Investor protection and civil liabilities for defective prospectuses: Bangladeshi laws compared with their equivalents in India and Malaysia

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Abstract
The Bangladesh securities market came into being in 1954, but it still remains in its infancy. The Disclosure-Based Regulation (DBR), a regulatory regime useful for the developed securities markets, was adopted in January 1999 for an embryonic securities market in Bangladesh by discarding the previous merit regulation. The new philosophy came into effect without any significant changes being made in the old legal and regulatory framework of initial public offerings (IPOs).

Keywords
protection, liabilities, prospectuses, laws, compared, their, india, malaysia, investor, defective, bangladeshi, equivalents, civil

Disciplines
Arts and Humanities | Law

Publication Details

This journal article is available at Research Online: http://ro.uow.edu.au/lhapapers/1381
INVESTOR PROTECTION AND CIVIL LIABILITIES FOR DEFECTIVE PROSPECTUSES: BANGLADESHI LAWS COMPARED WITH THEIR EQUIVALENTS IN INDIA AND MALAYSIA

S.M. Solaiman*

INTRODUCTION

The Bangladesh securities market came into being in 1954, but it still remains in its infancy. The Disclosure-Based Regulation (DBR), a regulatory regime useful for the developed securities markets, was adopted in January 1999 for an embryonic securities market in Bangladesh by discarding the previous merit regulation. The new philosophy came into effect without any significant changes being made in the old legal and regulatory framework of initial public offerings (IPOs).

The law defining the rights of both the shareholders and the quality of their enforcement is fundamental to corporate governance and finance. An empirical study reveals that the quality of the "legal environment" in a market for IPO has a notable effect on the ability of firms to raise funds from the public. "Good legal rules" are of paramount importance in all successful examples of securities market development. Rhee observes that a strong regulatory framework to protect the integrity of the IPO market, as well as the investors, is essential for a successful DBR. Generally, the regulation of securities markets is based on the liabilities for the infringements of regulatory provisions and their enforcement. One of the core tenets of IPO regulation is the imposition of liability on the persons involved in the preparation of a prospectus. This regulation is necessary to ensure accuracy, adequacy and

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1. Rafael La Porta et al., Legal Determinants of External Finance, 52 J. Fin. 1131, 1149 (1997);
Rafael La Porta et al., Investor Protection and Corporate Governance, 58 J. Fin. Econ. 3, 15 (2000).
2. "Legal environment" refers to the quality of legal protections for investors, the quality of laws and their enforcement. See Rafael La Porta et al., supra note 1, at 1132.
3. Id. at 1146.
6. In Bangladesh, the Companies Act of 1994 does not define the term "prospectus." However,
timeliness of the material information in relation to both the issue and the issuer concerned.

Companies willing to go public are required to disclose to all potential investors information which is necessary to make informed investment decisions. The availability of remedies against the violation of disclosure requirements primarily depends on "the suitability of liability regime."8 Civil liabilities have been imposed on certain persons for the inclusion of "untrue statements"9 in a prospectus. But the liability of several others is unclear. Civil liabilities for a defective prospectus in Bangladesh are comprised of the statutory liability as well as liability under the common law of torts.

This paper examines the inadequacy and loopholes of the current civil liability provisions for the prospectus in Bangladesh in the light of their equivalents in India and Malaysia. However, references to the relevant laws in some developed countries such as the United Kingdom, Australia and Canada will be made where appropriate. Although the Bangladesh securities market cannot be compared with the markets in the developed economies, the comparisons seem to be justified in this study for contextual perspective.

The findings of the discussion suggest that the Bangladeshi laws governing civil liabilities for disclosures in prospectuses are flawed in multifarious ways with weaknesses such as ambiguities and shortcomings in identifying potentially liable persons, and softness in terms of the scope for defences. Such flaws ultimately favour the wrongdoers at the expense of the investors affected by the contravention of the legal requirements of disclosures. This is so because in the absence of an effective enforcement mechanism, the weaknesses in the provisions for prospectus liabilities have increased the vulnerability of investors.

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7. See Companies Act of 1994 §§ 134-35 (Bangl.); Public Issue Rules of 1998 R. 7(B) (Bangl.).
8. In this analysis, "the suitability of liability regime" refers to the liability provisions suitable to the needs of the IPO market in Bangladesh and effective machinery for the enforcement of these provisions.
9. For the interpretation of provisions in relation to prospectuses in Bangladesh, the expression "untrue statements" includes the statements misleading in the form and context in which it is included, and any omission from a prospectus which is calculated to mislead. See Companies Act of 1994 § 143 (Bangl.).
OBJECTIVES OF PROSPECTUS LIABILITIES

Liabilities for wrongdoing in any respect generally create deterrence for the wrongdoers. Investors in the securities markets are best protected by a legal framework which is based on deterrence. Therefore, the main thrust of imposing liability for a defective prospectus is to provide protection to investors.

In respect of raising funds for companies from the public, the objectives of civil liabilities are twofold: first, to facilitate compensation for the victims of the defective prospectus; and second, to deter the persons involved in the preparation of prospectuses from flouting disclosure requirements.

CIVIL LIABILITIES FOR DEFECTIVE PROSPECTUSES

The civil liability, in this discussion, refers to the compensation of investors or subscribers who may have sustained loss or damage by subscribing for an IPO. A public offering of shares involves several distinct areas of activity which commonly include promoters and directors of the issuing company, accountants/auditors, lawyers, underwriters and issue managers (IPO Coalition). The Companies Act of 1994 (CA’94) and the Securities and Exchange Ordinance of 1969 (SEO’69), as well as the common law of torts, provide civil liabilities for a defective prospectus.

The CA’94 and the SEO’69 have imposed civil liability on certain persons to compensate the subscribers who sustained loss or damage from their subscriptions to an IPO on the faith of the prospectus. In addition to statutory liabilities, those persons are also liable under the common law of torts to compensate each investor who suffers loss or damage by investing in an IPO having relied on the defective prospectus. The SEO’69 and the common law also entitle the investors to rescind their investment contracts. This remedy is available against the issuer. The investors’ right to rescind their investment contracts is widely prevalent in common law jurisdictions and does not punish the persons involved in the preparation of the prospectus.

11. Id. at 405.
12. The terms “investors” and “subscribers” will be used interchangeably in this article.
Moreover, this remedy appears to be useless when the promoters and directors misappropriate the funds raised by the defective prospectus and the company goes into liquidation, leaving inadequate or no funds to implement the rescission of investment contracts. Furthermore, as the residual claimants of the company, the shareholders are entitled to get equitable shares in the company’s remaining assets after meeting the claims of the creditors. Therefore, the shareholders will be able to recover their money from the residual assets of the company, if any are left after liquidation, without any litigation for rescission of their investment contracts. In addition, the burden of liability of an issuer “falls primarily on innocent shareholders.” For these reasons, the present study will not focus on the investors’ right to rescind their contract against the issuers. The paper will concentrate on the liability of the persons involved in the process of raising funds from the public for the company. It will not look at the issues concerning the liability of the company which are beyond its scope.

PERSONS LIABLE FOR DEFECTIVE PROSPECTUSES UNDER THE COMPANIES ACT OF 1994

Section 145(1) of the Companies Act of 1994 imposes liability on certain persons for any “untrue statement” included in the prospectus. It provides that subject to the provisions of this section, the following persons will be liable to compensate the subscribers to a given public offer of securities:

(a) every person who is a director of the company at the time of the issue of the prospectus;
(b) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of sometime;
(c) every person who is a promoter of the company; and

15. Creditors generally include the holders of debt securities, such as debentures, and providers of loans to the company. They are also called the fixed claimants of the company as opposed to the equitable claimants.
17. According to the statutory interpretation of the term, an “untrue statement” implies such a statement which includes a statement misleading in the form and context in which it is included and which omits to state information therein that is calculated to mislead. *See Companies Act of 1994 § 143(1) (Bangl.).*
18. In respect of prospectus, the term “included” denotes “included in the prospectus itself or contained in any report of memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.” *Companies Act of 1994 § 143(2) (Bangl.).*
(d) every person who has authorised the issue of the prospectus.

This section clearly imposes liability on the directors and promoters, but it is unclear whether or not the other persons involved in the preparation of the prospectus, such as auditors, lawyers, underwriters and issue managers, fall within the ambit of this liability.

The above provisions of the CA'94 have never been interpreted by the courts in Bangladesh due to a dearth of cases, although there have been many allegations of the contravention of this section. Therefore, the liability of

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19. AIMS of Bangladesh Limited cancelled their commitment for underwriting the flotation of Modern Food Products Limited after the publication of the prospectus. AIMS decided on this cancellation after detecting that the audited account of the company provided to them by the Merchant Bankers and Issue Manager of the issue differed from the one published on the prospectus and concealed material facts. The audit report on the prospectus had been qualified by the auditors for not complying with Bangladesh Standard of Accounting (BSA) 4 and 16 on fixed asset schedule. It was also exposed that the sponsors of the issue are bank loan defaulters. The bad loan liability and litigation against them have been understated and concealed at Taka 5.205 million against actual Taka 13.465 million. See AIMS, *AIMS Ditches Modern Food*, Wkly. Market Rev., 10 July 2000, at 1; M.S. Rahman, *AIMS Backs Down on Pledge to Underwrite Modern Food: Audited Accounts Differ from Prospectus Statement*, Daily Star (Dhaka, Bangl.), 3 July 2000.

The SEC has sued the directors of Wonderland Toys, Ltd. and its issue manager (National Securities and Consultant, Ltd.) for allegedly "inducing the investors into purchasing its shares by artificially showing a rosy picture of the company." The company went for an IPO of Taka 50 million. In its prospectus, the company showed that Wonderland's counterpart in Hong Kong had provided them with the plant and machinery as per a joint venture agreement and all the machinery had been installed. The SEC filed the case based on its inquiry reports. The SEC complaint stated that "[a]ll these claims are outright false, deceptive and an illegal bid to gain by providing false information with a view to luring investors into buying its shares." It may be mentioned here that Wonderland failed to make any profit and pay dividend for two consecutive years. For detail, see M.S. Rahman, *Court Summons Wonderland Toys Directors for Alleged Deception: Fake IPO Info Make Investors Buy Scrips*, Daily Star (Dhaka, Bangl.), 19 Jan. 2001.

Audit firm M/S Ata Khan & Co. had been accused of certifying false statements by two companies on their balance sheets. The SEC inquiry as well as the investigation of the disciplinary committee of the Institute of Chartered Accountants of Bangladesh (ICAB), the professional statutory body of accountants, found the firm guilty for certifying balance sheets of two companies showing inflated amounts of bank liability. These two green field companies' sponsors sought to raise Taka 360 million from the IPOs. For details, see M.S. Rahman, *Auditing Firm under SEC-ICAB Fire*, Daily Star (Dhaka, Bangl.), 21 Apr. 1998.

Fu-Wang Ceramic Industry Limited, a Taiwanese-owned company, concealed tax evasive information in its prospectus for an IPO to raise Taka 50 million which was revealed during the subscription period. Such information is required to be published under the prevailing law and international accounting practices, which have been adopted by Bangladesh. See T.I. Khalidi, *IPO to Raise Tk 5 cr by Taiwanese Tiles Producers: Fu-Wang Conceals Information*, Daily Star (Dhaka, Bangl.), 11 Feb. 1998.

Madina Shoe Industries Ltd. submitted a petition for IPO for the SEC's approval. The petition enclosed a due diligence certificate with the forged signature of a director. Later, the SEC turned down the application. The SEC detected the forgery when directly contacting the director. See M.S. Rahman, *SEC Turns Down Madina Shoe's IPO Petition: Allegation of Submitting False Documents*, Daily Star (Dhaka, Bangl.), 12 June 2000.
various participants in an “IPO coalition,”\(^\text{20}\) other than the directors and promoters, has yet to be determined under these provisions. The absence of specific mention of their liabilities in the legislation, coupled with a lack of judicial interpretation, may imply to the public the misunderstanding that all members of an IPO coalition are not liable for the untrue statements in the prospectus. This impression may induce the persons involved in the preparation of the prospectus to commit wrongs and preclude the investors from seeking remedies under this section.

In pursuance of the articulation of Section 145(1) referred to, one may perceive that persons other than the directors and promoters may fall within the expression “every person who has authorised the issue of the prospectus” and thereby be liable for untrue statements included in the prospectus. But the CA’94 does not provide any explanation as to who authorises the issue within the meaning of the section. Moreover, the provisos added to Section 145(1), read with Section 138 of the CA’94, suggest that auditors, legal advisers, attorneys, solicitors and bankers to the issues of the company shall not be liable under this section as a person “who has authorised the issue” merely because of giving consent to the issue of the prospectus as required under Section 138 of the CA’94. The provisos further state that they may be liable if their names are shown in the prospectus as experts and the untrue statements in question purporting to be made by them are included therein. But the statutory definition of “expert”\(^\text{21}\) provided in Section 139(2) does not clearly include any of them.

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\(^{20}\) An “IPO coalition” in this article includes all persons involved in the preparation of a prospectus.

\(^{21}\) The term “expert” includes an engineer, a valuer, an accountant and any other person whose profession or reputation gives authority to a statement made by him. Prospectuses often include reports from valuers or geologists, who usually make reports on the viability of the businesses of the issuers. The term expert bears the same meaning in all three jurisdictions, Bangladesh, India and Malaysia. See Companies Act of 1994 § 139(2) (Bangl.); Companies Act of 1956 § 59(2) (India); Companies Act of 1965 § 4 (Malay.).
In this respect, the corresponding provisions of Section 62 of the Companies Act of 1956 (CA'56) of India is exactly same as Section 145 of the CA'94. Moreover, Section 46 of the Companies Act 1965 (CA'65) of Malaysia is little different from the companies legislation of Bangladesh and India. Section 46(1) of the CA'65 imposes liability on the directors, promoters or every person who "authorised or caused the issue of the prospectus." The same ambiguity exists in Malaysia too, because the CA'65 does not specify the persons who fall within the meaning of authorisation or causation under Section 46(1). Therefore, the question of liability of the persons other than the promoters and the directors for a defective prospectus is also unclear in Malaysia under company law. No case law has been found under this section for the judicial interpretation of this ambiguity in any of the three countries: Bangladesh, India and Malaysia. However, in a similar context, judicial observations in some common law jurisdictions show that directors fall within the purview of the meaning of the authorisation of issue of a prospectus. One writer observes that a "class of possible defendants" would not be liable under Section 146(1) and "[s]uch a class would include the advising solicitors, merchant bankers and reporting accountants, who assisted in the preparation of the prospectus." According to this observation, auditors, underwriters, issue managers and lawyers are not liable for defective prospectuses under the above section in Malaysia.

The ambiguity of the liability of those persons becomes more apparent from the comments of one writer on Section 62 of the CA'56 of India. According to this writer, Section 62 of the CA’56 restricts the civil liability to the promoters, directors and experts. As a result, it can be said that a general perception persists in those countries, including Bangladesh, that the auditors, lawyers, underwriters and issue managers do not fall within the meaning of "authorising the issue of the prospectus."

Those persons are not even considered to be liable within the meaning of "promoters" as long as they are only providing professional services. In Re Great Wheal Polgooth Co., 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." Hence, in the absence of judicial interpretation, the academic views seem to

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22. Companies Act of 1965 § 46(1)(d) (Malay.).
suggest that Section 145 of the CA’94 of Bangladesh does not impose any liability on the lawyers, auditors, underwriters and issue managers despite their crucial responsibility in the preparation of a prospectus. In fact, they are very influential in making disclosures in a prospectus through which they have an impact on the disclosure’s capacity to deceive the investors. Although the above statutes of Bangladesh, India and Malaysia are unclear about the civil liability of persons other than the promoters, directors and experts, the Securities Commission Act of 1993 in Malaysia contains very clear provisions regarding the liability of the persons in question. Section 57 of the Act imposes liability on all persons involved in the preparation of a prospectus to compensate investors for their loss and damages resulting from false and misleading statements in the prospectus. It clearly identifies the liable persons and these persons are, amongst other, directors, promoters, principal advisers, underwriters, auditors, and advocates of the issuer (lawyers) in relation to the issue. However, the defendants have a range of statutory defences against any claim of investors under this section. The defences are: due diligence, expertisation, reliance on public statement and withdrawal of consent. All of these defences are available under company laws which will be discussed later in this paper. It is therefore clear that all of the above persons are liable for a defective prospectus in Malaysia; but there are no similar provisions in Bangladesh and India.

In addition to the legislation of Malaysia, there are some statutory laws as well as judicial decisions which clearly impose civil liability on the above professionals and intermediaries involved in the process of prospectus preparation. Bangladeshi law is weaker in relation to the civil liabilities of underwriters, issue managers, auditors and lawyers. These legal lacunae result

28. For details, see the text of § 57 of the Securities Commission Act of 1993 (Malay.).
29. All defences bear the same meaning as analyzed earlier in the discussion on the civil liability under company laws.
31. Id. § 60.
32. Id. § 62.
33. Id. § 63.
34. The equivalent of the Securities Commission Act of 1993 (Malaysia) is the Securities and Exchange Commission Act of 1993 (Bangladesh) and the Securities and Exchange Board of India Rules of 1992 (India).
35. For details, see Securities Act of 1933 §§ 11-12 (U.S.); Financial Services Act of 1986 § 168(1) (U.K.); Securities Act of 1990 § 130 (Ont.); Corporations Act of 2001 §§ 728-729 (Austl.). Judicial precedents will be discussed later.
in weaker protection of investors for which the current civil liability provisions are unhelpful to protect investors in the disclosure regime in Bangladesh. The DBR is avowed to be a system adopted for the development of securities markets, but as some commentators have stated, the shortcomings of the protection of the investing public have adverse effects on this development.36

Underwriters, issue managers and auditors provide separate certificates to the effect that they have examined the prospectus issued to the public. Their certificates are published in the relevant prospectus. Similarly, lawyers have an important role to play in the corporate fundraising process. For their involvement in the IPO process, lawyers are also subject to the civil liability in other jurisdictions as will be discussed later in this article. The roles of underwriters, auditors, lawyers and issue managers with respect to a prospectus and the rationale for their liability for a defective prospectus are discussed below.

FUNCTIONS OF UNDERWRITERS AND RATIONALE FOR THEIR CIVIL LIABILITY FOR PROSPECTUSES

Pricing of shares in a public offer is very crucial for investor protection. In Bangladesh, underwriters justify the price of the shares in an IPO and provide a due diligence certificate which is included in the prospectus. The imposition of civil liability on the underwriters has been emphasised to ensure prospectus integrity from the viewpoint of investor protection.37 The following are arguments usually advanced for the liability of the underwriters:

i. As the most independent person, an “underwriter is in a position to evaluate and investigate” the various facets of the proposed issue, and the underwriter “must make some reasonable attempt” to do it.38

ii. Investors reasonably rely on underwriters “to check the accuracy of the statements and the soundness of the offer.”39

iii. Underwriters are in a position to impose their will on the issuers in order to ensure the accuracy of disclosures in prospectuses.40

37. Golding, supra note 10, at 431.
40. Ernest L. Folk, Civil Liabilities under the Federal Securities Acts: The BarChris Case, 55 VA.
All of the above reasons for the prospectus liability of underwriters are related to the interests of investors. The liability of underwriters therefore becomes more desirable for the restoration of public confidence in the operation of the Bangladesh IPO market which has been seriously lacking in an environment conducive to the DBR for several years. The absence of prerequisites for the DBR, including shortcomings and ambiguities of the civil liability regime, has prevailed in the Bangladesh securities market for years. Hence, the civil liability of underwriters is important for investor protection in the IPO market.

**FUNCTIONS OF AUDITORS AND RATIONALE FOR THEIR LIABILITY FOR PROSPECTUSES**

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. Generally, the auditors are the people who are hired first for the prospectus and they “must observe inventory and confirm accounts receivable” to furnish their reports. Auditors often have great influence over the contents of the prospectus that deceive investors. They usually work behind the scenes and it is reasonable to impose liability on the auditors because “they have an impact on the disclosure’s capacity to deceive” as is the case of underwriters. In the U.S., the Court of Appeals for the Ninth Circuit has suggested that primary liability be imposed on those who have a significant role in drafting fraudulent disclosure materials and that accountants have been directly identified as a source of these materials. A district court in California has expressed the view that the simple involvement or participation in a fraudulent disclosure is sufficient for liability to be imposed. A U.S. court in Adam v. Silicon Valley Bancshares observed that a defendant may be liable for participating considerably in a fraudulent scheme even if the misrepresentations are not made directly by the

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41. Beatty & Welch, supra note 13, at 548.
43. Langevoort, supra note 27, at 891-92.
44. Dannenberg v. PaineWebber Inc. (In re Software Toolworks Inc.), 38 F.3d 1078, 1090 n.3 (9th Cir. 1994).
defendant. Thus, the participation of auditors in the preparation of a defective prospectus should attract liability.

Further, from a different point of view, a study has shown that the level of effort of auditors in the performance of auditing depends on the extent of the liability. Similarly, another study suggests that potential liability works as an incentive for auditors to work hard and provide insurance for the investors.

The importance of the role of auditors in the preparation of a prospectus is evident in the reasons aforesaid. Therefore, the imposition of civil liability on the auditors for a defective prospectus is quite reasonable.

FUNCTIONS OF LAWYERS AND RATIONALE FOR THEIR LIABILITY FOR PROSPECTUSES

A lawyer provides advice to the issuer on the requirements of disclosure and certifies compliance with the law in preparing a prospectus. A lawyer is also responsible for guiding the issuer through various regulatory hurdles. A legal framework contributes to make the role of lawyers more credible by imposing potential liability on them for providing improper advice to the issuer and attaching untrue certification to the prospectus regarding its compliance with the law. It is argued that lawyers are not generally regarded as experts in respect of IPOs. They may not be experts in relation to the whole contents of a prospectus, but lawyers are expected to have expertise on the legal aspects of the prospectus. By virtue of their knowledge of the law, lawyers can provide opinions like experts on certain contents of a prospectus. For example, legal counsel may be held liable if an expert opinion is offered in the prospectus concerning the tax status of the issuer if the opinion is found to be inaccurate. Apart from offering expert opinions, mere participation of professionals (lawyers) like underwriters and auditors in the process of prospectus preparation “can provide an implicit certification” to potential investors about the accuracy of disclosures. Thus, simple involvement or

46. 884 F. Supp 1398, 1401 (N.D. Cal. 1995).
47. See Frank Gigler, Discussion of an Analysis of Auditor Liability Rules, 32 J. ACCT. RES. 61, 64 (1994).
49. Beatty & Welch, supra note 13, at 552.
participation of lawyers in a fraudulent prospectus should be considered sufficient for the imposition of civil liability on them as has been mentioned earlier in relation to auditors.\textsuperscript{52} There may be some arguments against the liability of lawyers on the plea that the service provided by lawyers in respect of the prospectus is basically of an advisory nature. Actually, their role is not limited to merely providing advice to the issuer, rather it extends to verifying compliance with the legal requirements of the prospectus contents and regulatory barriers in obtaining the regulator’s consent to the issue of the prospectus. Legally, an issuer is obligated to furnish only true information in the prospectus. At the same time, the issuer is required to refrain from incorporating false, misleading or deceptive information and non-disclosure of material facts as argued earlier. The lawyers get involved in the process of prospectus preparation at a much later stage than that of the auditors to verify the legal requirements for the prospectus.\textsuperscript{53} Lawyers have the opportunity to remind the issuer of the specific needs or shortcomings of the prospectus. It is therefore argued that the lawyers’ role is not just “blowing the whistle.” Their role is also a matter of helping the issuers commit wrongs.\textsuperscript{54} It can be further argued that had the lawyers warned the issuer of the flaws in the prospectus, the issuer could not have issued the prospectus to the public and the investors would not have lost their money as a result of their investment in a “bad” IPO. Due to the “historic lack of enforcement” of the prospectus provisions, issuers may find it rewarding to raise capital from the market by over looking their liability.\textsuperscript{55} This is especially true if the lawyers agree with the issuer to go public with the defective prospectus. Lawyers have the authority to control their issuers by not certifying a defective prospectus as a “clean” one, and a person who controls the issuer is also liable for the contravention of legal requirements by the issuer.\textsuperscript{56} Lawyers exercise discretion in deciding on the contents of disclosure in a prospectus.\textsuperscript{57} At times, a law firm can be regarded as a primary

\textsuperscript{52} See In re ZZZZ Best Sec. Litig., 864 F. Supp. at 970.
\textsuperscript{53} Beatty & Welch, supra note 13, at 549.
\textsuperscript{54} Harrison, supra note 42, at 537.
\textsuperscript{55} Golding, supra note 10, at 404.
\textsuperscript{56} See Lewis D. Lowenfels & Alan R. Bromberg, Controlling Person Liability under Section 20(a) of the Securities Exchange Act and Section 15 of the Securities Act, 53 Bus. Law. 1 (1997). Section 15 of the Securities Act of 1933 (U.S.) is applicable to sections 11-12, which imposes liability on various persons including current and future or prospective directors of the issuers of IPO’s. Hence, the controlling persons’ liability as set forth in section 15 is quite relevant.
\textsuperscript{57} Barondes, supra note 51, at 410.
From this point of view, Melissa Harrison argues that civil liability should be imposed on lawyers too. In view of the above reasons, the imposition of civil liability on lawyers is necessary for the protection of investors in the IPO market in Bangladesh.

**Functions of Issue Managers and Rationale for Their Liability for Prospectuses**

An issue manager has a significant role to play in the process of an IPO. The issue manager prepares the prospectus and is responsible for the accuracy of disclosures therein. The managers are required to provide a “due diligence certificate” which confirms that the prospectus contains true, fair and adequate disclosures. They are also involved in the pricing of the shares offered. As a whole, the issue managers selected by the issuers control IPOs. It is also said that they sometimes have the most control over the issue. Further, the issue manager “has de facto control over the actions” of the other participants in an IPO, for example, underwriters. Despite this obligation of certification of the adequacy and fairness of disclosures in a prospectus, the above-mentioned prospectus liability laws of Bangladesh do not clearly impose any liability on the issue manager. Managers should be liable on several counts, i.e. for getting involved in the preparation of prospectuses, providing confirmation of the fairness and adequacy of the disclosures, controlling their issuers, as well as other participants in an IPO coalition.

In *Stokes v. Lokken*, the court held that a person is liable for a defective prospectus if his or her participation is considered to be a significant and substantial factor in the offering of securities. Courts have found defendants liable for aiding and abetting the violation of disclosure requirements when

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58. See generally Breard v. Sarnoff & Weaver, Ltd., 941 F.2d 142 (2d Cir. 1991); Molecular Tech. Corp. v. Valentine, 925 F.2d 910, 913-14, 917-19 (6th Cir. 1991).
60. The “due diligence certificate” is required under regulation 14 of the Securities and Exchange Commission (Merchant Bankers and Portfolio Managers) Regulations of 1996. For an example of such certificate, see the Prospectus issued by the Fu-Wang Foods Limited in April 2000 at 2.
64. 644 F.2d 779, 785 (8th Cir. 1981).
they knowingly and substantially assisted the violation. Investors may reasonably rely on the reputation of the issue managers in making their investment decision. Thus, the issue managers are held liable for the defective prospectus.

It is therefore clear that issue managers play a very crucial role in an IPO for which civil liability has been imposed in some jurisdictions. However, in Bangladesh there have been no clear provisions regarding the liability of issue managers and therefore their liability for a defective prospectus is quite unclear and uncertain despite their role in the preparation of the prospectus. This ambiguity contributes to the exacerbation of the lack of investor protection, which is contrary to the prime objective of the DBR.

DEFENCES AGAINST CIVIL LIABILITY FOR THE UNTRUE STATEMENTS IN PROSPECTUSES

Section 145(2) of the CA'94 embedded some defences which are available to persons liable for the disclosure of untrue statements in the prospectus under Section 145(1). These defences can be divided into three separate categories: withdrawal defence, due diligence defence and expertisation defence.

WITHDRAWAL DEFENCE

In accordance with Section 145(2) of the CA'94, the withdrawal defence has two prongs. One is applicable before the publication of the prospectus and the other is applicable after its publication but before the allotment of shares thereunder.

At the first stage, a prospective director is entitled to prove that he or she withdrew his or her consent to be a director before the issue of the prospectus and the prospectus was issued without his or her consent.

At the second stage, the defendants may prove that the prospectus in question was issued without their knowledge or consent, and immediately on becoming aware of the issue, they withdrew their consent and gave public notice to that effect. If their consent was not withdrawn immediately after the issue of the prospectus, the defendants may also prove that they withdrew

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their consent after the issue of the prospectus but before the allotment of shares thereunder. To rely on this defence, the defendants are required to give a public notice of withdrawal of their consent with reasons given thereof.

It is therefore clear that the withdrawal defence before the issue of the prospectus is applicable only to the prospective directors. After the issue of the prospectus, this defence is applicable to all defendants. The defendants may claim this defence only when the allotment of shares under the prospectus in question has not been made, and once the allotment is made no such defence can be claimed.

The most important concern of the public about the withdrawal of consent by a defendant seems to be the public notice to make the potential investors aware of such a withdrawal. Without a public notice, the withdrawal of consent by the prospective director may not have any implications for potential investors. In the present provisions of the Bangladesh legislation, there is room for misleading the potential investors about the identity of directors. For example, Section 145(2)(a) entitles a prospective director to withdraw his or her consent given to the prospectus before its issuance. But the prospective director is not required to make the withdrawal public, although he or she can rely on this defence of withdrawal in a legal suit regarding the truth of the disclosures in the prospectus. There may be many investors who subscribed for an IPO mainly because of the directorship of such persons who have already withdrawn their consent to be directors before the issuance, but after the preparation of the prospectus. The prospectus may have been published with his or her name and no public notice given during the subscription period.

It can be argued that the notification of the withdrawal of consent of a proposed director may imply some serious problems with the IPO. The investing public may be sceptical about the particular public offer because of the public notice of the withdrawal of consent by the prospective directors. This is because the investors may have had a general idea that the withdrawal of consent by the prospective director might have followed the finding of "weak fundamentals" of the shares to be issued. This argument could be countered by saying that there might be some fatal problems with the truth of disclosures affecting the merits of the public offer, which could make the offer unworthy of investment. To save potential investors from being deceived by the defective prospectus, and for the sake of enabling investors to make

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informed investment decisions, the withdrawal of the consent of prospective directors with the reasons thereof should be made public. The investing public must not be concerned about the offer if a proposed director withdraws his or her consent, given to the prospectus to be a director, on personal grounds not related to the merit of the offer. If the reasons for such a withdrawal are considered to be "degrading" quality of disclosures, they must be published for the sake of investor protection as well as the integrity of the market itself. A defective prospectus usually exploits the general investors and diminishes investor confidence for which such disclosure is prejudicial to the healthy running of the market. The non-disclosure of the withdrawal of such a consent in the IPO market in Bangladesh is itself an omission to state facts and appears to be more harmful for a market which has been suffering from a severe lack of investor confidence for several years.

Further, it is not clear as to why the withdrawal of consent of prospective directors should not be made public in a regime where the withdrawal of the consent of other potential liable persons given to the prospectus is required to be disclosed with reasons thereof. The purpose of such notification is for the protection of investors and the integrity of the market. From the investors point of view, it is thus submitted that the requirement for a reasonable public notice should be equally applicable to the incumbent as well as proposed directors in respect of the withdrawal of their consent given to the prospectus. It is to be noted that the regulation should be directed to protect the interests of the investors and the market, not to mislead them. The lack of a requirement for issuing public notice of the withdrawal of consent of a prospective director favours the issuer who exploits the ignorance and innocence of investors. This favoritism is strictly contrary to investor protection, which is the main objective of the disclosure philosophy.

**Due Diligence Defence**

In a legal sense, the expression "due diligence" means "close examination ... of a transaction and its related documentation." In *Universal Telecasters*

68. Companies Act of 1994 § 145 (2)(b)-(c) (Bangl.).

69. In the U.S., the prospective director who has withdrawn his or her consent to the prospectus before its issuance to the public is required to advise the Securities and Exchange Commission on such a withdrawal. In such a situation, the U.S. securities regulator may give public notice with regard to the said withdrawal immediately after being advised by the prospective director concerned. Securities Act of 1933 § 11(b)(1) (U.S.).

70. BUTTERWORTHS AUSTRALIAN LEGAL DICTIONARY 393 (P.E. Nygh & P. Butt eds., 1997).
(Qld) Ltd. v. Guthrie, it was held that “due diligence” refers to a minimum standard of behaviour which is used to defend oneself against the violation of regulatory or supervisory provisions so as to ensure that the particular system was properly carried out.\(^7\) In Martin v. Hull, the court observed that the ignorance of a defendant is no defence under the prospectus liability and that some degree of competence in the performance of due diligence is expected.\(^7\)

Under this defence in Bangladesh, defendants can escape their prospectus liability for both an untrue statement and omission in the prospectus. According to Section 145(2)(d)(i) of the CA’94, which deals with the due diligence defence, the claim of exercising due diligence by the defendants can be premised on the personal belief of the defendants about the truth of the untrue statement incorporated in the prospectus. The defendants may prove that, although the statement in question was not based on any expert opinion or any official document, they had reasonable ground to believe, until the allotment of shares thereunder, that the impugned statement was true.\(^7\)

In keeping with judicial observation, mere personal belief may not be sufficient to establish the due diligence defence. In this respect, the court in SPCC v. Kelly held that general precautions are unlikely to be sufficient to establish this defence; rather the defendants must show that their minds concentrated on the potential risks associated with the transaction.\(^7\) The persons who seek to use the due diligence defence “must always conduct the due diligence investigation in person.”\(^7\)

Although the corresponding laws of India and Malaysia do not require investigation by the defendants to establish the due diligence defence, there are some countries which have clearly established the requirement of reasonable inquiries about the statements included in the prospectus.\(^7\) It is broadly recognised that financial transactions in developed countries are much more transparent than those of Bangladesh.\(^7\) Despite this fact, reasonable

\(^{71}\) 18 A.L.R. 531; 32 F.L.R. 360.
\(^{72}\) 92 F.2d 208, 210 (D.C. Cir. 1937).
\(^{73}\) Companies Act of 1994 § 145(2)(d)(i) (Bangl.).
\(^{74}\) (1991) 5 A.C.S.R. 607 at 608-09.
\(^{76}\) Countries are, for example, the U.S., the U.K. and Australia. Details are provided in the next subsection.
\(^{77}\) In terms of transparency in the activities of, amongst others, business people the scores/points of the United Kingdom, Australia, United States, and Bangladesh were 8.7, 8.6, 7.7 and 1.2 out of 10 respectively. Transparency International, Corruption Perception Index 2002, http://www.transparency.org/policy_and_research/surveys_indices/cpi/2002 (last viewed 22 Feb. 2006). Those points in 2004 are 8.6, 8.8, 7.5 and 1.5 respectively. Transparency International, Corruption Perception Index 2004, http://www
inquiries by the defendants are required for this defence under the laws of those countries, even if they rely on experts, public documents or opinions of respective public officers. Details of requirements for reasonable inquiries are explored below in analysing the expertisation defence in which the exercise of due diligence is relevant.

**EXPERTISATION DEFENCE**

Under Section 145(2)(d)(ii)-(iii) of the CA’94 in Bangladesh, the defendants of a suit for a prospectus containing an untrue statement may prove that the statement fairly represented the exact statement provided by the competent experts or respective officials, or was based on public documents. These experts are required to show that they had reasonable grounds to believe, and did believe until the allotment of shares under the impugned prospectus, that the providers of those statements were competent persons, and that they did not withdraw their consent given to the prospectus until the allotment of shares.  

Just like the flaws which are embedded in the due diligence defence discussed earlier, the weakness of the expertisation defence is the lack of reasonable inquiries by the defendants about the competency of the experts, the truth of their reports and the consistency between such reports and pertinent information in the prospectus. Although such inquiries are not legally required in India and Malaysia, there are laws which obligate persons involved in the preparation of a prospectus to carry out a reasonable investigation if they were to rely on the due diligence defence. The requirement of inquiries by the defendants limits their scope to escape their liability for the defective prospectus. The narrower scope of defences leaves little room for the defendants to avoid liabilities, which in turn facilitates to widen the scope of remedies for the plaintiffs. But the laws of Bangladesh suffer from a clear lack of investor protection in that they provide the defendants with the due diligence defence based on personal belief, without any corresponding requirements for reasonable inquiries to justify their belief in the untrue statement incorporated in the prospectus. Judicial approaches

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78. Companies Act of 1994 § 145(2)(d)(ii)-(iii) (Bangl.).

79. In this respect, § 11(b)(3)(A)-(B) of the Securities Act of 1933 (U.S.) requires the defendants to conduct reasonable investigation if they were to rely on the due diligence defence. In Australia, § 731 of the Corporations Act of 2001 emphasises the requirement of reasonable personal inquiry for the due diligence defence in respect of prospectus liability.
about reasonable investigations further narrowed down the scope of expertisation and the due diligence defence as discussed below.

**Position of Executive and Non-Executive Directors in Respect of the Due Diligence Defence**

A company usually appoints executive or non-executive directors. According to the articulation of Section 145 of the CA’94, there is no distinction between the executive and non-executive directors in respect of defences against prospectus liability. However the courts of various common law jurisdictions have clearly drawn a demarcation by saying that the executive directors are not allowed to rely on the defence of expert reports. For example, in *J. P. Coats v. Crossland*, the court rejected the due diligence defence and held that the blind acceptance of assurances regarding disclosures in a prospectus given by a “self-interested party” will not be acceptable. In *Stevens v. Hoare* the court accepted this defence when a non-executive director had given evidence that the grounds of his belief in the truth of the statements made in the prospectus were the result of reasonable inquiries carried out by the director of the legal advisers to the issuer and management of the issuer. The court contended that such an investigation is justified in the given circumstances.

In *Adams v. Thrift*, a leading English case, non-executive directors failed to establish the due diligence defence under the Directors Liability Act of 1890 (U.K.). In this case, the prospectus contained a number of misstatements concerning the business of the issuer. The judge was not satisfied with the

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80. An expert is considered to be one of the self-interested parties.
81. (1904) 20 T.L.R. 800, 806 (U.K.).
82. In this case it was said that:

Had he reasonable ground for believing the statements in question to be true? It cannot be, and has not been, said that he had no ground for so believing. But the case has been argued on the part of the plaintiff as if the statute had required of a director not merely reasonable, but sufficient, grounds for his belief. Indeed, it was rather suggested that a director is not entitled to rely upon the assistance or advice of solicitors or clerks, but that with his own hands and eyes he must search out and read every relevant document, and with his own mind judge of its operation and legal effect, and that he is not entitled to state anything in a prospectus that could not depose to of his own knowledge in a Court of justice. If so he would be bound to do a great deal more than the most industrious and prudent man [or woman] of business could not think of doing, or in most cases would be able to do, in the conduct of his own affairs. … And upon consideration of his evidence and all the circumstances of the case it would in my opinion be wrong, and I cannot bring myself, to conclude that he had not reasonable ground for such belief. I am of opinion that the defendant had reasonable ground for believing the statements of the prospectus to be true.

(1904) 20 T.L.R. 407 at 409 (U.K.).
requirement that the director believed that the statements furnished in the prospectus were true.\textsuperscript{81} The Adams case is authority for the proposition that the blind reliance on a report or valuation by experts for prospectus statements is not a reasonable ground to establish the due diligence defence. According to this case, directors must take positive steps to know the truth of the statements embodied in a prospectus before authorising them.\textsuperscript{84} This case thus provides a clear direction for the company directors that the mere claim of the due diligence defence is not sufficient to avoid liability as stated in the statutes. Rather, the defendants need to be proactive to be familiar with the disclosures made in the prospectus, including the expertised portion.

Further, executive directors are generally expected to know much more than the non-executive directors about the affairs of the company. The burden on the executive directors is much more onerous than that on the non-executive directors in establishing the due diligence defence as is evident in Escott \textit{v. BarChris Construction Corp.} (BarChris case), a leading American authority.\textsuperscript{85} The Court also held that the two portions of the prospectus, expertised and non-expertised,\textsuperscript{86} cannot be treated alike for the purpose of the due diligence defence.\textsuperscript{87} The BarChris case imposed a stringent requirement of knowledge upon the executive directors, which led to the conclusion that liability will lie in all cases of misstatements.\textsuperscript{88}

It would be more difficult to prove the due diligence defence for non-expertised portions. The analysis of BarChris was strongly affirmed in \textit{Feit v. Leasco Data Processing Equipment Corp.}\textsuperscript{89} In Deloitte Haskins and Sells \textit{v. National Mutual Life Nominees}, the Court of Appeal of New Zealand rejected an argument that the non-executive directors should be subject to a lower standard of care than that of the executive directors.\textsuperscript{90} In another U.S. case, the court observed that the duty of a director to exercise due care, skill and diligence in overseeing the affairs of a company cannot be met entirely by relying on other persons and he or she needs to be familiar with the business and financial condition of the entity.\textsuperscript{91} However, the approach of the court

\begin{itemize}
  \item \textsuperscript{81} (1915) 1 Ch. 557, 565-71 (U.K.).
  \item \textsuperscript{84} \textit{id.}
  \item \textsuperscript{85} 283 F. Supp. 643 (S.D.N.Y. 1968).
  \item \textsuperscript{86} For example, the financial statements that had been audited and certified by the accountants are expertised part.
  \item \textsuperscript{87} 283 F. Supp. at 683.
  \item \textsuperscript{88} See \textit{id.} at 684-92.
  \item \textsuperscript{89} 332 F. Supp. 544 (E.D.N.Y. 1971).
  \item \textsuperscript{91} Federal Deposit Insurance Corporation \textit{v. Stanley}, 770 F. Supp. 1281, 1310 (N.D. Ind. 1991).
\end{itemize}
demonstrated in the *BarChris* case has been criticised by Ernest Folk. He argued that a “director should be protected” if he or she depends on the specific opinion of an independent legal counsel, for example, that “the contested fact [is] immaterial or not false or [that] its omission [is] not misleading in the context.” However, Folk pointed out that a director would not be relieved from misstatement liability for relying on a vague opinion like “you need not worry about it.”

There are also some arguments from academics that the dependence on the specific advice of a competent lawyer will be allowed as a due diligence defence even if the lawyer is wrong in providing an opinion on the contested statement.

*In Daniels v. Anderson*, the court in Australia expressed the view that directors are under a duty to take necessary steps to know the affairs of the company concerned and they owe the company a duty to exercise reasonable care in discharging their official duties. The duty of care and reasonable inquiry are closely related. The standard of care to be taken by a director has been described in *Adams v. Thrift* as to the effect that the director satisfies a requirement of appropriate inquiry based on the standard of a reasonable person. This proposition was emphasised by the High Court of New Zealand in *R. v. Rada Corp. Ltd.* The court treated the executive and non-executive directors differently in respect of their reliance on the due diligence defence. In this case, the position of executive directors had not been made clear, but the court held that the non-executive directors would likely be able to establish the defence.

The preceding analysis suggests that, although the due diligence defence has been in place in many countries, its scope of application is not wide enough to escape the liability unduly. From the practical point of view, in this age of accountability and transparency, a director should not be absolved from misstatement liability on the grounds of the due diligence defence without exercising reasonable care. The application of this defence is subject to the

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93. Id. at 78.
94. Id.
97. (1915) 1 Ch. 557, 565 (U.K.).
99. Id. at 66,647-48.
exercise of reasonable care to verify the truth of the statements which are to be incorporated into a prospectus. The blind belief in the advice of other people will not be sufficient to establish this defence. Executive directors, i.e., the insiders of the issuer, have greater responsibility to carry out inquiries about the truth of the prospectus statements than do outsiders.

However, in Bangladesh, as alluded to earlier, Section 145 of the CA'94 does not require reasonable investigation by the defendants to establish the due diligence defence. In effect, the absence of this requirement has widened the scope of the defendants to escape the prospectus liabilities at the expense of investor protection in the IPO market. As regards the withdrawal defence, the lack of requirements for issuing public notice of the withdrawal of consent given by a prospective director to the prospectus has been shown to be prejudicial to the interests of investors. Therefore, the due diligence defence without reasonable care and the withdrawal of consent without public notice will implicitly support the impropriety of the persons involved in the preparation of a prospectus, which is prejudicial to the interests of the investors. These legal lacunae are contrary to the concept of protecting the interests of investors in the Bangladesh IPO market.

**Requirements of Reliance by Investors upon Prospectuses and the Elements of Causation for Compensation**

In Bangladesh, under Section 145(1) of the CA'94, investors are entitled to recover their loss or damages, sustained by subscribing to an IPO, from persons who are liable. The right of investors to get compensation is subject to two requirements. First, the investors have to prove that their investment decisions were made in reliance on the prospectus and second, that the loss or damage claimed was the result of the untrue statements incorporated into the prospectus. Subscribers will have no remedy if they rely on anything other than the prospectus, such as, the reputation of the promoters, directors and underwriters.

The above conditions are regarded as obstacles to the enforcement of the investors’ rights to recover damages. This is so because, in practice, investors, especially in a lesser developed country like Bangladesh, usually make their investment decisions having more reliance on the name and fame of the persons involved in the issue, rather than on the quality of disclosures made in the prospectus. Nevertheless, under the current liability provisions, the investors are not entitled to seek compensation for their loss or damages caused by the untrue statement, unless the reliance and causation elements are proved.
Considering the importance of compensation to the investors and the difficulty of proving their reliance on the prospectus, in some developed countries the investors are not required to prove such reliance. In this respect, it can be taken for granted that the investors in developed countries are better educated and trained and they generally invest in IPOs upon the advice of their investment advisers. Despite this fact, their laws do not require the investors to prove their reliance on the prospectus. For example, in Canada, Section 130(1) of the Securities Act of 1990 (Ontario) does not require the element of reliance on the prospectus for the purpose of claiming compensation. Instead, the section provides that a purchaser of securities offered to the public through a prospectus containing a misrepresentation "shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and [an investor] has a right of action for damages." In the U.S., Sections 11 and 12 of the Securities Act of 1933, which deal with prospectus liability, do not provide for this reliance requirement. Actually, Section 11(a) of the Securities Act of 1933 requires the plaintiffs to prove their reliance on the registration statement, "but such reliance may be established without proof of the reading of the registration statement by any person." Therefore, this requirement is less restrictive than that of Bangladesh.

In the U.S., Section 12 of the Securities Act of 1933, which directly deals with the prospectus, has imposed the onus of proof of investors' non-reliance on the disclosures upon the defendants. In accordance with this section, defendants have to prove that the compensation claimed by the plaintiffs is not the result of the "defect" of the prospectus. Thus, the plaintiffs need not prove their reliance on the impugned prospectus for the recovery of their loss or damage resulting from their investments in a "bad" IPO in the US.

In Australia, Section 729(1) of the Corporations Act of 2001 imposes liability on certain persons to pay compensation to the investors. Such a person is liable "even if the person did not commit, and was not involved in, the contravention" of disclosure requirements as set forth in Section 728. These persons, as mentioned earlier, "are almost absolutely liable" and the investors are not required to prove their reliance on the prospectus for claiming compensation.

The older cases show that the plaintiffs were required to prove their reliance on the prospectus to recover their compensation because the

100. KEN ROBSON, ROBSON'S ANNOTATED CORPORATIONS LAW 895 (5th ed. 2000).
legislation at the time required it. At present, to prevent well-known business persons from using their names in a defective prospectus, the requirement for the reliance on the prospectus by the investors is completely irrelevant, and the purchaser is not required to prove due diligence. Therefore, although the laws of the markets having the majority of sophisticated investors and the availability of professional investment advisers no longer require the investors to prove their reliance on the prospectus to recover the loss or damages arising out of their investments in defective prospectuses, the law of Bangladesh still imposes this burden on investors. This requirement ultimately precludes the investors a priori from their right to claim compensation from their investment in a defective prospectus. Moreover, the dearth of judicial interpretation of prospectus liability in Bangladesh may magnify the general perception that the reliance element is an obstacle for the recovery of loss or damages under Section 145 of the CA’94. In practice, the test of reliance on the prospectus is a subjective test which is very difficult to prove by evidence.

Regarding the causation element, the onus of proof on the plaintiff that the loss or damage is the result of the untrue statement included in the prospectus is considered to be another hindrance to the investors’ right to be compensated for their investment in a “bad” IPO. The imposition of this burden of proof of causation seems to be an extra burden for the investors, particularly in Bangladesh. Such an imposition in some developed markets may be reasonable because sophisticated investors dominate those markets. In addition, professional advisory services are also available in those markets. But this is not the case in Bangladesh where the dominant unsophisticated investors, in practice, rely on the brand name of the issuer and the persons involved in the fundraising process. In such a situation, it can be seen that the present requirements in Bangladesh of proving investors’ good faith on the prospectus or their reliance on the disclosure in subscribing for an IPO, as well as the element of proving causation of the loss or damage claimed by the investors, can be perceived as obstacles to the rights of investors to seek the civil remedy provided under Section 145 of the CA’94.

LIABILITY UNDER THE COMMON LAW OF TORTS

The common law of torts imposes civil liability on all participants in an IPO coalition. These participants include directors, promoters, auditors, lawyers and the issue managers. Therefore, the persons who do not fall within the ambit of the civil liability referred to earlier are liable to the investors under the common law of torts. The liability under the common law is based on the tort of deceit and the tort of negligence.

LIABILITY UNDER THE TORT OF DECEIT

The remedy under the tort of deceit is available against a fraudulent misrepresentation where the person making the statement in question knew that the statement was false, or he or she was reckless as to whether it was true or false.

Although the common law imposes liability on all of the participants in the process of prospectus preparation, the enforcement of the tort of deceit has become extremely difficult after the adoption of a fraudulent standard of behaviour for liability as set forth in Derry v. Peek more than a century ago. In this case, Lord Herschell insisted on proof by the plaintiffs “that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false.” However, the representation need not be made directly to the plaintiff. In this regard, the decision of the House of Lords in Peek v. Gurney also contributed to making it difficult to prove deceit. The House of Lords restricted the scope of the liability arising out of a false statement in a prospectus as it presumes that the intention of the prospectus was not to deceive the investors but to enable the company to find people to acquire its shares. In an earlier case, Polhill v. Walter, it was held that, to get a remedy under the common law of deceit, the plaintiffs will have to prove that the defendants must have lacked an honest
belief in the truth of the statement in question.\textsuperscript{114} Even recklessness in the sense of gross negligence will not be sufficient to recover compensation unless the defendants are consciously unresponsive to the truth.\textsuperscript{115} Hence, seeking a remedy under the tort of deceit is practically difficult for the investors and unenforceable to a great extent.

In the Madhya Pradesh High Court of India case of \textit{S. Chatterjee vs. K. L. Bhave}, it was said that:

In order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly careless whether it be true or false.\textsuperscript{116}

The court also pointed out that the tort of deceit is not completed unless the false report is acted upon and such a report has resulted in loss or damage. This interpretation of the tort of deceit is followed in the Indian subcontinent.\textsuperscript{117} The observation of the Indian High Court is similar to the decision in \textit{Derry v. Peek} in the sense that both cases dealt with the proof of fraud. In \textit{Derry v. Peek}, it was said that "a man who makes a statement without care and regard for its truth or falsity commits fraud."\textsuperscript{118} Seeking a remedy by a plaintiff under the tort of deceit is therefore practically difficult because of the problems involved in proving the elements of fraud.

Further, directors are not liable for a misstatement in the prospectus if they claimed that they honestly believed the statement true at the time it was made. As it was held in \textit{Baron Uno Carl v. Rolf de Mare}, it would be sufficient if a director honestly believed the statement to be true in the sense in which he or she understood it.\textsuperscript{119} Similarly, in this regard, the High Court of Australia held that, "[i]n order to succeed in fraud, a representee must prove, inter alia, that the representor had no honest belief in the truth of the representation in the sense in which the representor intended it to be understood."\textsuperscript{120} Thus it depends on a subjective test. In such a situation, it should be very difficult for the plaintiffs to disprove the director's claim of his or her honest belief in the truth of a statement which is actually untrue. In

\begin{itemize}
\item \textsuperscript{114} (1832) 3 B. & A.D. 115, 124 (U.K.); (1832) 110 E.R. 43, 46 (U.K.).
\item \textsuperscript{115} Lamb v. Johnson, (1914) 15 S.R. (N.S.W.) 65 at 74-75.
\item \textsuperscript{116} (1960) A.I.R. (M.P.) 323 (Madhya Pradesh H.C.).
\item \textsuperscript{117} M. Zahir, \textit{Company and Securities Laws} 131 (2000).
\item \textsuperscript{118} [1889] 14 App. Cas. 337, 350 (H.L.) (U.K.).
\item \textsuperscript{119} [1959] 3 W.L.R 108, 114 (Eng).
\item \textsuperscript{120} Krakowski v. Eurolynx Properties Ltd., (1995) 183 C.L.R. 563, 578 (Austl.).
\end{itemize}
addition, as expounded in the above-mentioned *S. Chatterjee v. K. L. Bhave*, it is to be proved that the plaintiff acted upon the false statements and the loss or damage incurred by the plaintiff is the result of such statements. These requirements make the plaintiffs' claims under the tort of deceit difficult to prove before the court. Commenting on this issue, Louis Loss and Joel Seligman said that it is very difficult for plaintiffs to get a remedy on the basis of fraud or deceit.121 As a result, the remedy available under the common law tort of deceit is not a useful remedy to investors in Bangladesh.

**LIABILITY UNDER THE TORT OF NEGLIGENCE**

The essence of this liability is the duty of care. In *Mutual Life & Citizens Assurance Co. Ltd. v. Evatt*, the Privy Council held that the duty of care is only imposed on a person who carries on a business, or profession, which involves providing a kind of advice calling for a special skill and competence.122 In this regard, the High Court of Australia in *Shaddock & Associates Pty. Ltd. v. Parramatta City Council* held that a duty of care arises "whenever a person gives information or advice to another upon a serious matter in circumstances where the speaker realizes, or ought to realize, that he [or she] is being trusted to give the best of his [or her] information or advice..."123 Liability for negligence arises even though the misstatement is made honestly and regardless of the existence of a fiduciary or contractual relationship between the parties of a suit concerning prospectus misstatements.124 In accordance with these observations, every person who has an involvement in the preparation of a prospectus is under a duty of care to provide accurate information in the prospectus.

The liability for the tort of negligence in respect of prospectus misstatements is not of much importance in many countries. This is so because the statutory liability in this regard imposes a negligence standard of conduct on every person involved in the public offering of securities.125 The persons who are negligent in preparing a prospectus will be held liable under statutory provision because of their failure to establish the due diligence

125. As discussed earlier, statutory civil liability of persons involved in the preparation of a prospectus is subject to some defences such as due diligence. See also Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1975).
defence. Conversely, if they successfully establish the due diligence defence in a suit filed under statutory laws, they can easily win the suit under the common law of negligence depending on the same evidence used in the proceeding under the statutory law. Thus, the negligence element under the common law is now of less significance because of its incorporation into the statutes. The common law of negligence therefore does not provide the investors with any extra means of remedy in reality for their loss or damage sustained from their investments in a defective prospectus. However, the discussion on the tort of negligence suggests that all persons involved in the preparation of a defective prospectus should be held liable to compensate the investors who have suffered loss or damage by investing in such a prospectus.

It can be seen from the above discussion that the common law remedies for untrue statements included in the prospectus are not much help for investors in Bangladesh. The common law remedies are available regardless of the regulatory philosophy (the MBR or DBR). These remedies do not warrant to be specially mentioned in looking for the protection for investors in the disclosure regime.

COUNTER-ARGUMENTS AGAINST THE EXTENSION OF THE CIVIL LIABILITY TO ALL PERSONS INVOLVED IN THE PREPARATION OF PROSPECTUSES

It may be argued that the imposition of potential civil liability on the auditors, underwriters, issue managers and lawyers will “chill” their participation, resulting in the reduction in the number of new IPOs. This may be partly true, because such a negative effect has been suggested, especially in high risk and high technology industries. General investors are usually unable to assess the risks associated with the IPOs. Moreover, the complex and scientific nature of such an industry at times makes the prospectus more difficult to allow an informed assessment. This is evident in Klein v. Computer Devices Inc. in which the plaintiffs complained that the prospectus failed to disclose the technical reasons for which the primary product of the issuer was substantially unmarketable. If it is difficult for market professionals of a developed jurisdiction like the market in the U.S. to discover the errors and complexities, it would certainly be impossible for the

127. 591 F. Supp. 270 (S.D.N.Y. 1984). The primary products in this case were portable computers which used 3.5 inch disk drives rather than 5.25 inch disk drives.
average investors in Bangladesh to discover these. If an IPO is really risky and the nature of risk is difficult to understand generally, the investors should be better off without such a public offer.

The impact of the lack of investors’ ability to make informed decisions in the true sense in a disclosure regime is evident in the reality of the share market in Bangladesh. It is a fact that many companies, having poor economic fundamentals, have been taking advantage of innocent investors in Bangladesh in collaboration with the professionals and intermediaries of issuers’ choice. Further, recent surveys showed that companies listed after the introduction of the DBR have raised huge amounts of money from general investors by making “palatable” disclosures in their prospectuses and that funds have been reportedly misappropriated (by the management of the companies).

From the practical point of view, it can be said that only the securities with high risks are likely to be reduced as a consequence of the imposition of liabilities on the professionals and intermediaries involved in the preparation of a prospectus. Such a decline in IPOs will not be detrimental to the market in the long run and the impediment to the issue of shares associated with high risks is desirable from the viewpoint of investor protection, especially in a country like Bangladesh. The reason is that once the confidence of investors is impaired by the “bad offers,” the “good offers” will fail to attract investors in some cases. Thus the bad offers eventually reduce the IPOs and cannot contribute to the development of the share market. In respect of corporate fundraising, John Coffee observes that statutory “liabilities . . . give this


130. In the case of 1998, a total of 20 companies obtained consent from the SEC to float, but only five companies went public and the remaining 15 companies could not float because of the lack of investor confidence in the market. The Managing Director of one of the 15 companies said that “[w]e did not take risk to float shares in the depressed market where investors continuously rejected the IPOs.” Two of the five companies which floated were rejected by the investors and another one narrowly escaped undersubscription. See for details, M.S. Rahman, Many Companies Unwilling to Float IPOs Fearing Undersubscription, DAILY STAR (Dhaka, Bangl.), 12 Apr. 1998. Further, at the end of 1999, eight insurance companies suspended their plan to go public because of lack of investor confidence in the country’s primary share market. See M.S. Rahman, Eight Insurance Companies Shelve Their Plans to Go Public, DAILY STAR (Dhaka, Bangl.), 12 Dec. 1999.
person a strong incentive to monitor for law violation by others and little incentive to cheat itself."

An appropriate legal regime and its effective enforcement help establish the rule of law which can contribute largely to increasing IPOs.\textsuperscript{132} Coffee observes that "[l]iability must be addressed legislatively."\textsuperscript{133} Hence, statutory liability has been argued to be more useful to accord better protection to the investors in IPO markets than liability based on the common law of torts. This is more important in Bangladesh because the culture of litigation under the common law of torts is yet to be developed. At the same time, the passivity of investors in relation to suing under the statutory law for the recovery of their loss or damages resulting from the defective prospectus is clearly evident from the paucity of reported cases. In such circumstances, the expectation for the enforcement of liability under the common law of torts for prospectuses seems to be unrealistic.

**SUMMARY AND CONCLUSIONS**

The DBR has emerged to meet the needs of developed markets and Bangladesh has adopted this disclosure philosophy following the path of developed markets without any commensurate amendments to the laws pertinent to the prospectus. The foregoing discussion demonstrates that the civil liability regime for the defective prospectus in Bangladesh is ambiguous, unclear and narrow as compared to that of other selected countries. This weakness has been measured in terms of the extent of the scope of civil liabilities and defences available to escape from these liabilities. The analysis shows that the civil liability of auditors, underwriters, lawyers and issue managers for the prospectus is unclear in the current statutory liability provisions in Bangladesh. Even their position in respect of prospectus liabilities has never been clarified by the courts due to the dearth of cases. The existing uncertainty regarding their statutory civil liability is considered to be unfavourable to investor protection in the IPO market. Any ambiguity would help create confusion about the scope and applicability of the law concerned. In recognition of the importance of the role of those professionals and intermediaries involved in the IPO markets, civil liability has been imposed on them in some jurisdictions as discussed earlier.

\begin{itemize}
  \item\textsuperscript{132} La Porta et al., *supra* note 1, at 1143.
  \item\textsuperscript{133} Coffee Jr., *supra* note 131, at 1187.
\end{itemize}
Although liability has been specifically imposed on the directors and promoters of the issuing companies in Bangladesh, the statutory defences have further weakened their liability to compensate investors.

It is widely conceded that the above professional and intermediary services are fairer in the developed countries as compared to those of many developing and least developed countries. The situation in Bangladesh is worst in respect of transparency, as is evident from some recent studies. The Berlin based Transparency International has placed Bangladesh at the top of the Corruption Perception Index as the most corrupt country in the world in the last four consecutive years. In line with the Transparency International report, another recent survey conducted by the Centre for Policy Dialogue (CPD), a leading research institution in Bangladesh, reveals a similar finding implying that one of the major impediments to investment in Bangladesh is corruption. Further, in June 2002, a joint report of the World Bank and the United Nations Development Program on “Bangladesh Financial Accountability for Good Governance” showed that the country’s accounts and auditing processes still lack transparency and accountability. The report also mentioned that financial management is still not up to international standards. Another alarming piece of information recently published is that the various banks and credit unions have disbursed a huge amount of money as loans against the deposition of fake shares of different listed companies. The amount involved was about one billion Taka (approximately U.S. $17.5 million) in the period between 1996 and 2000, while the total market capitalisation of the Dhaka Stock Exchange was 54 billion Taka as of 30 June 2000. There are widespread allegations that company officials, amongst others, are also involved in procuring fake shares. Even the business leaders themselves have testified that corruption has been eating away the economic growth of the country.

135. The other major impediment is violence/terrorism. See Report on CPD Survey, DAILY JUGANTOR (Dhaka, Bangl.), 28 Aug. 2002. The Centre for Policy Dialogue (CPD) carried out the survey upon the recommendation of the World Economic Forum (WEF) as a test of eligibility to take part in the 2003 Competition of World Economic Forum. The survey report of the CPD was released just a day ahead of the report of Transparency International.
139. Business Leaders Say: Violence, Corruption Eat Up Economic Growth, NEW NATION (Dhaka,
It goes without saying that the current chronic lack of investor confidence in the securities market in Bangladesh is the result of the various malfeasance practised by companies in collaboration with their intermediaries and professionals. Despite this reality, the statutory civil liability of the professionals and intermediaries involved in the corporate fundraising process is unclear and uncertain. Although civil liability may be imposed on them under the common law of torts, the implications for liability under the common law have been shown to be insignificant for investor protection. Hence, statutory liability is considered to be of paramount importance for the protection of investors. The uncertainty surrounding the liability of the professionals and intermediaries working with the IPO coalition displays legal lacunae with regard to the liability for the prospectus. The obligation created by law for securities regulation must be clear and "easily understandable."\footnote{140}

The shortcomings of the CA'94 in imposing liability on the members of the IPO coalition, in association with a wide range of defences provided by both the statutes and the common law, have made the whole liability regime difficult to enforce.

In addition, the investors’ onus of proof of their reliance on the prospectus, and the loss or damage being caused by the untrue statement included in the prospectus, are further impediments to the recovery of compensation for their investments in an IPO. The fact that this onus has not been imposed on the investors in some developed jurisdictions has been discussed.

The ambiguity of the law in imposing liability for the contravention of disclosure requirements, provisions for the broad scope of defences and difficulties in proving the onus imposed on investors, have ultimately lessened the usefulness and the scope of the application of prospectus liabilities in

\begin{footnotes}
\item[140] The SEC lodged a First Information Report (FIR) with a police station against three directors, auditors and issue managers of the IPO after necessary investigation. The investigation reveals that "... directors injected forged allotment letters into the stock market and siphoned huge amount of money by deceiving the general investors." See for detail, M.S. Rahman, \textit{Complaints Lodged with Motijheel Thana [police Station]: SEC Finds JH Directors, 3 Firms Involved in Share Forgery}, \textit{Daily Star} (Dhaka, Bangl.), 22 Dec. 1999; \textit{SEC Files FIR against 5 JH directors in Share Forgery}, \textit{Financial Express} (Dhaka, Bangl.), 22 Dec. 1999. Further, the relationship between the companies and their auditors is so unethical that the SEC had to promulgate a new rule to combat professional unfairness and unethical conduct. In accordance with this new rule issued by the SEC on 26 November 2001, companies were barred from appointing the same audit firms consecutively for more than three years. D.N. Saha, \textit{New SEC Law Removes Monopoly of Audit Firms}, \textit{The Independent} (Dhaka, Bangl.), 14 Nov. 2001.

\end{footnotes}
Bangladesh. As a consequence, the civil liability regime has appeared to be inappropriate for the DBR. It is to be taken into account that the "[l]aw's effectiveness depends initially on its drafting, and later on the interpretation given to it by judges and commentators."142 The drawbacks of criminal liabilities will demonstrate further weaknesses of the law relating to the prospectus, but that investigation will be carried out in another endeavour.