INTRODUCTION

OVERVIEW

This book discusses disclosure and due diligence in relation to offerings of debt and equity securities in the international capital markets. It is primarily intended as a practical guide to assist lawyers who are asked to draft a description of a new issuer, starting with a blank piece of paper. It will be an equally useful guide to a lawyer or investment banker who is asked to review and comment on a draft description of a new issuer. In addition, the disclosure discussion in Parts 1 and 2 will be of interest to new issuers and the due diligence and liability discussions in Parts 3 and 4 will be of interest to all issuers, investment banks and other professionals in the context of their potential liability for inadequate disclosure under, and the due diligence defences afforded to them by, English law.

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International offerings of securities are commonly referred to as *Regulation S offerings* and *Rule 144A offerings*. This terminology comes from US securities laws. In particular, the US Securities Act requires offers and sales of securities to be registered with the US Securities and Exchange Commission (known as the SEC).[1] Broadly speaking, Regulation S exempts from this requirement offerings which are conducted outside the US and Rule 144A exempts from this requirement offerings which are targeted only at a limited class of sophisticated US investors.

This book addresses those who work on Regulation S offerings in particular. These are typically offerings of debt securities, as most international offers of equity securities include a Rule 144A placement into the US.

However, I have deliberately not limited the focus of the book this narrowly. This is because it is impossible to describe properly the topic of disclosure and the related topic of due diligence without looking at US practice as applied to Rule 144A offerings. In addition, in many instances it is also helpful to flag distinctions with equity practice. Further, the core principles of disclosure drafting and due diligence apply equally across all types of securities issuance. As a result, much of the drafting guidance contained in this book is equally applicable to persons engaged in both debt and equity securities offerings and both Regulation S and Rule 144A offerings.

This book is divided into four parts as follows:

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[1] See s 5 of the US Securities Act of 1933 (27 May 1933, ch 38, title I, Sec 1, 48 Stat 74).

- In Part 1, I look at the three major sections of disclosure typically included in a securities offering document. These are the description of the issuer's business activities, the description of its financial position and the description of the risks associated with the issuer. I consider where you can find relevant information and what information is typically included in each description. I also provide guidance on how and how not to draft the relevant sections.
- In Part 2, I look at the applicable regulatory requirements in relation to disclosure. This principally comprises a review of the Prospectus Directive[2] and the Prospectus Directive Regulation[3] as they apply to different issuers and different types of securities offering. I also briefly consider the requirements of the three major exchange-regulated markets (the Professional Securities Market in London, the Euro-MTF in Luxembourg and the Global Exchange Market in Ireland). Notwithstanding that Rule 144A offerings tend to follow closely the requirements of the US Securities Act as they apply to domestic offerings, I do not look at those requirements in any detail as I am not a US-qualified securities lawyer and there are plenty of other books that cover these requirements.[4] I also do not consider the requirements of other exchanges, such as the Swiss Exchange and the Singapore Stock Exchange, where international debt securities are from time to time listed, as I believe that this would constitute too much detail for a book of this nature.
- In Part 3, I consider the topic of due diligence. The primary reason for due diligence is to protect the issuer and the investment banks involved in the issue against potential claims made by investors that the disclosure provided to them was misleading. In particular, I look at the limited available regulatory guidance and consider the major types of due diligence: financial; legal; and business due diligence.[5] I also examine some of the major US due diligence cases and the principles which they establish, which may be of persuasive relevance to an English court considering similar issues.
- In Part 4, I discuss the potential liability that arises when publishing an offering document in connection with an issue of securities in the international capital markets. I focus on liability under English law, including (in particular) statutory and contractual liability for issuers and their directors and potential liability in tort for advisers such as investment banks.

This book does not consider the new short-form key information document required to be provided to retail investors before they purchase a packaged

[2] Directive 2003/71/EC as amended by Directive 2008/11/EC, 2010/73/EU and 2010/78/EU.

[3] Commission Regulation (EC) No 809/2004 of 29 April 2004 as amended by Commission Regulation (EC) Nos 787/2006, 211/2007 and 1289/2008 and by Commission Delegated Regulation (EU) Nos 311/2012, 486/2012, 862/2012 and 759/2013.

[4] See, for example, Charles J Johnson, Jr and Joseph McLaughlin, *Corporate Finance and the Securities Laws* (4th edn, looseleaf).

[5] These are not terms of art. I first used these concepts in the mid 1990s when lecturing to potential issuers of GDR issues in a number of emerging market countries.

retail investment product or certain insurance-based products. This requirement will be imposed in 2016 pursuant to a regulation approved by the European Parliament on 15 April 2014.[6] Many of the products to which the regulation applies are outside the scope of this book and most of the detailed requirements are still to be developed and published. For these reasons, it is premature to consider this development in this book, although it may well be discussed in any future edition.

TERMINOLOGY

Terminology in the international capital markets can be confusing. For example:

- When a securities issue is made by an issuer to investors in the issuer's country of incorporation, that is typically considered to be an offering in the domestic market (or a domestic offering). When a securities issue is made to investors in more than one country, that is typically considered to be an international offering or an offering in the international capital markets, even if the majority of the issue is sold in the domestic market.
- A typical feature of an issue of securities in the international capital markets is the publication of an offering document which is issued to investors in all target markets. The offering document may be described in many ways, including as an offering circular, an information memorandum, a prospectus or an offering memorandum. In this book, I have used the generic term 'offering document' except where I am referring to an offering document which complies with the Prospectus Directive. In this case, I refer to the offering document as a prospectus.
- Another typical feature of an issue of securities in the international capital markets is that the offer is usually limited to qualified investors in most markets. This is because most jurisdictions regulate offers of securities to the public in their markets. This regulation usually requires the publication of an offering document that complies with specific content requirements and is approved by a securities regulator before the securities are issued. However, it also usually exempts specific offers, for example offers that are only made to sophisticated investors. Rule 144A is an example of such an exemption. Most offerings of securities in the international capital markets therefore aim to comply with only one set of regulation and to utilise exemptions afforded in other countries. Chapter 2 of this book describes the European regulation of securities offerings in the international capital markets.
- Issues of securities in the international capital markets are usually arranged on behalf of the issuer by a small syndicate of investment banks. These banks may also be described in many ways, including as managers,

[6] At the time of submitting this book for publication, the regulation still needed to be adopted by the Council and published in the Official Journal to become effective.

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underwriters and dealers. In this book, I have used the generic terms 'investment bank arrangers' or 'arrangers' to describe them.

- The securities offered can take many forms, including equity securities (or shares, which may be ordinary shares or preference shares), equity-linked securities (such as debt securities which are convertible or exchangeable into equity securities), unsecured debt securities (often known as bonds or notes, but also commercial paper and certificates of deposit), secured debt securities (such as asset-backed securities or securities issued as part of a securitisation or project financing), derivative securities (for example, securities whose returns depend on the performance of an underlying reference asset such as an index, an interest or exchange rate or a commodity price) and certificates (examples of which include depositary receipts[7] and sukuk[8]). In this book, I use the generic terms 'securities', 'equity securities' and 'debt securities' except where I am referring to a specific type of security.

Offerings of equity securities can involve newly issued shares or the sale of existing shares or both at the same time. An issue of new shares will raise capital for the issuer. A sale of existing shares will raise money for the seller but will not benefit the issuer of the shares. Offerings of debt securities can be guaranteed by one or more guarantors. In some cases, for example high yield debt securities, there may be a very large number of guarantors. I have not generally referred to guarantors in this book (save for Chapter 3 of Part 2), and most references to issuer can be understood as including guarantor, save where the context does not permit.

[7] A depositary receipt is a certificate issued by an entity (A) which records that another security (typically equity) has been deposited with A and in which A promises to pass on to the holder of the depositary receipt some or all of the benefits of ownership of that other security (eg dividends). A depositary receipt may or may not entitle its holder to exchange it for the underlying security.

[8] Sukuk are Islamic trust certificates which are issued by a special purpose company to investors. The issuer then passes on the proceeds raised to the ultimate borrower using an accepted Islamic structure such as a sale and leaseback arrangement.

Part 1

DISCLOSURE

INTRODUCTION

In this Part 1, I discuss the disclosure that is typically included in offering documents relating to securities offerings in the international capital markets. The nature of this disclosure varies significantly from offering to offering based on a range of factors. These include:

- **the securities being offered**: offering documents for equity securities generally contain more detailed disclosure than most offering documents for debt securities. There are three reasons for this:
  - different regulatory requirements;
  - the fact that an equity investor is buying a potentially long-term ownership share in a business whereas a debt investor is taking a generally relatively short-term credit exposure to the issuer of the securities; and
  - the fact that equity offerings normally include a Rule 144A placement;
- **the target market**: offering documents for issues which include a Rule 144A placement generally contain more detailed disclosure than offering documents for securities issued outside the US in reliance on Regulation S. This reflects the fact that there are detailed disclosure requirements for a domestic offering in the US. Although these requirements do not apply to Rule 144A offerings, the current market practice is to prepare disclosure that is substantially consistent with that which is required for a domestic offering in the US. It also reflects the significantly higher litigation risk in the US;
- **the nature of the issuer**: offering documents for first time issuers generally contain more detailed disclosure than for issuers who regularly access the international capital markets, reflecting the fact that first time issuers will not be well known to the proposed investor base. Offering documents for highly rated issuers of debt securities generally contain less disclosure than those for issuers who are rated at or below investment grade or are unrated, reflecting the fact that highly rated issues are perceived to be significantly less risky.[1] Offering documents for issuers from emerging markets generally contain more detailed disclosure than those for issuers from more well-established markets. This reflects the perceived increase in

[1] This perception may not always be accurate. See, for example, the AAA-rated mortgage-backed securities which contributed significantly to the global financial crisis.

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risk for an emerging markets offering which is driven by the fact that there is generally a weaker regulatory environment in emerging markets. As a result, potential investors are more concerned about business practices, disclosure levels and other factors and this is addressed by increased disclosure in the offering document and enhanced due diligence procedures.

This Part 1 is divided into five chapters as follows:

- in Chapter 1, I consider the key steps to take when preparing or reviewing an issuer description. This includes guidance on how to structure a business description and where to obtain source material for the description. I also look at the five major stages of business description preparation and provide suggestions to make that process as smooth and efficient as possible;
- in Chapter 2, I consider the content of a business description by looking at the major headings typically included in a business description and identifying the key factors to be disclosed under each heading.
- in Chapter 3, I look at the Financial Review section. This section is similar to, but different from, both:
  - the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section which typically appears in offering documents which include a Rule 144A placement; and
  - the Operating and Financial Review (OFR) section which is required by the Prospectus Directive to be included in equity prospectuses to which that directive applies.

  Unlike both MD&A and OFR sections, there is no regulatory guidance relating to the information to be included in Financial Review sections. Nevertheless, I look at the guidance that applies to MD&A and OFR sections and make suggestions as to the appropriate content for a Financial Review section;
- in Chapter 4, I consider risk factors and focus in particular on the key points to consider when drafting this section;
- in Chapter 5, I provide guidance on style and discuss some useful principles of plain English that, if applied, will considerably improve the disclosure sections.

CHAPTER 1

THE BUSINESS DESCRIPTION – STRUCTURE AND PREPARATION

INTRODUCTION

1.1 The international capital markets are now well-developed, dating from the first issue of eurobonds in 1963 by the Italian company, Autostrade.[1] Since that time, an enormous number of entities, including sovereigns, supranational organisations, banks and other corporate entities, have accessed the market. Many of these entities are frequent issuers of securities with well-established processes for managing their disclosure.

1.2 However, each year entities that have not (or have not for a considerable period of time) previously issued securities in the international capital markets do so. As part of the issuing process, each of these entities will typically need to prepare (or significantly update) disclosure about its business.

1.3 In this and the next chapter, I identify the information that should be included in a business description prepared for a new issuer or an issuer which has not issued for a significant period and offer guidance on how to prepare or review and comment on the disclosure with a view to minimising disclosure risk.[2]

1.4 The content of a business description can vary significantly depending on the security being offered and the markets in which it is offered. For example:

- offering documents relating to international securities offerings which include a Rule 144A placement are typically more detailed in disclosure terms than those for international Regulation S offerings. This reflects the significantly more developed disclosure standards in the US market based on a greater risk of liability for inadequate disclosure in the US;[3]
- equity offering documents generally provide more detailed disclosure than debt offering documents. This reflects the fact that investors in equity securities are purchasing an ownership share in the underlying business

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1 See Fuller, *The Law and Practice of International Capital Markets* (3rd edn, 2012) at 2.01.

2 Disclosure risk is, essentially, the risk that there is a material error or omission in the offering document, that investors rely on that inadequate disclosure in making their investment decision and that they suffer loss as a result.

3 See **19.3–19.8** for a brief discussion of potential US heads of liability.

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and are therefore primarily concerned about the future growth prospects of the business concerned.[4] It also reflects the fact that, when offered internationally (that is, other than in just a domestic market offering), equity offerings almost universally include a Rule 144A placement;

- offering documents for Regulation S debt offerings generally vary significantly in the amount and quality of their disclosure. The principal factor driving this is the credit rating of the issuer, with higher rated issuers generally being perceived as significantly less risky and therefore generally having significantly less disclosure. By contrast, high yield securities (which are issued by low rated or unrated issuers) and emerging market securities (where issuers again are generally either unrated or relatively low rated) usually merit more detailed disclosure;
- equity-linked offering documents[5] (which combine both debt and equity elements) are typically less detailed in disclosure terms than full equity offering documents for a number of reasons. These include:
  - different listing requirements;[6]
  - the fact that the issuer/exchange company (that is the company in respect of whose shares the investor has an option) is generally a well-known public listed company; and
  - in the case of an exchangeable security, the fact that there may be no ability to obtain the necessary detailed information from the exchange company, as frequently it may be unaware of the issue until after it happens; and
- finally, offering documents for issues of unlisted privately placed securities are not subject to any regulatory control or review and therefore the disclosure in them varies significantly in form and content, depending on the nature of the offering and the potential investors being targeted.

1.5 Typically, in this Part 1, when discussing disclosure norms I am assuming Regulation S debt disclosure for a debut or infrequent issuer, not highly rated and possibly, although not necessarily, from a less developed market, as this is one of the most common situations in the international capital markets where disclosure needs to be prepared. Variations on this base case position (particularly in relation to Rule 144A debt or equity disclosure) are flagged where appropriate and useful.

PREPARING DISCLOSURE

1.6 Preparing disclosure, if done properly, is a time-consuming and labour-intensive process for the author. In the early days of the international

4 This is typically referred to by investment bankers as the 'equity story'.

5 These are offering documents relating to convertible bonds (which are bonds which include an option for the investor to convert them into shares of the issuer of the bonds) and exchangeable bonds (which are bonds which include an option for the investor to exchange them for shares of an entity other than the issuer of the bonds).

6 See **6.18–6.37** for a discussion of the complex requirements applicable to equity-linked securities.

capital markets, disclosure (to the extent that it was included in the offering document at all)[7] was typically prepared by the issuer and the investment banks involved in the offering. Even during the late 1980s, disclosure in respect of some of the early international privatisations[8] was first prepared by the investment bank arranger of the transaction (in conjunction with the issuer) before, at a relatively advanced stage of the transaction, being submitted to the law firms involved for comment.

1.7 A significant change in disclosure practice followed the introduction in 1990 of Rule 144A which made it easier for international issuers to access sophisticated US investors without contravening US securities legislation. The first issue of equity securities under Rule 144A took place in June 1990[9] and the market expanded rapidly thereafter. In consequence, US securities lawyers increasingly became involved in these issues, importing US domestic market disclosure and due diligence practices, one of which was that the issuer's lawyers should draft the disclosure. As a result, the international legal advisers to the issuer increasingly began to assume responsibility for drafting the disclosure (in conjunction with the issuer). Although it took time, this has now become the standard practice for all issues in the international capital markets involving the preparation of new disclosure.

1.8 There is more than one way to set about drafting a business description. For example, some law firms might send the issuer a template description consisting of a list of headings with, perhaps, a brief explanation of the subject matter to be disclosed under each heading and, possibly, a couple of example offering documents from issuers in a comparable industry. They might then invite the issuer to complete the template. This approach usually results in:

- a description that has multiple different authors as many issuers typically ask the officers responsible for different parts of the business to complete the sections relevant to them. As a result, the description can be repetitive and/or contradictory in content and is generally difficult to read owing to the differing styles used;
- a description that is full of marketing hype as the authors typically believe that their job is to sell the issuer rather than to provide a balanced and factual overview of its business; and
- a description that fails to address all the information which is relevant to investors (which is not surprising as, for debut issuers at least, the authors will likely never have prepared a document of this type before).

1.9 If this approach is adopted, the relevant law firm will need to review carefully the draft description received from the issuer to address the

7 According to an article in Financial News 24, 30 June 2013 at p 12, the Autostrade offering document was only five pages long!

8 For example, the Dutch privatisation of NMB Postbank Groep NV in 1989, on which I worked as an associate.

9 An equity offering by the Finnish company, Huhtamaki.

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inconsistencies and contradictions, to ensure that missing information is provided and to adjust the tone to make it balanced and factual. If this is done properly, the process should result in a reasonable first draft description. Experience shows, however, that all too frequently the relevant law firm will simply circulate the document prepared by the issuer with only the most cursory review or attempt at making it internally consistent. This may be the result of inexperience, the fact that the relevant lawyers with the necessary experience are too busy to undertake what is a time-consuming exercise within the deadline they have been set and/or the fact that the relevant law firm has agreed to a fee cap and is therefore unwilling to invest significant effort in preparing a quality first draft. Whatever the reason, the circulation of a poorly reviewed description significantly increases the workload of the investment bank arrangers and their advisers as they seek to improve the disclosure. The improving process also frequently irritates the issuer, whose officers may have spent significant time preparing the disclosure based on the template supplied to them and do not understand why it is being rewritten. In turn, this can result in pressure to reduce comments which is not in anyone's interest.[10]

1.10 In my view, based on more than 25 years' experience, a better way to prepare disclosure involves a multi-stage process as follows:

(1) obtain relevant information on the issuer and its business;
(2) prepare a skeleton and seek to populate it as far as possible;
(3) submit the draft description to the issuer for comment; and
(4) revise the draft in line with the issuer's comments and then circulate it to all other parties (including any relevant listing authority if the issue is to be listed) for comment.

1.11 Whichever approach is adopted, the final stage is to refine the document based on comments received, the outcome of appropriate due diligence investigations (including the due diligence meeting with the issuer, any drafting sessions held and comments from the auditors as a result of their comfort letter process) and other factors.

I discuss each of these stages in more detail below.

Stage 1 – obtaining relevant information

1.12 The first step in preparing disclosure (and when reviewing disclosure) is to obtain, read and digest high quality relevant factual information relating to the issuer and its business. There are a number of sources from which this material can be obtained. These include the following:

[10] Especially the issuer (which has statutory responsibility for the disclosure) and the investment bank arrangers (which may also be liable to investors if the disclosure is inadequate). See Part 4.

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- **The issuer's website.** Almost all new issuers will have a website, although the quality and scope of the information on the website will vary greatly between issuers. However, it is often the case that a wealth of information can be found on a well-prepared website. Having said that, it is equally often the case that information on an issuer's website may not always be accurate or complete, particularly where it has not been updated recently. As a result, the accuracy and completeness of any information derived from this source should always be specifically confirmed with the issuer.
- **Other websites.** Other websites may also be useful sources of information. For example, industry-related websites which contain background information or source material for a discussion of the issuer's industry. Often, this information is specifically referenced in the disclosure and a website may be the easiest means of obtaining it. Other websites may also provide a different source for cross-checking information supplied to you by an issuer. By way of an illustration, an offering document for a sovereign issuer often includes a detailed description of political and economic developments, some of which can be checked against press and other reports. However, the same caveats that apply to an issuer's website apply here as well and it is important to confirm all information that is derived from other websites with the issuer.
- **The issuer's most recent annual reports.** As with websites, almost all new issuers will prepare and publish annual reports, although the quality and scope of the information in these reports will also vary greatly between issuers. Occasionally, you may encounter a new issuer which has never prepared an annual report (for example, a closely held private company such as a state-owned entity). Annual reports are usually prepared with a view to giving a snapshot of the issuer's activities during the most recent year and typically assume a general familiarity with the issuer, which limits their use as a disclosure source. Nevertheless, they may still contain useful material and, as they usually reflect the way in which the issuer looks at its own business, they can give a good indication as to how to structure a business description. One point to watch out for is the tendency of issuers and some lawyers to include lengthy sections from the annual report in a business description. Whilst it is important to ensure consistency of disclosure between an offering document and an issuer's published annual report (particularly for issuers which include detailed disclosures in their annual reports), this does not extend to including lengthy discussions of developments in the business over the most recent year. Such discussions are appropriate for existing shareholders (where the assumption is that they will have received and read several past annual reports). Debt and new equity investors, however, typically expect to see a more general discussion of the overall business.
- **The issuer's audited accounts.** The amount of information provided by the accounts will vary depending on the amount of disclosure included in the footnotes. Typically, a great deal of information can be gleaned from a well-prepared set of accounts. This is especially true if the accounts have

After this offering, we will have outstanding 24,000,000 shares of common stock. This includes the 6,000,000 we are selling in this offering, which may be resold in the public market immediately. The remaining 75%, or 18,000,000 shares, of our total outstanding shares will become available for resale in the public market as shown in the chart below. [Proper context – avoids unnecessary detail such as references to legislation and defined terms.]

As restrictions on resale end, the market price could drop significantly if the holders of these restricted shares sell them or are perceived by the market as intending to sell them. [Proper identification of risk.]

Number of shares/% of total outstanding	Date of availability for resale into public market
8,000,000 / 33%	180 days after the date of this prospectus due to an agreement these shareholders have with the underwriters. However, the underwriters can waive this restriction and allow these shareholders to sell their shares at any time.
10,000,000 / 42%	Between 90 and 365 days after the date of this prospectus due to the requirements of the federal securities laws.

For a more detailed description, see 'Shares Eligible for Future Sale,' on page 79. [Cross reference to more detail.]

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CHAPTER 5

STYLE

INTRODUCTION

5.1 Style is an important consideration when preparing disclosure. I use the term 'style' quite loosely to cover both the look and feel of the disclosure as well as some aspects of its content. Consider the following description of US disclosure around 1970:

> 'In at least some instances, what has developed … is a literary art form calculated to communicate as little of the essential information as possible while exuding an air of total candour. Masters of this medium utilize turgid prose to enshroud the occasional critical revelation in a morass of dull, and – to all but the sophisticates – useless financial and historical data. In the face of such obfuscatory tactics the common or even the moderately well informed investor … cannot by reading the prospectus discern the merit of the offering.'[1]

5.2 Although the SEC has since championed improved disclosure, including in some cases the use of plain English, there have to date been limited incentives for the authors of disclosure in the international capital markets to do likewise.[2]

5.3 Nevertheless, any author of disclosure should be concerned to make it as clear as possible.

STYLE RULES

5.4 I set out below a number of style rules to be observed when preparing an offering document or when reviewing an offering document's style. The rules

[1] *Feit v Leaseco Data Processing Equip Corp*, 332 F Supp 544, 1971 US Dist LEXIS 11885, Fed Sec L Rep (CCH) P93163 (EDNY 1971). See 332 F Supp 544, 565. See **19.24–19.29** for a more detailed discussion of this case.

[2] The Prospectus Directive imposes a requirement for prospectuses to present information in an 'easily analysable and comprehensible form' (see Article 5.1). In October 2013, the UK's Financial Conduct Authority initiated a consultation on its plans to interpret this requirement differently for retail and wholesale securities. See further the discussion below.

draw on a range of sources, including the SEC Handbook,[3] a draft technical note published by the FCA[4] and other sources referred to below.

Presentational structure

5.5 The ideal presentational structure for disclosure is:

- an overview at the start of each relevant section (as discussed at **2.12** and **3.10–3.11**). This provides readers with essential context and aids their understanding of subsequent disclosure; and
- the use of headings which aid understanding (this is particularly relevant in the context of risk factors, see **4.29**).

Use short sentences

5.6 A common criticism of lawyers is that they write in long and complicated sentences and, indeed, the need for absolute accuracy and clarity in drafting complex commercial contracts encourages this approach. However, a business description is not a complex commercial contract. While it is still important to preserve accuracy and clarity in disclosure, there is no reason why this cannot be achieved with short simple sentences. Martin Cutts, in his *Oxford Guide to Plain English*, offers the following guideline: 'over the whole document, make the average sentence length 15-20 words'. And what's the reason? He explains: 'More people fear snakes than full stops, so they recoil when a long sentence comes hissing across the page.'

Use the positive instead of the negative where possible

5.7 Look for negative formulations such as 'Persons other than the primary beneficiary may not receive these dividends'. These can easily be replaced by positive formulations such as 'Only the primary beneficiary may receive these dividends'.[5] Similarly, aim to replace a negative phrase with a single word that means the same thing. For example 'does not include' can be replaced by 'excludes' and 'not the same' by 'different'.

Use the active voice and strong verbs

5.8 According to the SEC:[6]

> 'The plodding verbosity of most offering documents makes readers yearn for clear words and short sentences. The quickest fix lies in using the active voice with strong verbs.'

[3] 'A Plain English Handbook: How to Create Clear SEC Disclosure Documents', published by the SEC. See Chapter 6 of the SEC Handbook in particular which contains a number of other recommendations.
[4] 'Non-equity retail prospectuses' (UKLA/TN/632.1 Consultation).
[5] SEC Handbook, page 27.
[6] SEC Handbook, page 19.

5.9 The SEC Handbook recommends only sparing use of the passive tense when there is a good reason for doing so. Passive verbs cause several problems – they can be confusing, they often make sentences longer and they make writing less lively. Weak verbs are typically identified by forms of verbs such as 'to be' or 'to have' or similar with a noun that could be turned into a strong verb. Examples quoted in the SEC Handbook include: 'We will have no stock ***ownership*** of the company' which can be replaced by 'We will not ***own*** the company's stock' and 'There is the possibility of prior Board ***approval*** of these investments' which can be replaced by 'The Board might ***approve*** these investments in advance'. Edward Good makes a similar point in his advice to avoid nouniness:[7]

> 'Nouny writing doesn't state something, it makes a statement. It doesn't conclude anything, it reaches a conclusion. Nouny writers have a preference for nouns. But good writers prefer verbs.'

Omit superfluous words and avoid long words if there is a shorter alternative

5.10 George Orwell's advice to help writers get rid of bad habits and think more clearly includes: 'If it is possible to cut a word out, always cut it out' and 'Never use a long word where a short one will do'.[8] Words are superfluous when they can be replaced with fewer words that mean the same thing. Examples quoted in the SEC Handbook include:

in order to	to
in the event that	if
subsequent to	after
prior to	before
despite the fact that	although
owing to the fact that	because, since

5.11 Examples of long words that can be replaced by shorter ones include 'commence' (use begin or start), 'terminate' (use end) and 'consequently' (use so).

Consistency

5.12 It is important to achieve as much consistency as possible in simple things like heading styles, date styles, presentation, definition styles, use of American or English spelling, the introduction to tables, table styles, and so on. This

[7] C. Edward Good 'A Grammar Book for you and I....oops, me'.
[8] Contained in *Politics and the English Language*, written in 1946. Orwell formulated six rules including these two, each of which, in the best tradition of rules, breaks itself ('always do it' instead of 'always cut it out' in the first rule and, in the second rule, he could have used 'if' which is shorter than 'where').

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results in a document which is easier to read and which appears more professional. The SEC Handbook also comments on this.[9]

Defined terms

5.13 It is important to use only one defined term where possible. Too often, multiple definitions (such as 'Bank', 'Issuer', 'XYZ'), are used for the same thing and these definitions are then used interchangeably throughout the text which does nothing to assist understanding. The FCA's draft technical note referred to above states that a retail prospectus 'should not be written in a legal style, nor should it place excessive reliance on the use of defined terms, technical language or market jargon'. No guidance is given as to what constitutes a 'legal style'.[10] The SEC Handbook also recommends that definitions should only be used sparingly.

Technical terms

5.14 Technical terms (eg ATMs) should not be used without first defining or explaining them.

Issuer/Group

5.15 Where the issuer is part of a group of companies, it is important to be as clear as possible when referring to 'Group' and 'Issuer' that the correct entity/ies are being referred to. This is not always as easy as it seems and is a common defect in first drafts. The SEC Handbook recommends the use of personal pronouns (ie 'we' for 'the issuer' and 'you' for 'the investor'). However, this is one of the plain English practices that has not yet been adopted outside of US domestic market practice.[11]

Cross references

5.16 These should be used to assist understanding. Two situations where cross references can best be used are:

[9] In Chapter 7 in relation to heading styles and table styles, where the suggestion is made not to reverse time (ie a time series of columns should, in the SEC's view, always read 2010, 2011 and 2012 rather than 2012, 2011 and 2010), although the reverse formulation is also commonly used in offering documents.

[10] The remainder of the Technical Note deals with the more legal sections (rather than the disclosure sections) of a prospectus. The FCA has stated, in Primary Market Bulletin No 7 of October 2013, that the draft Technical Note was driven by the FCA's obligation to secure 'an appropriate degree of protection for consumers' and the need for it to consider the amount of risk involved in different kinds of investment, the experience and expertise of different consumers and their potential expectations for different kinds of investments. From this, the FCA has concluded that retail prospectuses 'should look significantly different' from wholesale prospectuses and the Technical Note is expected to achieve this. To my mind, this is a bit of a missed opportunity.

[11] It is also difficult, when using personal pronouns, to make the distinction between issuer and group.

- to highlight a significant point (eg it may make sense to cross-reference a risk factor when discussing the same subject matter in the business description and vice versa); and
- to reduce unnecessary duplication.

Bullets and numbers

5.17 Bullets should be used instead of long lists within text as they are much easier to follow.[12]

Idiom

5.18 No idiomatic or other colourful language should be included – writing disclosure is not like writing a novel.[13]

Projections

5.19 Projections or other forward-looking statements should not be used if they can be avoided. This is because they are 'high risk' language as it is easy to identify where they have not been achieved. Although a prominent section disclaiming liability for forward-looking statements is frequently included in offering documents, this is based on US safe harbour practice[14] and there is no certainty that an English court would give effect to that disclaimer. Another common defect is the use of definitive statements such as 'the issuer will' which, unless the relevant act being referred to is certain to occur, generally benefit from being changed to 'the issuer intends' or 'the issuer expects'.

Marketing

5.20 Eliminate over-emphasis and other unnecessary marketing speak. By way of example, there is no meaningful difference in a business description between 'strong' and 'very strong'.

[12] See Rule 421(b) under the US Securities Act (as amended when the SEC introduced its plain English requirements). According to the Plain English Campaign's *How to Write in Plain English*, bullets are better than numbers or letters as they draw your attention to each point without giving you extra information to take in.

[13] The worst example of this that I have come across was a reference in a first draft offering document discussing tourism facilities in a Middle Eastern country. This referred to the opening of a new shopping mall which had an indoor ski slope and asserted that it was now possible to 'enjoy some quality slope time in the desert'.

[14] See 3.63.

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Claims

5.21 All claims (eg 'the issuer is the leading bank in Ruritania') should:

- make clear the terms on which the claim is based (eg leading in terms of assets, loans advanced, deposits taken, market capitalisation, something else?); and
- be sourced to an independent source where possible.

5.22 In other cases, for example where the statement is based solely on issuer belief, it is generally advisable to tone down the claim. Thus, 'the leading' can be changed to 'one of the leading'. In addition, the basis for the belief should be indicated where possible (eg 'based on the Issuer's knowledge of its industry' or 'based on the Issuer's internal research and information published by its competitors').[15]

[15] It is also a Prospectus Directive Regulation requirement to provide the basis for any statements made by the issuer regarding its competitive position. See 7.37.

Part 2

REGULATORY REQUIREMENTS RELATING TO DISCLOSURE

In Part 2, I discuss the relevant regulatory requirements which apply to an international offering of debt or equity securities. I focus on the Prospectus Directive and the Prospectus Directive Regulation which apply to all issues of debt[1] or equity[2] securities which are:

- listed on a regulated market in the European Economic Area (EEA); and/or
- offered to the public in an EEA member state.[3]

Both the Directive and the Regulation have been implemented into national legislation across the EEA member states. As the Directive is a maximum harmonisation directive and the Regulation is directly applicable in member states, this means that member states should not impose additional requirements relating to the contents of prospectuses. Accordingly, in theory, there should be no difference between the requirements relating to the content of prospectuses across the member states. In order to ensure that there is consistent implementation of the Directive and Regulation across different member states, ESMA publishes guidance which is not law but with which competent authorities and market participants are expected to comply.[4] ESMA's guidance was most recently updated and published in March 2013. ESMA also produces the ESMA Q&A[5] which provides market participants with answers to common questions raised on the Directive and Regulation.

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[1] The Regulation defines retail and wholesale debt securities (in Arts 8.2 and 16.2) as those in respect of which the issuer has an obligation to repay the investor 100%. Anything else which might normally be considered to be debt is a derivative security for the purposes of the Regulation (see Art 15.2 of the Regulation). Although this is a curious distinction and not reflective of market practice, it does not matter for the purposes of this book and so where, in this Part 2, I refer only to 'debt' securities this should be understood to include 'derivative' securities too.

[2] These are defined as shares and other transferable securities equivalent to shares and also include certain equity-linked securities. See Art 2.1(b) of the Prospectus Directive.

[3] Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, The Netherlands and the United Kingdom.

[4] Indeed, the UKLA takes the view that as it has announced its intention to comply with the recommendations, any deviation from them requested by an issuer requires a formal application for a derogation on one of the grounds specified in Art 8.2 of the Prospectus Directive. See further 6.7.

[5] ESMA Questions and Answers Prospectuses, most recently updated in January 2014 (ESMA/2014/35).

CHAPTER 12

STATES AND PUBLIC INTERNATIONAL BODIES

INTRODUCTION

12.1 The sovereign and quasi-sovereign disclosure annexes are:

- Annexes XVI (member states, third countries and their regional and local authorities); and
- Annex XVII (public international bodies and debt securities guaranteed by an OECD member state).

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12.2 Notwithstanding the fact that Annex XVI is expressed to apply to EEA member states and Annex XVII is expressed to apply to debt securities guaranteed by OECD member states, Arts 1.2(b) and 1.2(d) of the Prospectus Directive provide that non-equity securities issued by EEA member states, their regional or local authorities and public international bodies of which an EEA member state is a member (Art 1.2(b)) and securities unconditionally and irrevocably guaranteed by an EEA member state or one of its regional or local authorities (Art 1.2(d)) are exempt from the Prospectus Directive.

12.3 The logic for this, based upon Recital (19) to the 2010 amending directive (2010/73/EU), seems to be that EEA member states 'publish abundant information on their financial situation which is in general available in the public domain'. This is a both a curious and illogical position. The purpose of a prospectus is to ensure that investors are provided with all material information necessary to make their investment decision and to ensure, by requiring issuers (and others) to take responsibility for the contents of the prospectus, that the information is carefully prepared and is accurate and complete. By exempting EEA member states from the need to produce a prospectus, there is no longer any requirement for the member states to ensure that all material information is available or to take responsibility for the information published.[1]

12.4 Further, many provisions of prospectus legislation require the information published in a prospectus to be published in an easily analysable and comprehensive form.[2] Anyone who has ever looked at the mass of statistical information provided by sovereigns will happily testify that it is

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[1] Juvenal's phrase 'Quis custodiet ipsos custodes?' springs to mind.
[2] See, for example, Art 5.1 of the Prospectus Directive.

completely incomprehensible to all save, perhaps, experts in economics. In addition, when sovereign prospectuses are published, they typically provide commentary on statistical developments (including the reasons why statistics may have developed in a particular manner) which is helpful for readers of the prospectus. Sovereigns rarely publish any commentary with their statistical information and, even when they do, it is frequently neither clear nor easily comprehensible.

12.5 In addition, even though EEA member states may publish detailed statistical information, it is unlikely that their regional or local authorities will do so to the same extent. Further, although many public international bodies in which an EEA member state is a member will publish annual reports, for the reasons stated at **1.12**, an annual report does not normally contain all the information that is included in a prospectus.

12.6 Particularly in the context of the European sovereign debt crisis which started in 2009, this approach does not appear to have any merit or justification.[3]

REQUIRED SOVEREIGN DISCLOSURE

12.7 The table below analyses the different sovereign and quasi-sovereign issuer disclosure annexes in terms of their content requirements:

	Annex	
	XVI	XVII
Persons responsible	✓	✓
Risk factors	✓	✓
Information about the issuer	✓	✓
Public finance and trade	✓	
Significant change	✓	
Financial information		✓
Legal and arbitration proceedings	✓	✓
Expert statements	✓	✓
Documents on display	✓	✓

[3] It is also interesting to note that sovereigns which have been bailed out in recent years, at considerable expense to the European public, are now beginning to issue new debt securities while still not making any public disclosure in a prospectus. It seems that investors have very short memories.

Persons responsible

12.8 This requires the identification of the persons responsible for the prospectus (as to which, see **20.10**) and the inclusion of a statement in the prospectus by those persons as to the accuracy and completeness of the prospectus.

12.9 This statement is usually included as one of the first statements on the inside front cover of the prospectus.

Risk factors

12.10 This requires prominent disclosure of the risks that may 'affect the issuer's ability to fulfil its obligations under the securities to investors'.

12.11 This is usually addressed in a separate section entitled Risk Factors towards the front of the prospectus and the requirement for prominence is also satisfied by including a cross-reference to the Risk Factor section in bold type on the front cover of the prospectus. The Risk Factor section is discussed in detail in Chapter 4.

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Information about the issuer

Annex XVI

12.12 For Annex XVI, this requires basic information on the issuer (such as, but not limited to, its name and position within the national governmental framework, its geographical location, its legal form and its contact address and number). In addition, a general description of the issuer's political system and government is also required. This information is usually included in the first section of the Business Description, which typically provides a general overview of the issuer.

12.13 In addition, details of any recent events relevant to an evaluation of the issuer's solvency are required to be included, notwithstanding that it is rare for sovereign issuers to become insolvent or to be in a position to issue debt securities should they be at risk of becoming insolvent.[4] As a result, usually there is no relevant information to include under this heading in the prospectus. Article 23.4 of the Prospectus Directive Regulation specifically permits the omission of information required by an Annex where it is 'not pertinent'.

12.14 A description of the issuer's economy is also required, including details of the main economic sectors and a GDP breakdown by sector for the last 2 years. This information is usually included in the second section of the Business

[4] Although, during the years of the European sovereign debt crisis, certain exposed countries managed to issue securities notwithstanding considerable market speculation as to their ability to repay. These countries were, however, all exempt from the requirement to publish a prospectus.

Description, typically entitled 'Economy'. See **2.1–2.8** for a description of the typical disclosure content of a sovereign offering document.

Annex XVII

12.15 For Annex XVII, basic information on the issuer (such as, but not limited to, its name and legal status, its legal form, the location of its principal office and its contact address and number and a list of its members) as well as a brief description of its purpose and functions and its sources of funding, guarantees and other obligations owed to it by its members is required.

12.16 Certain of this information is specific to public international bodies and so will not be relevant to debt securities guaranteed by an OECD member state. Indeed, Annex XVII is the only article to explicitly apply to a guarantor and it is not at all obvious why the drafters of the Prospectus Directive Regulation did not simply rely on Annex VI given that Annex XVI already applies to EEA member states and third countries.

12.17 In addition, details of any recent events relevant to an evaluation of the issuer's solvency are also required to be included for Annex XVII issuers.

Public finance and trade

12.18 This requirement applies to Annex XVI only.[5]

12.19 It requires at least 2 years' information on:

- the issuer's tax and budgetary systems (which is usually included in the Public Finance section of the business description);
- the issuer's gross public debt (which is usually included in the Indebtedness section of the business description);
- the issuer's foreign trade and balance of payments (which is usually included in the Balance of Payments and Foreign Trade section of the business description);
- the issuer's foreign exchange reserves, including any encumbrances on them (which is usually included in the Monetary and Financial System section of the business description);
- the issuer's financial position and resources including liquid deposits in its domestic currency (it is not entirely clear what this is requiring given that states usually do not publish balance sheet type information, although certain information typically included in the Indebtedness section of the business description may be relevant to this item); and
- income and expenditure figures (which are usually included in the Public Finance section of the business description).

[5] As a result, guarantors that are OECD member states do not have to produce any of this information, which is a curious result.

12.20 In addition, a description of any auditing procedures applied to the issuer's accounts must be included and is also usually discussed in the Public Finance section of the business description.

Significant change

12.21 This requirement applies to Annex XVI only.

12.22 It requires details of any significant changes to information required at **12.19–12.20** (but not, therefore, GDP information) which have occurred since the end of the last fiscal year or an appropriate negative statement.

Given that sovereigns which publish prospectuses usually provide the most recently published statistics, this requirement is unlikely to result in relevant disclosure.

Financial information

12.23 This requirement applies to Annex XVII only.

12.24 It requires the inclusion of the two most recently published audited annual financial statements of the issuer and a brief description of the accounting and auditing principles used. In addition, details must be given of any significant changes to the issuer's financial position which have occurred since the latest published audited annual financial statements or an appropriate negative statement must be made.

12.25 Again, these are provisions which do not obviously apply to OECD member state guarantors, given that states generally do not publish audited annual financial statements in the same way that companies do.

Legal and arbitration proceedings

12.26 Information on relevant legal proceedings or a negative statement must be provided. At least for the UKLA, the negative statement is required to track exactly the requirements of the provision and so typically reads as follows (notwithstanding the poor English and lack of clarity (eg 'recent past')):

> 'There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the issuer is aware), during a period covering at least the previous 12 months which may have, or have had in the recent past significant effects on the issuer financial position.'

12.27 Where there is significant litigation to disclose, this is generally included in the business description under a separate heading and the negative statement,

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CHAPTER 23

TORTIOUS LIABILITY

EXECUTIVE SUMMARY

It is an open question as to whether an aggrieved investor could successfully pursue a common law claim for negligent misstatement against an investment bank arranger in relation to inaccurate disclosure in an offering document for a securities issue. English case-law continues to develop in this area and, although claimants may face difficulties in establishing that they were owed a duty of care that was breached, it is not inconceivable that they could prevail. Investors may also have claims for misrepresentations negligently made to them under the Misrepresentation Act 1967 but this depends on the existence of a contract between the investor and the arranger (which limits the potential class of claimants). Investment bank arrangers may also, where they have acted recklessly, potentially have liability under the tort of deceit, although appropriate due diligence is likely to render such liability a remote possibility.

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INTRODUCTION

23.1 It is an open question under English law as to whether an aggrieved investor could successfully pursue a common law negligence claim against an investment bank arranger in relation to inaccurate disclosure in a prospectus for a securities issue. The most likely such claim would be one for negligent misstatement under the principle established in *Hedley Byrne v Heller*.[1] An alternative claim might lie in the tort of deceit.[2] Both these potential claims are discussed further below.

BACKGROUND TO SECURITIES OFFERINGS

23.2 Typically, an issuer appoints one or more investment bank arrangers to arrange its securities offering. These banks usually sign a mandate letter with

1 [1964] AC 465.

2 Another possibility would be a claim for misrepresentation under the Misrepresentation Act 1967, although that would require there to be a contract between the investment bank arranger and the aggrieved investor and so is only open to initial purchasers from the arranger concerned where the arranger has misrepresented facts.

the issuer in which they agree to advise the issuer and manage the issue. Each bank will have its own standard form of letter and, where more than one bank is appointed as arranger, the mandate letter is often an amalgam of different standard forms. However, under a mandate letter, the investment bank arrangers typically agree to assist the issuer in documenting the issue (ie in preparing the offering document), in marketing the issue (ie arranging investor meetings and in preparing associated presentations) and to coordinate the overall issue process. The mandate letter will also set out the agreed fees payable to the arrangers and is usually subject to conditions, including completion of customary due diligence. There is usually a disclaimer of any fiduciary or other similar role on the part of the arrangers.[3]

23.3 The arrangers then assist the issuer during the offering process, including by reviewing and commenting on the disclosure in the offering document, conducting due diligence as described in Part 3 and preparing in conjunction with the issuer (or reviewing and commenting on) an appropriate investor presentation (where investor meetings are held).

23.4 The arrangers hold pricing discussions with the issuer and, once the final terms of the transaction (such as the issue price of the securities and their interest rate) are agreed, coordinate the sale of the securities on behalf of the issuer to a range of investors. The arrangers may or may not have investment advisory or other contracts in place with some of the investors but will, in any event, enter into sale contracts in relation to the securities.

INTRODUCTION TO NEGLIGENCE AND NEGLIGENT MISSTATEMENT

23.5 At this point a brief introduction to the key principles of the tort of negligence (of which negligent misstatement is a category) may be useful.[4]

23.6 There are four requirements to establish negligence:

- the existence in law of a duty of care;
- breach of that duty;
- a causal connection between the breach and the damage suffered; and
- the damage not being too remote.[5]

[3] Driven by the US eToys case (*EBC I, Inc v Goldman Sachs & Co* Court of Appeals of New York 5 NY3d 11; 832 NE2d 26; 799 NYS2d 170; 2005 NY LEXIS 1178; 29 March 2005, argued; 7 June 2005, decided) which held that a lead arranger of an IPO might owe a fiduciary duty to the issuer to disclose conflicts of interest when it provided financial advice to the issuer.

[4] This is deliberately crafted as an introduction and I am indebted to *Clerk & Lindsell on Torts* (20th edn, 2010) for much of this introduction. Anyone who is interested in pursuing this topic further should refer to Ch 8 and other chapters of the textbook itself.

[5] *Clerk & Lindsell on Torts* at 8-04.

23.7 The discussion that follows focuses mainly on the first of these requirements.

23.8 Clerk & Lindsell[6] distinguish two types of duty of care: a notional duty and a factual duty. A notional duty applies to a general class of relationship and damage and the key question is whether, in relation to all factual situations within that class, a notional duty exists. For example, Lord Browne-Wilkinson expressed the concept as follows:[7]

> 'In English law the decision as to whether it is fair, just and reasonable to impose a liability in negligence on a particular class of would-be defendants depends on weighing in the balance the total detriment to the public interest in all cases from holding such class liable in negligence against the total loss to all would-be claimants if they are not to have a cause of action in respect of the loss they have individually suffered ... The decision does not depend on weighing the balance between the extent of the damage to the claimant and the damage to the public in each particular case.'

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23.9 The test for whether a notional duty of care exists has developed significantly since Lord Atkin formulated the twin reasonable foresight and proximity test in *Donoghue v Stevenson*.[8] Following some judicial debate, the House of Lords in *Caparo v Dickman*,[9] a case concerned with economic loss, formulated a more sophisticated three-part test for determining whether a notional duty of care existed, being:

- foreseeability of damage;
- a relationship of proximity or neighbourhood between the party owing the duty and the one to whom the duty is owed; and
- the situation is one where the court considers it fair, just and reasonable that the law should impose the duty.[10]

23.10 It is important to note that different aspects of this test are given different emphasis in different cases and there is also significant overlap between the different limbs. For example, commenting on this test in *Caparo*, Lord Oliver said:[11]

> '... it is difficult to resist the conclusion that what have been treated as three separate requirements are, at least in most cases, in fact merely facets of the same thing, for in some cases the degree of foreseeability is such that it is from that alone the requisite proximity can be deduced, whilst in others the absence of the essential

[6] In Ch 8, Section 2 Sub-section (a).

[7] In *Barrett v Enfield LBC* [2001] 2 AC 550 at 559, quoted by *Clerk & Lindsell on Torts* at 8-06.

[8] [1932] AC 562

[9] [1990] 2 AC 605.

[10] See further the discussion of *Caparo* below.

[11] Quoted in *Clerk & Lindsell on Torts* at 8-15.

relationship can most rationally be attributed simply to the court's view that it would not be fair and reasonable to impose a duty of a given scope on the one party for the benefit of the other.'

23.11 Although this three-part test has been generally accepted as being of universal application, Clerk & Lindsell note that it is of particular significance in cases which seek to extend liability to a novel relationship, means of causing loss or type of loss and that, in cases of economic loss, the nature of any pre-existing relationship between the parties (which is generally relevant to questions of proximity) is 'sometimes elevated to the status of a separate requirement of assumption of responsibility'.[12]

23.12 Once a notional duty is accepted, the second question is whether the particular claimant comes within the scope of that duty so as to be able to bring a claim.

KEY CASES

23.13 Focusing on the issue of economic loss caused by negligent misstatement, there are a few key cases that are worth considering, including *Hedley Byrne*, *Caparo* and *Commissioners of Customs & Excise v Barclays Bank plc*.[13]

Hedley Byrne (1963)

23.14 In *Hedley Byrne v Heller*, the appellant was an advertising agent who had placed advertising for a client on terms by which it, Hedley Byrne, was liable for the cost. Hedley Byrne asked its bankers to enquire into the client's financial stability and its bankers made enquiries of Heller, the client's bankers. In reliance on the favourable reference, which was given 'without responsibility', Hedley Byrne placed the advertising and ultimately suffered a loss when its client failed to reimburse it.

23.15 In the House of Lords, the key issue to be decided was whether or not Heller owed Hedley Byrne a duty of care when giving the reference. In that case, the House of Lords determined that a duty of care could arise where a special relationship existed between the parties. For example, Lord Morris of Borth–y–Gest stated that where a person possessed of a special skill applies that skill, irrespective of there being a contractual relationship between them, for the benefit of another who relies on it, a duty of care will arise. Lord Hodson expressly agreed with this conclusion. Lord Devlin also tentatively supported this conclusion[14] but, more cautiously, concluded 'I shall therefore content myself with the proposition that wherever there is a relationship equivalent to

[12] *Clerk & Lindsell on Torts* at 8-28.
[13] [2007] 1 AC 181.
[14] See 530: 'I am prepared to adopt any one of your Lordships' statements as showing the general rule.'

contract, there is a duty of care'.[15] Lord Reid adopted different language, focusing on the recipient of the statement reasonably trusting the maker of it to take care and the maker of it knowing the recipient was relying on him.[16]

23.16 The following passage from Lord Morris' judgment is particularly apposite to the question of negligent misstatements in an offering document:[17]

> 'Furthermore, if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful enquiry, a person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise.'

23.17 In this context it is interesting to note that there is much US authority to the effect that the public rely on investment bank arrangers because of their ability to conduct an investigation of the issuer, including regulator pronouncements, academic discussion and cases. Some of this authority is discussed in Chapter 19. However, it is also important to remember that investment bank arrangers have statutory liability for registration statements under the Securities Act.

23.18 Although the House of Lords held that a duty of care could have arisen in *Hedley Byrne*, on the facts no duty of care was implied due to the disclaimer of responsibility made by Heller when giving the reference.[18] Almost all offering documents for internationally offered securities also include a disclaimer, with the following being a typical example:

> 'The arrangers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the arrangers as to the accuracy or completeness of the information contained in this document or any other information provided by the issuer in connection with the securities.'

Caparo (1990)

23.19 In *Caparo*, the House of Lords held that liability for economic loss due to negligent misstatement was confined to cases where the statement or advice had been given to a known recipient for a specific purpose of which the maker was aware and upon which the recipient had relied and acted to his detriment. The claim in that case was by purchasers in the secondary market of shares in a company, Fidelity. The purchasers alleged that they had relied on an audit report in deciding to purchase sufficient shares to acquire control of Fidelity. They argued that the auditors owed a duty of care not just to shareholders but also to potential investors. The House of Lords dismissed the claim.

[15] Also at 530.
[16] See 486.
[17] See 503.
[18] A point to which we will return below as *Hedley Byrne* pre-dated both the Misrepresentation Act and the Unfair Contract Terms Act, which have limited the effectiveness of disclaimers.

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