Inc Sec Litig, 346 F Supp 2d 628, 659.
argue that this section is ‘not connected with gatekeeper liability’. Similarly Loss and Seligman assert that ‘it seems quite clear that s12 contemplates only an action by a buyer against his or her immediate seller. That is to say, in the case of the typical ‘firm-commitment underwriting,’ the ultimate investor can recover only from the dealer [underwriter] who sold to him or her.’

Relying on this argument, it can be said that neither an auditor nor a lawyer can take the position of an underwriter or solicit the plaintiff’s purchase like a vendor’s agent as they cannot transfer title to the securities nor can they generally solicit a purchase of securities in their professional capacity.

Having regard to the above judicial interpretations and academic comments, it can be said that some gatekeepers such as firm commitment underwriters can be held liable under s12. Other gatekeepers, such as underwriters (best effort underwriting), accountants and lawyers, cannot be held liable simply because of rendering their professional service to their clients being the issuer. However, they may be found liable if they directly contact potential investors intending to promote the sale of securities being motivated at least in part by a desire to serve their own financial interests or those of the securities owner. Even brokers and dealers can be found liable under this section based on their contact with the subscribers, but it is arguably not applicable to auditors or lawyers as they have hardly any direct contact with the prospective subscribers.

However, it should be mentioned in order to avoid confusion that the lower courts had not always interpreted the meanings of ‘offerors’ and ‘sellers’ (two terms used

113 See Moore v Kayport Package Exp Inc 885 F 2d 531, 538-39 (9th Cir 1989).
synonymously in this research) uniformly as they had been initially divided on the constructions of these two terms, where some favour a narrow meaning whilst some others construe the terms more broadly. The narrow construction of the terms relies on the traditional common law principle of the privity of contract which refers to only issuers and firm commitment underwriters.\footnote{See \textit{Sanders v John Nuveen & Co Inc} 619 F 2d 1222, 1226 (7th Cir 1980); \textit{Collins v Signetics Corp} 605 F 2d 110, 114 (3rd Cir 1979).} The courts have shown reluctance in imposing liability on an underwriter under a best efforts underwriting contract as the title to the securities does not pass on to the underwriter, therefore, the relationship between such an underwriter and investors suffers from a lack of privity of contract.\footnote{See \textit{Bailey v Huntington See Co} 35 F R D 169 at 175 (S D N Y 1963); \textit{Unicorn Field Inc v Cannon Group Inc} 60 F R D 217, 222-223 (S D N Y 1973).} Conversely, the broad view gives emphasis to the agency relationship between the owner of securities and their agents in selling the securities. So, the issuers and/or firm commitment underwriters as well as the third party acting as an agent of the owner could be held liable when they had been actively solicited in, and contributed to, the sale of securities.\footnote{See, for details, \textit{Katz v Amos Tread & Co} 411 F 2d 1046, 1052-53 (2d Cir 1969); \textit{Hill York v American Int Franchises Inc} 448 F 2d 680, 692-693 (5th Cir 1971); \textit{Anderson v Aurotek} 774 F 2d 927, 930 (9th Cir 1985).} The Court also asserted that 'the language, history, and statutory context of s12(1) demonstrate that the “substantial factor” test, whereby a nontransferor seller is defined as one whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place, is not an appropriate standard for assessing s12(1) liability as a statutory seller'.\footnote{\textit{Pinter v Dahl} 486 US 622, 624 (1988). The ‘substantial factor test’ will be discussed shortly in this article in the discussion of s10(b) and Rule 10b-5 of the SEA1934-US.} The Supreme Court in \textit{Pinter v Dahl} thus overruled the decisions of the lower courts discussed above as it pronounced that that s12 imposes liability arguably on any person involved in selling securities being motivated at least partially by a desire to
have a financial benefit for himself/herself or for the owner of the securities.\(^{118}\) So the present test for the civil liability for defective prospectuses according to *Pinter v Dahl* are twofold: firstly solicitation in sale or offer of securities; and secondly, the solicitation must have been done with an intention to gain financial benefits for himself/herself or for the transferor of the securities.\(^{119}\) Mere participation in the preparation of a prospectus in professional capacity such as an auditor or a lawyer is not sufficient to trigger liability under s12(a)(1).

The scope of s12(a)(2) seems to be broader than that of s12(a)(1) in that the former goes beyond the registration statements whilst the latter covers the breach of registration requirements only. Until 1987, s12(a)(2) used to ‘apply to misstatements or omissions in any form, in any transaction, whether or not subject to the registration provisions… provided there was some use of the mails or facilities of interstate commerce in the course of transaction’ until the Supreme Court in *Gustafson v Alloyd*\(^{120}\) in 1995 confined its application to the initial distribution of securities.

There is a difference between s12(a)(1) and s12(a)(2) with regard to the onus of proof to succeed in a claim. Section 12(a)(1) is almost absolute liability provision in that, the plaintiff will have to prove that he/she bought the securities from the defendant who was the seller and they were sold without registration in violation of s5. The only statutory defence is that the securities sold were exempt from s5.\(^{121}\) Section 12(a)(2) requires the ‘material misstatement or omission’ in the prospectus or oral communication to be proved. Although reliance on the defective communication does

\(^{118}\) *Pinter v Dahl* 486 US 622, 623 (1988).


not necessarily have to be shown under s12(a)(2),\textsuperscript{122} some casual relationship between the disclosure and the investment decision is required.\textsuperscript{123} However, the Congress amended this section in 1995 by adding s12(b) which allows the defendant to prove in defence that the loss suffered by the plaintiff was caused in part or full by factors unconnected with the misstatement.

The meaning of ‘materiality’ applicable to both ss11 and 12 is identical and is judged objectively, ie, a statement will be regarded material if a reasonable investor or his/her adviser would find the statement of the information in question significant.\textsuperscript{124} Hence both ss11 and 12 impose a negligence or objective standard in respect of liability. Do I need this section?

The foregoing discussion demonstrates that both s12(a)(1) and s12(a)(2) imposes liability on the same person by saying that ‘[a]ny person who... offers or sell a security.....’. It can be concluded that, apart from the issuer, firm commitment underwriters can be held liable, but lawyers and auditors may not be found liable simply because of providing their professional services.

The applicability of s10(b) of the SEA1934 and Rule 10b-5 to defective prospectuses also suffers from a lack of clarity. The full text of Rule 10b-5 reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) 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, or

\textsuperscript{122} \textit{Johns Hopkins v Hutton} 422 F2d 1124 (4th Cir 1970).
\textsuperscript{123} \textit{Jackson v Oppenheim} 533 F 2d 826 (2d Cir 1976).
\textsuperscript{124} See \textit{In re WorldCom Inc Sec Litig}, 346 F Supp 2d 628, 657-58.
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

The SA1933-US and SEA1934-US were originally designed to regulate respectively the primary and secondary markets. From 1966 to 1994, s10(b) and Rule 10b-5 had been applied by the lower federal courts under the doctrine 'aiding and abetting civil liability' for securities fraud in which victims could be awarded civil remedies.\(^{125}\)

Thus a significant portion of frauds in securities\(^{126}\) had been tried under this doctrine until 1994 when the Supreme Court eliminated that right of private action in *Central Bank of Denver v First Interstate Bank of Denver*.\(^{127}\) In fact, for three decades preceding the *Central Bank* decision, aider and abettor liability 'routinely attached to accountants, attorneys, underwriters, banks and others in every federal circuit'.\(^{128}\) The *Central Bank* unequivocally eliminated liability for aiding and abetting a violation of s10(b)\(^{129}\) and ruled that neither the SA1933-US nor the SEA1934-US expressly provided for a private cause of action against the persons who aid and abet primary violators in committing securities fraud.\(^{130}\) The Supreme Court in *Central Bank* as cited in *Enron*\(^{131}\) rejected as implausible the argument that silence in the legislation constituted an 'implicit congressional intent to impose s10(b) aiding and abetting

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\(^{126}\) See R A Prentice, 'Locating That "Indistinct" and "Virtually Nonexistent" Line between Primary and Secondary Liability Under Section 10(b)' (1997) 75 North Carolina Law Review 691 at 700.

\(^{127}\) 511 U S 164 (1994).


\(^{129}\) 'The Supreme Court's decision in *Central Bank of Denver* unequivocally abolished aider and abettor liability under section 10(b) and rule 10b-5, but lower courts and commentators have been unable to agree upon the point at which a secondary actor's conduct rises to the level of a primary violation': R D. Chrisman, "Bright Line," Substantial Participation," or Something Else: Who is a Primary Violator Under Rule 10b-5? (2001) 89 Kentucky Law Journal 201 at 224.


\(^{131}\) In Re Enron Corporation Securities, Derivative & ERISA Litigation 235 F. Supp. 2d 549 (2002).
liability.' The Court then construed s10(b) and Rule 10b-5 of the SEA1934-US as proscribing ‘only the making of a material misstatement (or omission) or the commission of a manipulative act’ and concluded that it does not prohibit aiding a person who then commits a violation of s10b. Importantly, the Supreme Court added that any ‘person or entity, including a lawyer, accountant, or bank, who... makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.’ This Rule thus in turn offers a defence to the primary liability of secondary actors for making a material misstatement or omission or employ a manipulative device for which they can be held liable. Then a need to distinguish between ‘aiding and abetting’ a primary violator and ‘making’ a defective disclosure became obvious. But the Supreme Court had not set out any tests as to how their liability will be determined. Thus the highest Court actually ‘left it to the lower courts to determine when the conduct of a secondary actor makes it a primary violator under the statute’. So, in the aftermath of the Spume Court’s landmark decision in Central Bank, lower appellate courts developed two major standards or tests to determine primary violation of Rule 10b-5 by secondary actors such as lawyers and auditors. They are the ‘substantial participation test’ and the ‘bright line test’. As the name suggests, the former requires ‘substantial participation or intricate involvement’ of the gatekeepers in the preparation of a defective disclosure containing a material misstatement (or omission) even if the

136 For a detailed discussion of these tests, see Chrisman (2001) above n 129.
statement had been made by another person.\textsuperscript{137} The articulation of this test overtly goes beyond the \textit{Central Bank} decision which pronounced that s10(b) ‘prohibits only the making of a material misstatement (or omission) as mentioned above. Hence participation in the preparation of a statement made by another person should not be sufficient. Several courts criticised this test.\textsuperscript{138} The other test called the ‘bright line test’ requires that:

\ldots in order for the conduct of a secondary actor to rise to the level of a primary violation, the secondary actor must not only make a material misstatement or omission, but “the misrepresentation must be attributed to the specific actor at the time of public dissemination,” i.e., in advance of the investment decision, so as not to undermine the element of reliance required for s10(b) liability.\textsuperscript{139}

The Court in \textit{Enron} also quoted that ‘[i]f \textit{Central Bank} is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be it is not enough to trigger liability under Section 10(b).’\textsuperscript{140} So, U.S. District Judge Melinda Harmon of Houston federal court in \textit{Enron} accepted the criticism of the two tests by the US Securities and Exchange Commission (SEC), rejected both of them and adopted an SEC sponsored test instead as the SEC submitted test in the role of \textit{amicus curiae}.\textsuperscript{141} The central point of the SEC criticism was that the ‘substantial test’ fell short of the requirement of

\textsuperscript{137} See the applications of this test: \textit{Howard v Everex Systems, Inc} 228 F.3d 1057, 1061 (9th Cir. 2000); \textit{Dannenberg v PaineWebber Inc} (\textit{In re Software Toolworks Inc. Sec. Litig.}), 50 F.3d 615, 628 (9th Cir. 1994); \textit{In re ZZZZ Best Sec. Litig.}, 864 F. Supp. 960, 971 (C.D. Cal. 1994); \textit{Cashman v Coopers & Lybrand}, 877 F. Supp. 425, 432-34 (N.D. Ill. 1995); \textit{McNamara v Bre-X Minerals Ltd.}, 57 F. Supp.2d 396, 426 (E.D. Tex. 1999).

\textsuperscript{138} See, for example, \textit{Anixter v Home-Stake Production Co} 77 F 1215, 1226 (10th Cir. 1996).

\textsuperscript{139} As stated in \textit{In Re Enron Corporation Securities, Derivative & ERISA Litigation} 235 F. Supp. 2d 549 at 583 (2002) quoting \textit{Wright v Ernst & Young LLP}, 152 F.3d 169, 175 (2d Cir. 1998), cert. denied, 525 U.S. 1104 (1999); see also \textit{Shapiro v. Cantor}, 123 F.3d 717, 720 (2d Cir. 1997).


\textsuperscript{141} \textit{In Re Enron Corporation Securities, Derivative & ERISA Litigation} 235 F. Supp. 2d 549, 585 (2002).
‘making’ the defective disclosure, whilst the ‘bright line test’ looked more stringent than requirements set forth in the Central Bank.

The new test of primary liability (Enron test) under s10(b) and Rule 10b-5 as advocated by the SEC and adopted by the Judge Harmon in Enron provides that ‘when a person, acting alone or with others, creates a misrepresentation [on which the investor-plaintiffs relied], the person can be liable as a primary violator . . . if . . . he [or she] acts with the requisite scienter.” 142 It was also added that:

Moreover it would not be necessary for a person to be the initiator of a misrepresentation in order to be a primary violator. Provided that a plaintiff can plead and prove scienter, a person can be a primary violator if he or she writes misrepresentations for inclusion in a document to be given to investors, even if the idea for those misrepresentations came from someone else.143

If the above two assertions are read together, it seems that Judge Harmon, in an effort to properly apply the Central Bank decision, has used ‘creating’ in place of ‘making’ which was mentioned in the Central Bank decision. Also as quoted, ‘creating’ appears to equate ‘writing’ in the Enron test even if the idea came from someone else. Besides, ‘scienter’ and ‘reliance’ elements have been added. An apparent contradiction may arise in the equality of ‘creating’ and ‘writing’ something based on an idea supplied by someone else.

The above discussion suggests that gatekeepers can be hooked up under s10(b) and Rule 10b-5 if they ‘make’ the misrepresentation. However, there has been no uniform interpretation of the conduct that may attract liability, as in the absence of a concrete guideline from the Supreme Court, the different lower courts have been interpreting the requirements of ‘making’ a misstatement differently, which may not be supportive of the smooth enforcement of this liability.

142 In Re Enron Corporation Securities, Derivative & ERISA Litigation 235 F. Supp. 2d 549,692 (2002). For details of these three tests as criticised, interpreted and applied in Enron, see at 581-694.
Importantly, the US Congress had declined to restore the judicially developed right of private civil action to enforce secondary actors' liability on several occasions since its elimination by the Supreme Court in 1994, and the latest rejection is evident from its absence in the *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (Dodd-Frank Act 2010). The Dodd-Frank Act 2010 clearly negates the private litigation right for securities fraud. The Supreme Court in recent two cases, *Stoneridge Investment Partners LLC v Scientific-Atlanta Inc* and *Janus Capital Group Inc v First Derivative Traders* has reaffirmed its narrow view and reluctance to impose liability on the secondary actors for defective disclosures under s10(b) and Rule 10b-5 as they do not have the 'ultimate authority' over the contents of disclosures, and therefore they cannot 'make' misstatements as required under Rule 10b-5. As a result, the US Supreme Court 'has established extensive protection for secondary actors and largely closed the door to private actions against them in the post - Central Bank era'. It is evident in the decision of the 9th Circuit Court which dismissed the claim of securities fraud against secondary actors. Academic commentators are critical of such a restriction on private cause of action from the perspective of investor protection as they find it harmful to investors.

Amid such statutory ambiguities and their diverse judicial interpretations, the SOX adds momentum to the liability of gatekeepers in the aftermath of high profile

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144 Ho (2012) above n 125 at 176.
145 Ibid.
147 131 S Ct 2296 (2011).
148 *Janus Capital Group Inc v First Derivative Traders* 131 S Ct 2296 at 2302-06 as cited Ho (2012) above n 125 at 180.
149 Ho (2012) id at 180-81.
150 *In re Peregrine Systems Inc* Sec Litig 310 F App’x 149, 151-52 (9th Cir 2009).
151 Ho (2012) above n 125 at 190-91; E Cosenza, 'Is the Third Time the Charm? Janus and the Proper Balance between Primary and Secondary Actor Liability under Section 10(b)' (2012) 33 *Cardozo Law Review* 1019 at 1083.
corporate collapses such as Enron and WorldCom. The SOX is said to be the most significant reform in corporate law in the US since 1933 when the federal regulation of securities was introduced for the first time by enacting securities legislation. The SOX strengthens the accountability of corporate insiders as an instrument to maintain market integrity. It was aimed at restoring investor confidence in the integrity of the market, which was shattered by the aforesaid corporate debacles. The SOX disclosure provisions are largely concerned with periodic disclosure which is a central issue of the secondary market. Further it imposes liability basically under civil penalty and criminal liability regime. It also imposes whistle-blowing responsibilities on lawyers. All these aspects of the SOX fall beyond the scope of this research.

To sum up, the statutory provisions regarding gatekeeper civil liability for defective prospectuses in the US are lean towards shielding gatekeepers and suffer from lack of clarity. Taking advantage of loopholes in the legislation, different courts have been providing diverse interpretations of such crucial provisions. Ambiguities in laws may impede effective enforcement of gatekeeper liability which may in turn be hostile to investor protection in the largest securities market in the world. The liability of the secondary actors becomes extremely critical especially where a primary violator has gone bankrupt. Ho intensely argues that the Dodd-Frank Act ‘ought to authorize a private cause of action against aiders and abettors for securities fraud’ and term such an omission as ‘a missed opportunity for Wall Street Reform.’ Referring to the denial of private litigation as discussed earlier, Cosenza spells out that ‘[p]rivate

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154 Ibid.
156 Ho (2012) above n 125 at 190.
157 Ibid.
securities litigation is a valuable and necessary part of the overall enforcement regime that compensates defrauded investors, deters fraud, promotes investors confidence in the financial markets, and facilitates the fair and efficient functioning of our capital markets'. Commenting on the private civil action and the recent Supreme Court decisions thereon, she goes on to say that:

To restrict it in the manner the Supreme Court has in Janus (and even prior to that in Central Bank and Stoneridge) is improvident. It is now time for Congress to take action to protect investors and ensure that they are not left without sufficient protection from the fraud that has engulfed the financial markets since Central Bank.159

**UK – Statutory Provisions of Civil Liability for Defective Prospectuses**

The provisions governing liability of gatekeeper in the UK developed through case law. It was almost impossible to hold accountants and other gatekeepers liable for negligent misstatements in disclosure documents until 1964.160 In that year the House of Lords in *Hedley Byrne & Co v Heller & Partners*161 pronounced that investors who relied on the negligent misstatement and ended up incurring loss in their investment are entitled to sue accountants regardless of the existence of privity of contract.162 The House of Lords held that all persons who provide a statement owed a duty to any third person with whom a special relationship existed.163 The House of Lords in fact approved a dissenting opinion of Lord Denning given in 1951 in *Candler v Crane Christmas & Co*164 that accountants owe a duty 'to any third person to whom they themselves show the accounts, or to whom they know their employer is going to show

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158 Cosenza (2012) above n 151 at 1083.
159 Ibid.
164 (1951) All E R 426 (Eng C A).
the accounts'.165 Although the phrase ‘special relationship’ had not been defined, the House of Lords held that special relationship existed due to the fact that the defendant voluntarily assumed the responsibility of making accurate disclosures to the public.166 The judiciary of the UK started applying this ruling of the House of Lords broadly,167 and gradually the scope and meaning of the phrase ‘special relationship’ changed from the concept of ‘voluntary assumption of responsibility’ by gatekeepers to ‘reasonable reliance’ of third party, and then to ‘foreseeability’ which was first introduced in 1978 in Anns v London Borough of Merton.168

The crucial factors namely ‘causation’ and ‘reliance’ were often found to be extremely difficult to prove against the defendants.169 Thus it has been argued that the judicial decisions in effect narrowed down the scope of gatekeeper liability for negligent misstatements.170 Under the case law regime in the UK, an auditor as a gatekeeper could be held liable for misstatements only if it could be proved that he/she knew that the audited work would be communicated to non-client third parties and that those non-clients would rely on the work in relation to a financial transaction.171

Based on case law developed over the past several decades, gatekeeper liabilities are now incorporated in legislation in the UK as well. Their liabilities for defective prospectuses are now governed under the Financial Services and Markets Act 2000

165 Chapman (1992) above n 163 at 180-84.
168 (1978) A C 728 (Eg H L).
171 Id at 35.
(UK) (FSMA2000-UK) as amended by the Prospectus Regulations 2005(UK), a statutory instrument, enacted to implement the EC Prospectus Directives referred to earlier and the Prospectus Rules made by the FSA. Rule 5.5.3(2) of the Prospectus Rules which is concerned with equity securities lists the persons liable for a defective prospectus in consistence with s84 of the FSMA2000-UK. According to this Rule, in addition to the issuer and its present and proposed directors, ‘each person who accepts, and is stated in the prospectus as accepting, responsibility for the prospectus’, and if not listed otherwise in this Rule, each person who has authorised the contents of the prospectus is liable for defective disclosures. However, Rule 5.5.8 provides that

A person who accepts responsibility for a prospectus ... or authorises the contents of a prospectus ..., may state that they do so only in relation to specified parts of the prospectus, or only in specified respects, and in that case the person is responsible under those paragraphs:
(1) only to the extent specified; and
(2) only if the material in question is included in (or substantially in) the form and context to which the person has agreed.

This Rule may limit the liability of gatekeepers, but it does not absolve them from civil liability.

Section 79(3) of the FSMA2000-UK empowers the Treasury to determine responsibility for a listing particulars and prospectuses. In pursuance of this authority, the Treasury defines the persons liable for defective disclosures and presently those persons are: the issuer of the shares, the directors and proposed directors of the
issuing company; the experts for their own parts of the prospectus where they have consented to the inclusion of the relevant part.  

Rule 5.5.9 of the Prospectus Rules provides for an exemption of gatekeeper liability by saying that ‘[n]othing in the rules in this section is to be construed as making a person responsible for any prospectus by reason only of the person giving advice about its contents in a professional capacity’. It creates confusion as to when one will be considered to have ‘taken responsibility’ for or ‘authorised the contents’ of a prospectus. All these liability provisions were made in July 2005 and it appears to be difficult to find judicial interpretations of these phrases. Referring to PR 5.5.3(2) R, Nigel Boardman mentions that under this new scheme of prospectus regulation, only the issuing company and its directors are liable for defective prospectuses issued to raise share capital, whilst the issuer alone has to take full responsibility for securities other than shares.¹⁷³ It is unclear as to why the description of persons liable for defective prospectus provided in this Rule will not include any of the three gatekeepers who are the subject of this research. This is so because, as discussed in the roles of these gatekeepers earlier, they take responsibility for prospectus at least for a certain part of it, if not the whole, and they also authorise the contents otherwise the issuer could not issue the prospectus to the public. They should share the liability arising from defective disclosures until and unless they withdraw their consent to issue the prospectus to the public. It is interesting to see that Rules do not mention whether they will be civilly or criminally liable, rather they use the expression – ‘persons responsible for the prospectus’. Prospectus Rule 2.1.7 imposes civil liability

on the persons responsible for the summary of the prospectus including its translation only if the summary is judged to be misleading, inaccurate or inconsistent with other parts of the prospectus when read together. The summary should be regarded as an introduction to the prospectus and ‘any decision to invest in the transferable securities should be based on consideration of the prospectus as a whole by the investor’ as stated in Rule 2.1.7.

Assumingly, none of the gatekeepers is supposed to be engaged in the preparation of summary or translation of a prospectus in their official capacity, because it may not be part of their professional responsibility. Hence it is unlikely that any of them can be held civilly liable for such a summary unless they prepare it on request of the company. The above discussion shows that neither the statutes nor regulations categorically name any of the gatekeepers, but the broad or wide coverage of Rule 5.5.3(2) of the Prospectus Rules may apply to all of them.

Rule 5.5 of the Prospectus Rules resembles regulation 6 of Regulations 2001. In line with s79(3) of the FSMA2000-UK, regulation 6 of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 (Regulations 2001) identifies the persons responsible for listing particulars. According to regulation 6(1), persons responsible for defective listing particulars are: (a) the issuer of the relevant securities; (b) directors at the time of submission of the disputed particulars; (c) persons who agreed to be a director as mentioned in the particulars; (d) persons who accept responsibility for particulars as stated therein; and (e) all other persons who have authorised the contents of the particulars but not falling within the above four categories.
Some specific defences and limitations to their liabilities are stated in regulation 6. Regulation 6(2) provides defences to the persons in the above category (b). They can avoid liability if the particulars are published without their knowledge or consent and they give reasonable public notice immediately after being aware of such publication. However, it is unclear whether the plaintiff or defendant bears the onus of proof. Regulation 6(3) limits the liability of persons mentioned in the above categories (d) and (e) by providing that they can claim that they accepted responsibility for, or authorised only particular parts of the particulars or only in certain specified respects, where their liability can be confined to that limit. Regulation 6(4) grants immunity from liability to those who give advice as to their contents in a professional capacity. This immunity may have a serious implication for the liability as advisors such as lawyers may avoid liability.

While s79(3) of the FSMA2000-UK enables the Treasury to identify the persons responsible for defective listing particulars and prospectuses, s90(1) of this Act, based on the same cause of action, provides compensation for untrue and misleading statements or omissions. It says that:

Any person responsible for listing particulars [including prospectuses] is liable to pay compensation to a person who has—(a) acquired securities to which the particulars apply; and (b) suffered loss in respect of them as a result of—(i) any untrue or misleading statement in the particulars; or (ii) the omission from the particulars of any matter required to be included...

This section does not explicitly include the term ‘prospectus’ but it is included in the listing particulars, hence it applies to prospectuses as well.\(^\text{174}\) Recently, the Queen’s Bench Division in \textit{Hall v Cable and Wireless plc} interprets the meaning of ‘listing particulars’ as being inclusive of ‘particulars issued prior to the listing’.\(^\text{175}\) The Court

\(^{174}\) Wild (2009) above n 172 at 178.
clearly mentions that the supplementary listing particulars\textsuperscript{176} are expressly included in s90 as they are ‘issued after preparation of the listing particulars and before the commencement of dealings in the securities following their admission to the official list.’\textsuperscript{177} Prospectuses are obviously issued well before the admission of securities to the official list for secondary trading. Hence, s90 does apply to prospectuses even though the section is silent about this very term (prospectus).\textsuperscript{178}

The Chancery Division in \textit{Possfund Custodian Trustees v Diamond} deals with a dispute as to whether the persons issuing prospectuses owing duty of care to subsequent purchasers in addition to the subscribers. The Court held that:

It was arguable that persons responsible for the issue of a company’s share prospectus owed a duty of care to, and could be liable in damages at the instance of, subsequent purchasers of that company’s shares on the unlisted securities market, provided that the purchaser could establish that he [or she] had reasonably relied on representations made in the prospectus and reasonably believed that the representor intended him [or her] to act on them, and that there existed a sufficient direct connection between the purchaser and the representor to render the imposition of such a duty fair, just and reasonable.\textsuperscript{179}

The above decision virtually expands the civil liability of the persons responsible for a defective prospectus from the subscribers to subsequent share purchasers subject to certain conditions. This decision appears to depart from its previous decision in \textit{Al-Nakib Investments v Longcroft} in which it was held that directors owed duty of care to the subscribers who made their subscription in reliance on a prospectus, and they did not owe a duty of care to subsequent purchasers because of lack of sufficient proximate relationship between the directors and such a shareholder.\textsuperscript{180} However, the

\textsuperscript{176} See s81 of the FSMA2000-UK for the relevance and contents supplementary listing particulars.
\textsuperscript{177} \textit{Hall v Cable and Wireless plc} [2009] EWHC 1793 (Comm), [2010] 1 BCLC 95. See also s81(1) of the FSMA2000-UK.
\textsuperscript{178} For further details of prospectus liability, see \textit{Possfund Custodian Trustees v Diamond} [1996] 2 All ER 774, 2 BCLC 665.
\textsuperscript{179} [1996] 2 All ER 774; [1996] 2 BCLC 665.
\textsuperscript{180} [1990] 3 ALL ER 321; [1990] 1 WLR 1390.
decision in *Possfund Custodian Trustees v Diamond* was concerned with the secondary trading in unlisted securities, whereas the Court in *Al-Nakib Investments v Longcroft* dealt with/resolved an issue involving listed securities. Moreover, the issue of proximate relationship has not been ignored, rather it has been given due consideration in the articulation of the decision in *Possfund Custodian Trustees v Diamond* in that the subsequent purchaser must establish this proximity in order to get remedy.

The issue at hand is the clarity of s90(1) of the FSMA2000-UK, which seems to be all inclusive and ambiguous in terms of both the persons liable and the wrongs for which one should be held liable. It has both benefits and detriments. The benefit is that anyone involved in the preparation of a prospectus can be caught for defective disclosure based on their failure to successfully rely on any of the statutory defences. Another benefit is that it does not relate to the issuance of shares, instead it is concerned with the preparation of prospectuses. The detriment may be that it does not limit the liability explicitly by the scope of duties of gatekeepers. Some sharp differences between s79 and s90 of the FSMA2000-UK are evident at least in respect of their expressions. The former is specific and categorically identifies everyone who can be held liable and for what, such as, one is liable for his/her own part of the prospectus only; whereas the latter is a general provision which provides for compensation to injured investors, and gives a emphasis to the success of establishing statutory defences. It is unclear whether ‘anyone’ includes the company itself or not. In addition to the liability discussed above, s90(6) of the FSMA2000-UK preserves remedies under any other laws such as common law remedies of recession and
compensation for the tort of deceit or tort of negligence as no contractual relations exist between investors and the gatekeepers.\textsuperscript{181}

**Canada - Statutory Provisions of Civil Liability for Defective Prospectuses**

Following the strict requirements of civil liability of gatekeepers under common law in Canada as elucidated in *Filipovic v Upshall\textsuperscript{182}* and *CC&L Dedicated Enterprise Fund v Fisherman\textsuperscript{183}*, the securities legislation has eased their liability provisions to strengthen the protection of investors.\textsuperscript{184} Section 130(1) of the SA1990-Ontario provides that:

Where a prospectus, together with any amendment to the prospectus, contains a misrepresentation, a purchaser who purchases a security offered by the prospectus during the period of distribution or during distribution to the public has, without regard to whether the purchaser relied on the misrepresentation, a right of action for damages...

Section 130(1) stipulates liability for misrepresentation in prospectuses issued for raising capital. It imposes liability on, amongst others, each underwriter, every person whose consent has been filed with respect to reports, opinions or statements that have been made by them; and any other person who has signed the prospectus but not otherwise listed in this section. The section seems to be very wide and the purchasers need not show their reliance on the prospectus in making their investment decisions.

A representation or statement is regarded as 'misrepresentation' under s1 of the OSA1990-Ontario when it is: '(a) an untrue statement of material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made'. As described in s1 of OSA1990-Ontario, a fact is material under this section

\textsuperscript{181} Wild (2009) above n 172 at 180.
\textsuperscript{182} (1998) O J No 2256 (Ont Ct, Gen Div.)
\textsuperscript{183} 18 BLR (3d) 240 (Ont Ct J 2001)
\textsuperscript{184} For a brief discussion of complexity of common law liability provisions and the burdensome onus of proof there under, see Ben-Ishai (2007) above n 25 at 446-447.
when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities”.

The above description of victim’s right to sue for damages shows that underwriters, amongst the selected gatekeepers are clearly liable for corporate defective disclosures. However, others, though not named by designations, may also be held liable for giving consent to, or for signing a prospectus containing defective disclosures.\(^{185}\) This right is accorded in addition to any other rights conferred under any other law.\(^{186}\) Interestingly, unlike the other jurisdictions, Ontario provides for joint and several liability for defective disclosures,\(^{187}\) which is subject to the limitation that each underwriter is responsible for the portion of the offer it underwrote.

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Statutory Civil Liability of Auditors for Defective Prospectuses in Australia, the USA, the UK and Canada
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The gatekeepers are believed to be ‘incorruptible outsiders’... [paid] to gain legitimacy or expertise or to meet a legal requirement’ in the process of corporate capital raising from the public.\(^{188}\) Auditors and accountants are primarily liable as they are categorically named in s11(4) of the SA1933-US. With respect to the

\(^{185}\) Section 130(1)(d) every person or company whose consent to disclosure of information in the prospectus has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and (e) every person or company who signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d).

\(^{186}\) Securities Act 1990 (Ontario) s130 (1)(10).

\(^{187}\) Section 130(1)(8) of the Securities Act 1990 (Ontario) reads as follows: ‘All or any one or more of the persons or companies specified in subsection (1) are jointly and severally liable, and every person or company who becomes liable to make any payment under this section may recover a contribution from any person or company who, if sued separately, would have been liable to make the same payment provided that the court may deny the right to recover such contribution where, in all the circumstances of the case, it is satisfied that to permit recovery of such contribution would not be just and equitable. R.S.O. 1990, c. S.5, s. 130 (8).’

prospectus preparation process in Australia, it has been recommended in a recent doctoral research, that their liability be primary.\textsuperscript{189} None of the statutory provisions of the four selected countries discussed above categorically names auditors as one of the persons who should be held civilly liable for defective prospectuses. Despite this ‘omission’ in the statutes, they can potentially be sued for their participation in the preparation of prospectuses in all of these four jurisdictions. Amongst the four, s11(4) of the SA1933-US uses the term ‘accountant’ and makes ‘every accountant’ liable for defective disclosures. Hence the US legislation seems to be in a better position regarding auditors. The Court in \textit{Admiralty Fund v Hugh Johnson & Co} has suggested about accountant’s liability that they cannot avoid liability even if they follow generally accepted accounting standards, but knowingly or recklessly fail to disclose the truth.\textsuperscript{190} Other relevant sections of the SA1933-US and SEA1934-US as well as their accompanying rules are ambiguous as discussed earlier. Besides, judicial interpretations of those statutory provisions are not consistent, which makes the gatekeeper liability uncertain and it is almost certain that they cannot be held liable for providing merely professional service. Statutes in other three jurisdictions governing auditor liability are vague. In Australia, s729 of the CA2001 imposes liability on ‘a person named in the disclosure document with their consent as having made a statement: (a) that is included in the disclosure document; or (b) on which a statement made in the disclosure document is based’. Quite reasonably, such a person is not liable for any loss or damage caused by the prospectus generally, rather they are liable for the injury caused by the inclusion of a particular statement attributed to him/her as mentioned in this section. This liability is primary under category 5 of the Table in s729, and they can also be potentially liable as an accessory under category 6

\textsuperscript{189} Golding (2001) above n 19 at 351.
\textsuperscript{190} 677 F 2d 1301 (9th Cir 1982) at 1313.
which imposes liability on ‘a person who contravenes, or is involved in the contravention of, subsection 728(1). In respect of civil accessorial liability the High Court of Australia in *Yorke & Anor v Lucas* held that both civil and criminal accessorial liability are based on the same legal principles and the distinctive aspect is basically the standard and burden of proof. 191 This liability is imposed based on their involvement in the preparation of the prospectus, and the relevant statutory principles are: aiding, abetting, counseling or procuring a contravention; inducing a contravention; knowingly getting engaged in a contravention; or conspiring with others to commit a contravention. 192 In this regard, s79 of the CA2001-Australia prohibits involvement in any contravention of this Act by aiding, abetting, counseling or procuring someone who may be held primarily liable for the wrongful acts. It provides that:

A person is involved in a contravention if, and only if, the person:

(a) has aided, abetted, counselled or procured the contravention, or (b) has induced, whether by threats or promises or otherwise, the contravention; or (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned, or (d) has conspired with others to effect the contravention.

Section 79 should be applicable to prospectuses as a general prohibition against any contraventions of the CA2001-Australia.

Basically two things are required – knowledge of defects in disclosures and participation in the preparation of the prospectus - thus the issue of scietenter should not arise. 193 It does not require any positive actions to give rise to this liability. They will face potential accessorial liability even if they are not named in the prospectus,

191 (1985) 158 CLR 661 at 669
192 These legal principles are derived from s11 of the *Criminal Code 1995* (Cth) and originally imported from s8 of the *Accessories and Abettors Act 1861* (UK).
193 *Yorke & Anor v Lucas* (1985) 158 CLR 661 at 669.
however the liability would be subject to due diligence and reasonable reliance defences with a belief that the disclosure will not give rise to any material defects.\textsuperscript{194}

The UK laws of prospectus liability regarding the persons liable are similar to those of Australia as discussed above. They are not named but the articulations of Rule 5.5.3(2) and Rule 5.5.8 of the Prospectus Rules as alluded to earlier suggest that auditors could be held liable for defective prospectuses for accepting responsibility for the accuracy of the financial statement of the company included in the disclosure document. They can also be potentially liable for the same reason under s90 of the FSMA2000-UK.

In Canada, statutory law is the main source of liability for auditors. They are liable for misstatements in prospectuses under s130(1) of the SA1990-Ontario as an expert as alluded to earlier. However, the judicial interpretation of auditor liability for negligent misstatements under Manitoba corporation legislation makes the enforcement of s130(1) somewhat complicated in that, victims of defective disclosures in which an auditor was a party would need to rely on a shareholder’s derivative action. This is because the Supreme Court of Canada in Hercules Management Ltd v Ernst & Young held that auditors owe a duty of care to the entity itself, not to any individuals such as shareholder, therefore they can use derivative action in order to sue auditors.\textsuperscript{195} This interpretation should be relevant to the SA1990-Ontario in the absence of any clear provisions that makes auditors directly liable to third parties such as shareholders. Thus the Hercules Management decision has basically inhibited the expansion of auditor liability to non-clients third parties for negligent misstatements in prospectuses. This case offers the first legal test for the

\textsuperscript{194} Golding (2001) above n 19 at 371-372.
\textsuperscript{195} 2 S C R 165 (1997) (Can) at 171-72.
determination of the scope of civil liability of gatekeepers and it apparently contradicts the recent trend towards investor protection.

**Statutory Civil Liability of Underwriters for Defective Prospectuses in Australia, the USA, the UK and Canada**

Underwriters are liable for defective prospectuses very clearly in Australia as category 4 of s729(1) of the CA2001 identifies them as responsible for loss or damage of investors for any contravention of s728(1) in relation to disclosure document. This liability is of course subject to defences available to them. Similarly, their liability in the USA is also clear under s11 of the SA1933, even under s12 as a seller with respect to selling securities under firm commitment underwriting agreement as explained earlier. In Canada, they are also named in s130(1) of the SA1990-Ontario as liable for defective disclosure in prospectuses. Section 130(1) requires them to provide certification of accuracy of prospectus disclosures by stating that to the best of their knowledge, information and belief, the prospectus contains full, true and plain disclosure of all material facts relevant to, and required for, the given offer.\(^{196}\) Unlike auditors, underwriters are civilly liable to the shareholders for damages with a maximum limit of the portion of distribution underwritten by a particular underwriter where there is more than one underwriter.\(^{197}\) However, unlike the other three jurisdictions, their liability in the UK is less clear in that, the law does not plainly name them as responsible for such a disclosure. However, they can still face potential liability under the same provisions as applicable to auditors because they certainly accept the responsibility for the prospectus as reasonably perceived by investors. They also authorise the contents of the prospectus without which the issuer could not make the public offer.

\(^{196}\) *Ontario Securities Act 1990* s59(1).

\(^{197}\) *Ontario Securities Act 1990* ss59 and 130(1)(b).
Statutory Civil Liability of Lawyers for Defective Prospectuses in Australia, the USA, the UK and Canada

The legal profession is indeed old, but the idea of a lawyer’s gate-keeping responsibility for investors is a relatively recent concept. Lawyers are traditionally hired by both the issuer and underwriters to verify the truth in the disclosure document apparently aiming at avoiding liability. In order to rely on a due diligence defence—they are obliged to properly conduct reasonable investigation about the information supplied and statements made by the issuer. A federal district court in the Southern District of New York in Escott v BarChris Consortium Co held that lawyers could not just rely on the statements made by their clients, but they should conduct ‘a check of matters easily verifiable’. However they can rely on auditors with respect to financial statements.

The position of lawyers is pretty much the same in all of the selected four jurisdictions in regard to prospectus liability. Although they are not categorically named in any of these jurisdictions, nonetheless they can face potential civil liability due to their significant role in the corporate fund raising process. However, the judicial interpretations of prospectus liability provisions are unclear as to the liability of lawyers.

They can face potential primary liability in Australia under s729(1) category 5, only if they consent to being named in the disclosure document. This liability will be restricted to the defective statement made by them in the document, or statements included in the document made by others based on the lawyer’s statement. In Greg Golding’s view, lawyer’s consent does not refer to being named only, rather to the

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199 283 F Supp 643 (S D N Y) 1968.
inclusion of the misstatement that attracts primary potential liability.\textsuperscript{200} The defects in question included in the document must be related to the materials legally required to be embodied in the disclosure. In the absence of the primary liability, they can still be charged with accessorial liability for their participation in the preparation of the prospectus under category 6 of the Table in s929 of the CA2001-Australia.\textsuperscript{201}

Lawyers in the USA can be held liable under s11(4) of the SA1933 as it makes liable ‘... any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement....’ They may not be held liable under s12 of the SA1933 which imposes liability only on ‘sellers’ and lawyers are not sellers for the purposes of this section as pronounced in Pinter v Dahl.\textsuperscript{202} However, Judge McLean in the BarChris case observes that although the lawyer provides advice about the legal requirements of a prospectus, it does not mean the entire document has been prepared by that person as an expert.\textsuperscript{203} Similarly it has been argued that securities lawyers in the USA have no liability as an expert with respect to their engagement in the preparation of disclosure document.\textsuperscript{204} Nevertheless, they can be held liable as a legal adviser.\textsuperscript{205}

In the UK, like auditors - lawyers are not categorically named in the law imposing prospectus liability. Nonetheless, they can face potential liability under Rule 5.5.3(2) of the Prospectus Rule. It imposes liability on ‘each person who accepts, and is stated as accepting responsibility for the prospectus, and each person who has

\textsuperscript{200} Golding (2001) above n 19 at 362.
\textsuperscript{201} For a detailed analysis of lawyer liability as an advisor, see Golding (2001) above n 19 at 349-373.
\textsuperscript{202} 486 US 622 (1988).
\textsuperscript{203} BarChris case at 683.
\textsuperscript{204} For details, see M V Freeman, ‘Liability of Counsel for Issuer’ (1969) Business Lawyers 635 at 636-37.
\textsuperscript{205} See Schneider v Traweek Fed Sec L Rep P 95 419 (1990), In Re ZZZZ Best Co Inc, Sec Litig 864 F Supp 960 (1994) at 970.
authorised the contents of the prospectus.' Given their role of the 'field marshal' or 'transaction engineer' as the principal verifiers of legal requirements through exercising due diligence inquiry, they are perceived to have accepted the responsibility for, and authorised the contents of, the prospectus as far as their professional roles are concerned. Hence they can be found liable for investor loss or damage resulting from their failure to discharge their duties in a proper manner.

Section 130(1) of the SA1990-Ontario lays down prospectus liability and it applies to lawyers including their statements given as an expert opinion.\textsuperscript{206} It is argued that lawyers are liable as an expert under s130(1).\textsuperscript{207} In contrast, the Court in the \textit{BarChris} case held that neither lawyers nor auditors are expert under s11 of the SA1933-US.\textsuperscript{208} Recently in Canada, the issue of the liability of gatekeepers, especially lawyers, has been decided in \textit{Wilder v Ontario Securities Commission}.\textsuperscript{209} This case basically relates to the power of the securities regulator, namely Ontario Securities Commission (OSC) with respect to the regulation of lawyers. The court had to interpret the meaning of the term 'person' used in s127(1)(6) of the SA1990-Ontario, which provides that 'if in its opinion it is in the public interest to make the order ... a person or company be reprimanded' by the OSC for the violation of the SA1990-Ontario as amended in 1994. The court interprets 'person' to include lawyers and adds that 'it gave the Commission a general power, in s127(1), to reprimand a

\textsuperscript{206} \textit{Securities Act} R S O Ch S-5, s58 (1990).
\textsuperscript{207} See Ben-ishai (2007) above n 25 at 452.
\textsuperscript{208} Katner et al (2005) above n 85 at 92.
\textsuperscript{209} (2000) 47 OR (3d) 361 (Div. Ct) per Swinton J.
person or company’ even in respect of prospectuses. 210 Hence it can be safely inferred that securities lawyers in Canada are liable for defective prospectuses.

The above discussions of lawyer liability provisions demonstrate that they are not categorically named in any jurisdictions, but nevertheless, they can be held liable for their failure to perform their duties in ensuring full and fair prospectus disclosures by their clients which issue shares to the public.

**Conclusions**

Admittedly, civil liability provisions have two major objectives: firstly, compensating investors for economic injuries; and secondly, compelling companies to comply with the law to avoid losses that may arise from contravention of the prospectus requirements. 211 In addition, one of the primary purposes of civil liability is creating deterrence which can be both specific and general. However, the direct liability of issuers arguably does not create adequate deterrence for repeat or individual potential wrongdoers. 212 Instead, the liability of gatekeepers such as lawyers, auditors and underwriters is thought to be an effective means of deterring wrongdoings by corporations as can be inferred from recent corporate scandals. 213 Likewise, Reinier Kraakman concludes that gatekeepers’ inhibitive response to intended corporate misconduct by withholding their support has considerable advantage over the enforcement of contravention of law by victims of defective disclosure. 214 It can also

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211 Shulman (1933) above n 81 at 253.
213 See ibid.
save the social costs associated with the enforcement of the law. 215 In recognition of
the need for the identification of persons responsible for information contained in
prospectuses, Art 6 of the EC Prospectus Directives provides that:

The persons responsible [for statements and information contained in a
prospectus] shall be clearly identified in the prospectus by their names and
functions ... as well as declarations by them that, to the best of their
knowledge, the information contained in the prospectus is in accordance with
the facts and that the prospectus makes no omission likely to affect its
import.216

The creation and maintenance of investor confidence in securities markets critically
depend on the integrity of the marketplace in which the investing public put their
savings for profits. This integrity is assessed by reference to the environment of fair-
play that can be created and promoted by appropriate legal and regulatory regime and
their effective enforcement by competent authorities.

The foregoing discussions demonstrate that gatekeepers have a vital role to play
in assisting their clients both in the contravention of, as well as compliance with, the
requirements of corporate disclosure in the primary share market. As to how they will
deal with their clients and the potential users of their works largely depends on their
honesty, sincerity, diligence and professionalism. Their clients may hire them for
partly compliance with or partly contravention of the disclosure requirements or for
both. Their services in practice across the globe show that they are helpful for their
clients in doing both. John Coffee, who has recently popularised the gatekeeper
concept initiated by Reinier Kraakman, puts blame on the gatekeepers for corporate
collapses in the 1990s, and argues that those incidents are the result of their assistance
to their clients in contravening disclosure provisions taking advantage of declining

Prospectus to be published when securities are offered to the public or admitted to trading.
exposure to liability.\textsuperscript{217} Referring to the involvement of gatekeepers in the preparation of defective disclosures and their significant effects on investors and the share market, a US court held that even simple participation of professionals may trigger liability.\textsuperscript{218} But their liability provisions were unclear in all of the four countries discussed above and were wide enough to hold all gatekeepers liable for defective disclosures in their respective primary share markets, although they may arguably be caught by judicial inference. They are not categorically named in line with the EC Prospectus Directives referred to earlier, although underwriters are named in the US and Australian statutes. Victims of defective disclosures generally prefer suing the issuer itself rather than individuals. One reason for this may be that issuers can be easily identified as a person responsible for a defective prospectus unlike their gatekeepers. It is recommended that all the major gatekeepers be named by their professions and/or functions. In addition to those specific names, the prospectus should contain its current expressions such as ‘any person’ or ‘every person’ involved in the preparation of defective prospectuses should be held liable for the defects resulting from their failure to carry out their responsibilities properly.

The provisions concerning liability of gatekeepers in the primary share market should be drafted in clear and simple terms to facilitate their smooth and efficient enforcement. An ambiguity in law is an impediment to its enforcement, which may encourage contraventions, whereas strict compliance with the disclosure requirements is essential for investor protection in the market. An appropriate liability regime can encourage both the gatekeepers and their clients to abide by the law, which would be

\textsuperscript{218} \textit{In re ZZZZ Best Co Sec Litig} 864 F Supp 960, 970 (CD Cal 1994).
beneficial for all parties concerned with corporate capital. It is evident from Schwartz’s study that the potential liability works as an incentive for the gatekeepers to work hard and provide insurance for investors. However their liability itself is not a panacea, because a complete solution to deterring corporate misconduct does not lie in the gatekeeper liability alone, rather the joint use of this liability and the regulation of other wrongdoers such as issuers providing an effective prevention of wrongdoings. It should be borne in mind that the regulation of corporations and their allies (gatekeepers) with respect to wrongdoings has a significant positive impact on the economic well-being of a country.

The judicial decisions between the 1960s and 1980s in the developed common law countries expanded the liability of gatekeepers, but a reverse trend towards their liability for misstatements became evident from the cases following the 1990s. Now ‘it is too difficult to determine the judicial interpretations in this area, which lies on a continuum of possible liability outcome’. But it is to be admitted that the certainty about, and enforcement of, gatekeeper liability and public awareness thereof are important for the development of capital markets.

In the context of the sub-prime problem which contributed largely to the recent global financial crisis, Jeffrey Manns suggests that gatekeepers should be paid by government administered pooled resources of beneficiaries in order to avoid two-master problem and ensure their accountability to the end users of their services as

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220 Wan (2008) above n 212 at 514
221 Fox (2008) above n 2 at 1093.
223 Id at 71.
alluded to earlier.\textsuperscript{225} He adds that for the gatekeepers in securities markets, the securities regulator can administer the pooled funds.\textsuperscript{226}

La Porta, Lopez-De-Silanes, Shleifer and Vishny, whose works are believed to have been most cited in the contemporary research on investor protection, have found that one of the fundamental tenets of the regulation of primary share markets is the imposition of liability on the persons involved in the preparation of a prospectus.\textsuperscript{227} This regulation is necessary to ensure accuracy, adequacy and timeliness of the material information embodied in the disclosure documents in relation to both the issue and the issuer concerned. In support of this view, several recent studies of different scholars show that legal liabilities and their effective enforcement are critical to the development of the primary share market.\textsuperscript{228} Achieving an effective liability regime entails clarity of laws in their articulation. This is because the benefit of a particular law depends on its enforcement by competent authorities in an effective and efficient manner.

While gatekeepers are appointed to reduce the informational asymmetry, their failure to properly perform their duties essentially sends a wrong message to prospective investors in the market. Prevention of this message warrants the watchdogs to bark more effectively. Following the aftershock of the 1929 crash when the securities market was in ‘complete disarray’, Roosevelt asked the US Congress to legislate a law that “puts the burden of telling the whole truth on the seller” of


\textsuperscript{226} Id at 1089.


\textsuperscript{228} See Coffee (2006) above n 7 at 317-377 and the sources cited in above n11.

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securities in order to "bring back investor confidence". Gatekeepers have a pivotal role to play in compelling the issuer to tell the whole truth. Therefore, their liability as incentive to performing their responsibilities properly should be imposed in emphatic terms. It is to be borne in mind that gatekeepers are central to generating a strong investor protection culture within the securities market.

A survey of six major stock market crashes between the 1690s and 1990s reveals that bubbles, bursts and reforms are interrelated. In the past, most of the new regulatory laws came into being following the bubbles owing to laxity in regulation. Time is ripe to bring about reforms in gatekeeper liability before innocent investors burst into tears further.

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229 E F Greene, ‘Determining the Responsibilities of Underwriters Distributing Securities Within an Integrated Disclosure System’ (1981) 56 Notre Dame Lawyer 756 at 767, cited as quoted in H R Rep No 85 73\textsuperscript{1} Cong 1st Sess 2 (1933).