

Securities Commission Report 11 October 2007

The Liquidators and their legal counsel have reviewed the comprehensive report of the Securities Commission released on 11 October 2007. The report concluded that Feltex had breached the ongoing disclosure requirements of the Securities Markets Act 1988 (SMA) and breached provisions of the Financial Reporting Act 1993 (FRA). We consider that the investigation was thorough. Submissions and evidence were received from a number of parties with significant interests in the outcome.

The liquidators had identified many of the same issues as part of our investigation using the funding from the Liquidation Surplus Account. The amendments to the financing arrangements with the ANZ Group in October 2005 and the implications that arose from that are of concern to us. We believe those changes raise significant issues regarding whether the directors met their respective duties to the Company irrespective of the failure to make ongoing disclosure that the Securities Commission as found. The changes demonstrated significant increases in risk premiums paid by the Company and thus large increased funding costs as the Securities Commission has identified.

In our letter dated 19 March 2007, to shareholder claimants (posted on our website), we noted that shareholder claimants needed to distinguish between IPO claims and ongoing disclosure issues. Under s 19M of the SMA, shareholders can make claims against the Company for compensation. To date, the claims lodged have not been sufficiently detailed to be able to advance them. Claims that have been lodged have not yet been admitted or rejected.

We note that the Securities Commission has recorded that the SMA applicable at the time does not impose direct liability on the directors for breaches of the SMA. However, we have foreshadowed a claim against the directors for any losses the Company may suffer through claims by shareholders. The matters raised with the directors are for breaches of their duties to the Company by failing to ensure the Company complied with the SMA.

For example, the directors are by s 134 of the Companies Act 1993 obliged not to agree to the Company acting in a manner that contravenes its constitution. By its constitution, Feltex and its directors were obligated to comply with the NZX listing rules and legislation. Rule 10 requires the Continuous Disclosure of Material Information to NZX and therefore to the market. We consider also that the directors were reckless to continue to trade a public company and not comply with ongoing disclosure obligations.

Section 300 of the Companies Act 1993 can also give rise to directors' liability for failure to comply with s 10 of the FRA. This therefore brings in the sort of issues that the Securities Commission has suggested constitute breaches of the FRA. The liquidators have also raised these issues with the directors in anticipation that such findings might well be made by the Securities Commission.

The liquidators have been awaiting the outcome of the Securities Commission investigation and can now look at advancing matters. In March 2007, the liquidators made demand on the relevant directors in respect of a range of issues that we had identified. We refer to our last liquidators report for more details (see website). One of the issues raised in the demand related to the SMA, on the basis that if the Company was found to breach the SMA and suffered losses, the directors would be looked to for compensation.

To date, only one director has reverted to the liquidators with any comments on the demand made. That director is Joan Withers. She has provided a detailed response in relation to her position and the issues the liquidators have raised. The liquidators have agreed to fully consider and discuss her response with her before any proceedings are issued. She was not involved in many of the issues the liquidators have raised with Feltex directors.

The key issue for the liquidators to be able to take matters forward is having the necessary funding. There have been approaches to provide funding from external sources and there are pros and cons with that. The liquidators are currently addressing these funding issues and are hopeful of being able to conclude matters in the near future.

The liquidators also have their application against ANZ Banking Group coming up for hearing on 19 November 2007. That application seeks the provision of mainly internal bank documents. The ANZ Group have filed opposition papers to actively oppose the application and have also applied to require the liquidators to pay any costs associated with providing any documents the Court says the banks should provide. We consider that obtaining access to the internal bank documents is very important and we will pursue the application. The ANZ Group had a central role in all of the matters of interest to us. We are hopeful that we may be able to negotiate the provision of the documents we want without having to go to Court, but time will tell.

We note that the Securities Commission has again referred in its report to the IPO and repeated its earlier view that there was no breach of the Securities Act. The liquidators are aware that the Securities Commission has been willing to receive information from interested shareholders on whether its initial conclusions remained valid. This willingness had been communicated to the solicitor acting for various shareholder claimants in Christchurch. We do not know if the information that group claims to have (and which it has been said will be included in and justify the issuing of proceedings) was provided to the Securities Commission. We also do not know what that information is.

The liquidators have received no further significant information from shareholder claimants to support claims that have been lodged and if that information is not forthcoming within a reasonable period of time, those claims will have to be rejected as they stand.