



Case note

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New Cap Reinsurance Holdings Limited

The long running saga involving the capital raising in 1999 by New Cap Reinsurance Holdings Limited (NCRH) in which CBP Partner, Greg Skehan has been acting for three non-executive directors, Messrs Beach, Deery & Morrissey (and their D&O insurers in the London market), finally ended in the High Court of Australia on Friday, 4 September 2009. Chief Justice French and Justices Gummow and Bell dismissed the applications for leave to appeal made by the plaintiffs (the Ingot parties) and Mr Daya from the decision of the NSW Court of Appeal of December 2008.

The six plaintiffs had invested approximately \$40M in a convertible note issue. (All the plaintiffs were associated with Mr Duncan Saville). Thirteen defendants had been sued in connection with that transaction.

Apart from the three non-executive directors for whom CBP were acting, they included Macquarie Bank Limited (and two of its subsidiaries), acting as lead manager, underwriter and broker for the issue; Mr Ghose, the chairman and chief executive of NCRH; Mr Daya, who was the managing director of NCRH; Mr Peck, a director of NCRH and partner of Phillips Fox, solicitors. He was also chairman of the Due Diligence Committee (DDC) appointed by NCRH in connection with the issue; Mr Williams, the deputy managing director of NCRH and member of the DDC; Mr Aroney, the CFO of NCRH and member of the DDC, PWC, the accountants of NCRH, Phillips Fox who had been retained by NCRH to advise in relation to the issue, and John Trowbridge Consulting Pty Ltd, who was retained as consulting actuary by NCRH. The claim against it was settled but it remained a party to a cross-claim.

McDougall J had held that the plaintiffs failed to establish liability against any of the defendants, except Mr Daya, but also that they had failed to prove their loss, based on the rule in *Potts v Miller* [1940] 64 CLR 282.

The Court of Appeal overturned this latter finding in holding that the damages should be assessed "as the difference between what they paid for their investments and the value of the investments following the failure of NCRH. Because the investments ultimately proved to be worthless, the (plaintiffs) damages are the entirety of the amounts invested, less the proceeds of any investments sold". In so holding, Ipp J said that the rule in *Potts v Miller* "will not ordinarily apply in cases where a plaintiff becomes "locked in" to property acquired as a result of contravening conduct". (That is under section 1005 of the *Corporations Law* which his Honour described as being similar to section 82(1) of the *Trade Practices Act*). In *Potts v Miller* the High Court had held that the measure of damages flowing from the acquisition of shares following upon fraudulent misrepresentation is the difference between the amount paid for the shares and the real value of the shares at the time they were received.

Mr Daya sought to challenge the Court of Appeal's decision in which he had been found liable to pay \$36M to the plaintiffs for misleading conduct of NCRH.

His application for leave to appeal the High Court expressed the opinion that it was not satisfied that there had been an error in principle by the Court of Appeal or that it had applied a wrong test.

The principal grounds of appeal by the plaintiffs against the non-executive directors and others was based upon its assertion that the trial judge had not in his judgment addressed a contention which the plaintiffs had advanced at the trial. It was said that the Court of Appeal had erred by drawing an inference that the trial judge had nevertheless consciously decided that the contention was outside the pleadings and should not be allowed on that basis. The plaintiffs alleged a contravention of section 996 of the *Corporations Law* which prohibited the issue of a prospectus containing a material statement which was false or misleading, or from which there was a material omission.

If contravention had been established the directors would have been liable pursuant to section 1006 (subject to affirmative defences).

The basis of the claim under section 996 was the repetition in the prospectus of the figure for "retrocession recoveries receivable" from the half yearly accounts. It was contended that the figure had been falsified by the "smoothing cover". The prospectus contained balance sheet figures for NCRH. It included among the assets an item for "Retrocession Recoveries Receivable" of US\$13.839M. The figure had been inflated by US\$5.675M as a result of a

transaction with General Cologne Reinsurance Group which had become known as the “smoothing cover” during the proceedings.

The non-executive directors had argued successfully at first instance that although the false increase in the retrocession recovery figure might have been material it was largely cancelled out by a simultaneous increase in NCRH’s claims provisions affected by increasing a component known as the “prudential margin”. The non-executive directors had contended that the prudential margin was only increased so as to offset the first leg of the “smoothing cover”, the true entries therefore had to be considered together, and the net effect was too small to be material in a financial sense.

Essentially the non-executive directors and others argued before the High Court with reference to the pleadings, transcripts and the judgments that both the Court of Appeal and the first instance Judge had determined that the case which the plaintiffs now wished to run before the High Court had not been pleaded.

Once again, the High Court found that it was not satisfied that the Court of Appeal had erred.

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