

IN THE SUPREME COURT OF NEW ZEALAND

SC

BETWEEN

**DOUGLAS ARTHUR MONTROSE GRAHAM,
MICHAEL HOWARD REEVES, WILLIAM PATRICK
JEFFRIES and LAWRENCE ROLAND VALPY
BRYANT**

Appellants

AND

THE QUEEN

Respondent

**APPLICATION FOR LEAVE TO APPEAL JUDGMENT OF COURT OF APPEAL
2 July 2013**

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NOTICE OF APPLICATION FOR LEAVE TO BRING CRIMINAL APPEALS

In the Supreme Court of New Zealand

CA 201/2012

CA 194/2012

CA 191/2012

CA 204/2012

(collectively the conviction appeals)

CA 225/2012

CA 226/2012

CA 227/2012

CA 228/2012

(collectively the Solicitor General's sentence appeals)

To the Registrar of the Supreme Court

Douglas Arthur Montrose Graham, Michael Howard Reeves, William Patrick Jeffries and Lawrence Roland Valpy Bryant, the Appellants in the conviction appeals identified above and the Respondents in the Solicitor General's sentence appeals identified above give you notice that they apply for the leave of the Supreme Court to appeal to the Court against the Judgments of the Court of Appeal delivered on 30 May 2013 and 2 July 2013 in relation to both the conviction and sentence decisions of that Court.

Specific grounds of proposed appeals

Rulings and findings that amended prospectus was untrue

1. The Court erred in fact and law in concluding (Judgment, paragraph [170]) that on the evidence it was open to the trial Judge to conclude that the statements in the amended prospectus were untrue by the omission of reference to what was described by the Court as:
 - The sharp deterioration in the company's cash position and in particular between August/September 2007 (Judgment, paragraph [150], [152], [170])
 - The serious downward trend in the company's cash position
 - The pattern of serious delays in the recovery of loan repayments
 - The significant discrepancies between the projected timing of loan repayments and their actual receipt (Judgment, paragraphs [153], [161]-[164], [170])

- The extent of the directors' concerns about these matters and about the liquidity of the company in particular (Judgment, paragraph [149]).
2. In this respect, the Court failed to determine whether the omission of those specific matters altered the total mix of information made available in the amended prospectus and thereby rendered the prospectus and the statements contained in it untrue. In particular, the Court erred in ruling that the amended prospectus read as a whole did not adequately convey the risks that investors faced both in relation to the finance sector generally in the circumstances then existing and to the company, having regard to the fact that the amended prospectus specifically disclosed:
- considerable detail of Lombard's business and the risks investors faced
 - the measures taken by the company to manage those risks, including regular reviews of developments and as a matter of routine adjusting weekly cashflows to reflect those reviews
 - the fact that the company was experiencing reduced levels of reinvestment
 - the fact that sales of properties were delayed and that allowances were made for that fact when completing cash flow projections
 - the fact that market confidence in the finance sector had decreased and might decrease further if there were failures of other finance companies
 - that a period of constrained liquidity would impact on the company's future growth and profitability
3. In so ruling, the Court erred in failing to take account of the uncontested evidence that:
- the directors had taken several internal measures to deal with what they had seen was a more difficult market contributed to by some finance company collapses and a consequential reduction in investor confidence in the finance sector
 - such measures included decisions to cease new loans in the interim, to focus on ensuring recovery of existing loans, to establish a major loans committee to monitor the recovery of larger loans and to involve directors in that process
 - the directors in September 2007 obtained an independent review of the company's financial projections from Ferrier Hodgson, who found those projections reasonable)
 - the directors took steps to establish a higher cash level than was normal to meet any exceptional demands on cash resources and on the prospect of the company's normal cash retention policies and patterns not being met
 - the directors determined to prepare an amended prospectus that better stated the ongoing position of the finance sector and of the company within it and obtained specialised external advice on the form of the prospectus as well as disclosing drafts to the statutory trustee and to the Companies Office for scrutiny and comment before finalising its terms
 - the directors through their managing director began investigating alternative complementary business models and revenue streams and alternative funding to take

- account of the changing circumstances of the finance sector and the challenges facing the company (Judgment, paragraphs [117], [121], [122], [123], [128], [129], [132]).
- the 12 month forecasts that were presented to the directors at the 19 December 2007 board meeting when the amended prospectus was approved, and of the fact that, notwithstanding concerns that the directors had, they fully examined and satisfied themselves, by reference to the underlying assumptions, that the forecasts were realistic and achievable (Judgment, paragraph [132])
4. The Court has not found any statement in the amended prospectus to be untrue in its own terms but has ruled that the omission of the matters in paragraph 1 above renders the amended prospectus untrue because they were matters which investors should have in order to make their own judgement on whether to invest (Judgment, paragraph [167]). The Court has thereby misinterpreted section 55(a)(ii) of the Securities Act and has failed to identify which statement or statements in the amended prospectus is or are misleading by virtue of the omission of the matters listed.
 5. The Court erred in ruling that the cause of the company's collapse in April 2008 – namely, the unanticipated events of February and March 2008 including the decision by New Zealand banks to cease lending to developers and to apartment purchasers – was irrelevant to the truthfulness and materiality of the statements contained in the prospectus at 24 December 2007 “in the light of what was known or could have been reasonably anticipated at that time” (Judgment, paragraph [169]).
 6. The Court erred in concluding that the amended prospectus should have conveyed beyond what was stated in it that the risks identified were imminent and that, by virtue of the matters listed in paragraph 1 above, the company was in a vulnerable state beyond what was stated in the amended prospectus (Judgment, paragraphs [170], [171]).
 7. The Court, having correctly accepted that it is within the province of the directors to exercise a degree of judgment in deciding upon the wording of the offer documents and on issues of materiality (Judgment, paragraph [167]), has, through the application of “notional investor” test¹, given undue weight to the identified omissions and has in fact assessed the exercise of the directors' judgment with the benefit of hindsight.
 8. The Court has compounded that error by refusing to examine and take into account the causes of the company's collapse and the unanticipated events of early 2008 (Judgment, paragraph [169]).
 9. The Court erred in ruling that, in carrying out their obligations under the Act, the directors are not entitled to rely on information supplied by management (Judgment, paragraph [173]),

¹ It is wrongly stated in the Judgment that the appellants did not challenge the approach adopted by the trial Judge at paragraph [24] of his Judgment (referring to Heath J in *R.v. Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at paragraphs [28]-[51] that a material omission is one that could well have made a difference to the decision whether to invest: written submissions of the Appellants in the Court of Appeal, paragraphs 18 and 24-29.

[196]). In particular, the directors were entitled to rely on the explanations given to them by competent and experienced loan managers as to predictions of loan repayments when stating in the amended prospectus that, based on a range of conservative scenarios, the board remained confident that the company would have the required cash resources to fund all repayments to investors when due and that were not reinvested (Judgment, paragraph [189]).

10. The Court erred in ruling that it was open to the trial Judge on the evidence before him relating to the reduction in the company's cash reserves between August and December 2007 and to the disparity between forecast loan repayments and actual repayments (Judgment, paragraph [101]) to be satisfied beyond reasonable doubt of the guilt of the directors (Judgment, paragraph [140]). In particular:

- (1) The trial Judge placed significant weight on the analysis prepared by Ms Peden relating to loan repayments (forecast and actual) in convicting the directors;
- (2) The Court of Appeal, while acknowledging that the Peden analysis was prepared in hindsight and that it was not the sort of detailed analysis that the directors could have been expected to undertake and that it may have contained inaccuracies, also placed significant weight on the analysis as being illustrative of the extent to which loan repayments were not being met as forecast despite close monitoring and frequent adjustments of the forecasts to take account of changing circumstances as they arose (Judgment, paragraphs [153][159][160]);
- (3) The Court of Appeal was wrong to give the Peden analysis any weight, having regard to the defects in its methodology, the demonstrable errors in its conclusions as to the extent to which loan repayments were not being made as forecast (Judgment, paragraphs [153] and [157]), to the unsatisfactory manner in which it came to be regarded as evidence in the case and to the resulting prejudice caused to the accused (Judgment, paragraphs [153][157]).

Rulings and findings that directors did not have reasonable grounds for their honest belief that the amended prospectus was true

11. The Court misdirected itself in approving the trial Judge's conclusion that the statutory defence of reasonable grounds for belief was not made out because investors might have taken a different view from the directors about the extent of risk that arose from the cash flow projections relied on by the directors if more detail of loan repayment projections had been provided in the amended prospectus (Judgment, paragraph [190]).
12. The Court misdirected itself in approving the trial Judge's conclusion that the statutory defence of reasonable grounds for belief was not made out because investors of the offer documents ought not to have been reliant on the directors' judgment as to liquidity (Judgment, paragraph [190]).

13. In both these last two respects, the Court failed to apply the correct legal test for determining whether there were reasonable grounds of belief, as stated by the Supreme Court of Canada in *Sharbern Holding Inc. v. Vancouver Airport Centre* [2011] 2 SCR 175 at [92] by applying instead an incorrect test, namely whether it was reasonable for the directors to conclude that they could omit the matters that the Court thought should have been included in the amended prospectus (Judgment, paragraphs [183]-[187], [189]-[191]).
14. The Court erred in concluding that, it having been found that the statements in the amended prospectus were untrue by reason of omission, it followed inevitably from that finding that the directors did not have reasonable grounds for their belief in the truth of the statement (Judgment, paragraph 194). By conflating the offence and defence provisions and deriving its findings on the second from its findings on the first, the Court effectively emasculated the statutory defence and deprived the directors of it.
15. The Court erred in ruling that the directors were not entitled to rely on the views of the company's executives or on the advice of professionals in forming their view in the accuracy of the amended prospectus (Judgment, paragraphs [196]-[197]). In so doing, the Court failed to apply the provisions of section 138 of the Companies Act 1993.
15. The Court erred in ruling that the directors were obliged to take a much more direct personal interest in the company's affairs and in so ruling failed to consider or take proper account of the evidence that demonstrated that the directors in fact did take a direct personal approach to loan repayment and liquidity issues and had also committed personal care and attention to the offer documents (Judgment, paragraphs [197], [210]).
16. The Court, having stated that the truthfulness and materiality of the statements in the amended prospectus must be assessed as at 24 December 2007 "in the light of what was known or could have been reasonably anticipated at that time" wrongly failed to consider the effect that the events of February and March 2008 and in particular the effect that the decision taken by banks in New Zealand to cease lending to developers and the purchasers of apartments had on the liquidity of the company and on the reasonableness of the directors' reliance in December 2007 on management cash and loan repayment projections (Judgment, paragraph [169]).

The Solicitor-General's sentence appeal rulings

17. The Court erred, in the light of the rulings that the directors acted honestly and were at worst guilty only of misjudgement, in ruling that the sentences imposed by the trial Judge were manifestly inadequate and that in particular the starting point for considering appropriate sentences should have been a period of imprisonment (Judgment, paragraphs [250], [261], [262]). In this respect, the Court failed to give proper credit for the honesty and diligence of the directors and the fact that the company was managed according to sound principles of corporate governance and had a policy of not engaging in related party transactions and failed also to give weight to the fact that:

- (1) the statutory offence is one of strict liability (including a deeming provision (section 55(a)(ii) of the Securities Act) in respect of which the traditional presumption of innocence is reversed in part by a statutory onus being placed on a defendant to prove that he had honest and reasonable grounds for belief in the truth of the statements in the prospectus;
- (2) it contravenes the principles laid down in article 11(1) of the Universal Declaration of Human Rights 1948 and other international Conventions and also section 25(c) of the Bill of Rights Act 1990 for a court to impose a sentence of detention in circumstances where a finding of honesty has been made and the conduct of the defendants has been that of misjudgement only and where detention is not specifically required in such circumstances;
- (3) Parliament has before it the Financial Markets Conduct Bill which has all-Party support and which will, when enacted, decriminalise the offence except where directors know or are reckless as to whether disclosure is defective, the onus of proving which will be on the Crown;
- (4) The Court failed to have regard to the principles contained in section 16 of the Sentencing Act 2002 relating to desirability of keeping offenders in the community as far as that is practicable and consonant with the safety of the community.

18. The Court erred in applying the principle of consistency in sentencing by failing to give proper weight to the significant difference between an honest misjudgement, which was what was attributed to the directors in the present case, and to findings of gross negligence, related lending, failure to make proper inquiries before the issue of a prospectus, positive misstatements and longer periods of offending in other comparator cases (Judgment, paragraphs [234], [235], [239], [240], [242], [243]).

19. In ruling that the trial Judge had placed too little weight on the statutory purposes of denunciation and deterrence (Judgment, paragraph [248], [249]) and in ruling that the starting point for honest misjudgement was imprisonment, the Court failed to take account of the desirability of not deterring honest and competent persons from accepting appointments as directors of companies that issue offer documents to the investing public.

20. The Court erred in the weight which it gave to the losses to investors arising from the receivership of the company (Judgment, paragraph [246]) and in effect created a status offence by which directors who were guilty of honest misjudgment only should be found accountable for those losses.

Criteria for leave to appeal

21. It is necessary in the interests of Justice for the Court to hear and determine the proposed appeals in that, as a result of the wrongful interpretation and application of sections 58 and 55 of the Securities Act 1978 and the failure to apply section 138 of the Companies Act 1993, the appellants have been wrongly convicted and sentenced and a substantial miscarriage of

Justice has occurred or may occur unless the appeals are heard. Further, the proposed appeals involve matters of general or public importance and matters of general commercial significance (section 13(1)(a)(c) Supreme Court Act 2003).

22. In particular:

- (1) The true meaning and scope of section 58 of the Securities Act 1978 has not been the subject of a ruling by this Court and is a matter on which the commercial community and finance sector would benefit from the guidance that this Court can give, particularly given the strict liability nature of the section.
- (2) The present case was one, and possibly the only one, in which liability as found by the Court has not been based at least in part on a positive misrepresentation but has arisen because of omissions as to detail that the Court has found make the statements in the offer documents misleading and therefore untrue. There is, it is submitted, a resulting uncertainty of how much detail relating to statements concerning investment risk needs to be stated.
- (3) Both the trial Judge and the Court of Appeal have interpreted the statutory defence in a manner which conflates the offence provision (section 58(3)) and the defence provision (section 58(4)) by finding that if matters are omitted that render the offer documents misleading and untrue, the directors cannot be regarded as having reasonable grounds for their belief in the truth of the statements in the documents. This interpretation emasculates the statutory defence.
- (4) The ruling by the Court of Appeal that, in carrying out their statutory obligations in the circumstances of this case, the directors are not entitled to rely on information supplied by management or on advice received from professionals, is a matter upon which the commercial community and directors in particular are entitled to authoritative guidance from this Court, having regard in particular to the defence of reasonable grounds for belief in the correctness of a disclosure that relates to civil liability under the Financial Markets Conduct Bill referred to above.
- (5) The sentence imposed by the Court of Appeal involving the deprivation of the liberty of the directors notwithstanding findings by the trial Judge (and accepted by the Court of Appeal) that they acted honestly and that the omissions from the amended prospectus were matters of misjudgment only is a ruling that should be tested against the principles relating to deprivation of liberty laid down in international conventions, the Bill of Rights Act and the Sentencing Act.

23. The rulings as to liability given by both the trial Judge and by the Court of Appeal and as to sentence by the Court of Appeal are likely to deter prospective directors from accepting appointments on the boards of companies which issue or may issue offer documents seeking investment from the public.

Judgment sought from the Supreme Court

24. The appellants seek the following orders:

- (1) An Order allowing the appeals (if leave is granted)
- (2) Orders setting aside the convictions and sentences in the High Court
- (3) An Order setting aside the orders and directions made in the Court of Appeal
- (4) In the event that the appeal against convictions is dismissed, Orders setting aside the orders and directions relating to sentence made in the Court of Appeal and the restoration of the Orders as to sentence made in the High Court.

Dated: 2 July 2013



J A Farmer QC/M A Corlett/D H O'Leary/Michele Sissons

Counsel for the Appellants