

BUSINESS ORGANISATIONS LAW GUIDEBOOK

SECOND EDITION

MICHAEL ADAMS AND MARINA NEHME

CHAPTER 5

PROBLEM QUESTION 1

Viva Game Ltd specialises in the creation of computer games. The company's board of directors wanted to raise capital from the public through the issue of shares because it needed the capital to market a new game developed by the company called 'Far Space'.

The company asked Josephine, a renowned expert in the gaming community, to assess 'Far Space', and Viva Game Ltd received her consent to include her statements in the prospectus. Emily stated the following:

'Far Space' is a computer game that will create a new generation of player. The game has no glitches or faults. It runs smoothly and has excellent configuration and design.

In reality, Josephine was too busy to check the game. She actually wrote her statement based on past games produced by Viva Game Ltd. A number of investors bought shares based on her statement.

When the game was launched, it was a total disaster. It was not designed properly and had a number of glitches and faults that prevented users from playing the game. The investors would like to take action against Josephine.

Advise Josephine on her civil liability.

ANSWER

This question deals with fundraising provisions of Chapter 6D of the *Corporations Act*. Section 728(1) notes that information contained in a disclosure document should not be misleading or deceptive. In this case the statement made by Josephine appears to have been misleading since the game had a number of glitches and was not properly designed.

Accordingly to s 729 an expert will be liable to compensate investors for their losses if the expert gave consent for the statement to be included in the disclosure document and the statement was misleading. Josephine agreed to her statement being included in the prospectus and it was misleading. The investors invested in the company based on her statement (as noted in the facts) and as a result they have suffered a loss.

As for defences available, s 731 (the due diligence defence) does not apply here because Josephine did not check the game. Section 732 does not apply because the disclosure document in the question is a prospectus and not an offer information statement or a profile statement. Section 733 defences do not apply here.

Josephine may have to pay compensation for investors based on s 729.

PROBLEM QUESTION 2

Fame Ltd has 2500 shareholders who hold ordinary shares. The company has been successful for quite some time. However, in 2014, it became insolvent due to risky investments conducted by the directors. Further, rumours were spreading in the market that the company was in trouble. To stop these rumours, Hadler, one of the directors of Fame Ltd, started buying shares in the company with money provided to him by Fame Ltd.

Has there a breach to the principle of capital maintenance?

ANSWER

The basic rule of maintenance of share capital is that the company does not return the capital to its members. This was laid down in the classic case of *Trevor v Whitworth* [1886–90] All ER Rep 46 and was confirmed in s 259A. However, a number of exceptions apply. One of these exceptions can occur if financial assistance is given.

Financial assistance takes place where the company indirectly lends money to an investor, who purchases shares in that same company. This seems to have occurred in this case since Hadler was given money by Fame Ltd and he used the money to buy shares in the company.

However, such financial assistance can occur if one of the requirements of s 260A has been complied with. These requirements are:

- That the assistance does not prejudice the interests of the company or its shareholders or the ability of the company to pay its creditors. That is not the case here, since the question notes that Fame Ltd is insolvent.

□ That the assistance is approved by shareholders under s 260B. In this case, the question does not note that the shareholders have passed a resolution to allow the financial assistance to take place.

□ That the assistance is exempt under s 260C. This is a broader exemption if the loan is in the ordinary course of commercial dealing, or under an approved employee share scheme (s 260C). Section 260C does not seem to apply here, since Hadler bought the shares to stop the rumours surrounding the company.

Accordingly, the financial assistance is illegal. This does not invalidate the financial assistance itself. However, the person involved in the contravention, Hadler, can be liable, both civilly and criminally under s 260D.