

# Liability for Omission in Prospectus under the Companies Act of 2007: Need for Reformation

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**Abstract**— Prospectus is a legally mandated document which reflects the status of a company which has offered securities to the public. Based on the information provided in the prospectus, the investors make their decisions as to whether or not accept the offer and purchase securities of that enterprise. As a result of this vital role played by prospectuses in inducing investors to invest in securities, it is of immense importance that the prospectus not only provide accurate information, but also do not omit any fact which is essential to make a proper decision. However, under the company law of Sri Lanka, although the liability for misstatements could be imposed on persons who are responsible for making the prospectus, there cannot be found any provisions which provide for liability for omissions. Nonetheless, with reference to other legal systems in the world such as India, the United Kingdom (UK), and the United States (USA), it can be seen that provisions relating to liability for misstatements as well as for omissions are included in their relevant legislations. Hence this can be identified as a loophole in Sri Lankan company law regime owing to which a subscriber who has suffered a loss as a result of any omission lacks an effective legal remedy to claim compensation from the party who is responsible for such an omission. Therefore, this study recommends that the existing company law of Sri Lanka should be amended in order to include provisions relating to liability for omissions as well. The author uses primary and secondary data such as Acts and Statutes, judicial decisions, and web articles to achieve the objectives of analysing the company law regime of Sri Lanka in relation to the liability for omissions in prospectuses with a comparative analysis of other jurisdictions; India, the UK and the USA.

**Keywords**— Company Law, Prospectus, Liability for Omissions, Sri Lanka

## I. INTRODUCTION

Prospectus is a form of legal document issued by a company offering securities to general public or a part thereof. As pointed out by the court in *Possfund Custodian Trustee Ltd and another v Diamond and others* [1996] 1 WLR 1351, the main purpose of issuing a prospectus is to;

”...[P]rovide the necessary information for an investor to enable him to make an informed decision as to whether or not accept the offer made by the company to take shares on the proposed allotment...(emphasis added)”.

Hence it is of paramount importance that prospectuses not only carry accurate information, but also do not omit any substantial fact about the true status of the company which has the gravity of affecting the decision of the investor to purchase securities of the company. In Company Law of many countries in the world including the United Kingdom (UK), the United States of America (USA) as well as our neighbouring country India, both of those aspects relating to the content of the prospectus are successfully addressed in their respective legislation. However, under *Companies Act No 7 of 2007*, which is the main piece of legislation governing the conduct of business enterprises in Sri Lanka, the liability for an omission of a material fact in the prospectus is not properly being addressed. Thus, it can be considered as a loophole in Sri Lankan Company Law regime which provides an unjustifiable opportunity for companies to mislead the public and make them purchase securities through concealment of important information.

The primary objective of conducting this study is to propose an amendment to the Companies Act of Sri Lanka to provide for the imposition of liability for omissions in prospectuses. In order to achieve that primary objective, several secondary objectives are set; namely, to analyse the company Law regime of Sri Lanka in relation to the omissions in Prospectuses, and, to find out the legal status for omissions in prospectuses in other jurisdictions such as the UK, the USA, and India while emphasising the importance of imposing liability for such omissions.

## II. METHODOLOGY

This study was conducted as a doctrinal legal research based on qualitative data extracted from primary and secondary sources. Existing legislation such as *Companies Act No 7 of 2007*, Sri Lanka, and other relevant legislation relating to company law in other countries were used, along with judicial decisions, as primary data to achieve the objectives of this research. Moreover, sources such as books and journal articles, both in and outside Sri

Lanka, were reviewed to gather secondary data which provide necessary information regarding the research problem.

### III. RESULTS AND DISCUSSION

The present Company Law of Sri Lanka is mainly governed by the *Companies Act No 7 of 2007* which repealed the provisions of *Companies Act No 17 of 1982*. Other than that, as discussed later in this paper, the law of England applies to commercial matters in Sri Lanka by virtue of section 3 of the *Civil Law Ordinance No 5 of 1852*.

#### A. Imposition of Liability for Omissions

##### 1) Sri Lanka:

Part IV of the *Companies Act No 7 of 2007* deals with the matters relating to the issue of prospectuses, including the imposition of civil and criminal liability for untrue statements. According to section 41 of the Act, civil liability could be imposed on a person who is responsible for issuing the prospectus, to pay compensation to any subscriber who has suffered any loss or damage by reason of any untrue statement contained in such a prospectus. Similarly, criminal liability could be imposed on a person, under section 42 of the Act, for authorising the issue of a prospectus in which an untrue statement was included. Moreover, an untrue statement is defined in section 44 of the Act, as a statement which is of misleading nature. However, as can be seen, although the *Companies Act No 7 of 2007* of Sri Lanka makes explicit reference to imposition of civil and criminal liabilities for inclusion of untrue/misleading statements in prospectuses, it does not make any clear reference to liability for omissions of material facts in a prospectus which have the potential of making an impact on a subscriber's decision as to whether or not purchase securities which are offered to the public by the company. Therefore, the company law of Sri Lanka appears to be silent with regard to the imposition of liability for omissions in prospectuses.

However, the situation is rather different in company law of other jurisdictions in the world such as India, the UK, as well as the USA where, in addition to untrue/misleading statements, the liability for omissions can also be attributed to persons who are responsible for issuing prospectuses under their respective legislation.

##### 2) India:

The law relating to issuing of prospectuses in India is mainly provided in the *Companies Act No 18 of 2013*, which repealed the provisions of *Companies Act, 1956* in a partial manner. Section 36 of the above Act reads as follows;

“Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into...any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities... shall be liable for action under section 447 (Punishment for fraud).”

Thus, it can be seen with reference to the wording of the above provision that the legislature of India has intended to extend the liability of a person who is responsible for issuing prospectuses not only to misstatements, but also for deliberate omissions.

Moreover, Section 35 of the above Act imposes civil liability for misstatements in prospectuses. Here again, the liability can be imposed not only with regard to misstatements but also for omissions in a prospectus.

Furthermore, criminal liability can also be imposed on persons who authorise the issue of a prospectus for misstatements contained thereof, as well as for omissions of material facts, under section 34 of the Act.

##### 3) The United Kingdom (UK):

The situation appears to be the same in the UK as well. There, the matters relating to the content of prospectuses are regulated by *Financial Services and Markets Act 2000 c.8ff*. Under sections 80 and 81 of the Act, it imposes a general duty of disclosure of all such information that investors and their professional advisers would reasonably require in making an informed decision regarding purchasing securities of a company. It is further provided under section 90 of the Act that if any such information as required by sections 80 and 81 is omitted, any responsible person is liable to pay compensation to a person who has suffered any loss owing to such an omission in the prospectus.

Moreover, the duty to disclose every fact without any omission was also identified in number of common law cases. For example, in *New Brunswick and Canada Railway and Land Co v Muggeridge* [1850] 62 ER 263, it was observed by the court that;

“...[p]ersons who make prospectuses are not only bound to state everything with strict and scrupulous accuracy but also not to omit any fact within their knowledge, the existence of which might affect the nature of privileges and advantages which the prospectus holds out as inducement to take shares...(emphasis added)”.

Furthermore, in *Central railway Co of Venezuela v Kisch* [1865] 46 ER 584, Lord Chelmsford held that “...no

concealment of any material fact ought to be permitted...".

A question that does deserve attention is that whether the provisions of the *Financial Services and Markets Act 2000* of the UK regarding the liability for omissions in prospectuses apply to Sri Lanka through the gateway of section 3 of the *Civil Law Ordinance 1852* which states that the law of England should be observed in all commercial matters. In decided cases such as *Duhilanomal and Others v Mahakande Housing Co. Ltd* [1982] 2 SLR 504, *Lily M. de Costa v Bank of Ceylon* [1969] 72 NLR 457, and *Amarasekere v Mitsui and Company Ltd. and Others* [1993] 1 Sri LR 22, it was held by the courts that the law of England, including statutory law applied to Sri Lanka with regard to commercial matters, in the absence of any enactment in Sri Lanka governing the same aspect. However, due to the fact that the present regime of company law of Sri Lanka operates under such an enactment (i.e. *Companies Act No 7 of 2007*), the importation of provisions of *Financial Services and Markets Act 2000*, UK to supplement the provisions of a well-established Act in Sri Lanka is highly debatable.

#### 4) *The United States of America (USA):*

The main piece of legislation which deals with the requirements of issuing prospectuses in the USA is the *Securities Act of 1933*, under section 11 of which a general obligation is imposed on persons who are responsible for issuing a prospectus to ensure that it does not only carry any untrue statement, but also does not omit any material fact which is required to make an informed decision, while giving an expressed right to any buyer who has suffered any loss due to such an untrue statement or omission to bring a legal action against any responsible person.

Moreover, section 12 of the Act provides for the imposition of civil liability for untrue statements as well as for omissions of material facts on any person who offers or sells a security.

In addition, Rule 10b of the Securities and Exchange Commission, USA imposes a general obligation on every person not to use any deceptive and manipulative devices in connection with the sale or purchase of any security. In particular, it makes it unlawful under part (b) to omit any material fact which is necessary to make the statement made, not misleading. This rule was given judicial recognition in cases such as; *Chiarella v. United States*, 445 U.S. 222 (1980), *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and *United States v. O'Hagan*, 521 U.S. 642 (1997).

Thus, it is evident that, by referring to aforementioned legislations, unlike in company law of Sri Lanka, which is

mainly operated under the *Companies Act No 7 of 2007*, in India, the UK, and the USA, the statutory law explicitly provides for the imposition of liability on persons responsible for making prospectuses, not only for untrue/misleading statements, but also for omissions of material facts, which are necessary for the proper decision making.

#### IV. CONCLUSION AND RECOMMENDATIONS

A prospectus is a document required by law to be issued along with an issue of securities of a company to enable the investors to make an informed decision as to whether or not make a subscription. Due to the fact that an investor relies on the information provided in the prospectus to a large extent in making his/her decision in purchasing securities so offered, the information provided in the prospectus should, not only be accurate but also be sufficient. Thus, it is vital that the law of prospectus explicitly provides an effective remedy for subscribers who have purchased securities not only based on untrue/misleading information, but also unknowing the true facts of the company which were omitted in the prospectus and consequently suffered a loss/damage.

It appears that the *Companies Act No 7 2007* which is the main piece of legislation governing the commercial matters of Sri Lanka, imposes liability on persons responsible for issuing prospectuses only for untrue/misleading statements contained thereof. Hence, the liability for omissions of material facts appears to be left unregulated.

However, in countries such as India, the UK, and the USA, liability for both misleading/untrue statements as well as for omissions of material facts can successfully be imposed under their respective legislations.

Although it is arguable that, as discussed above, by virtue of section 3 of the *Civil Law Ordinance 1852*, the law of England relating to the imposition of liability for omissions could be imported to supplement the company law of Sri Lanka, a legal system requires a precise set of rules of its own to operate effectively.

Therefore, this study recommends that an amendment to the *Companies Act No 7 of 2007* should be made in order to include provisions relating to the liability for omissions of material facts in prospectuses to protect subscribers from any loss/damage by allowing them to make an informed decision after being aware of all the necessary information regarding the true status of the company, in which they are about to invest.

By considering all the above analysed jurisdictions (i.e. India, the UK, and the USA), this study suggests that the *Companies Act No 18 of 2013* of India shall be taken as a model in achieving the object of amending the *Companies Act No 7 of 2007* of Sri Lanka as the Indian

Companies Act appears to contain similar provisions as in the Sri Lankan Companies Act with regard to matters relating to prospectuses. Moreover, unlike in other jurisdictions where matters relating to issuing of securities and matters relating to conduct of business enterprises are mainly governed by different legislations, both in India and Sri Lanka both of those aspects are mainly governed under a single piece of legislation which is the Companies Act.

Thus, this study recommends that the sections 41 and 42 of the *Companies Act No 7 of 2007* of Sri Lanka should be amended in accordance with the sections 35 and 34 of the *Companies Act No 18 of 2013* of India to impose civil and criminal liability for omissions of material facts in addition to misstatements in prospectuses on persons who are responsible for issuing the prospectus, namely; directors of the company, promoters of the company, as well as any other person who has authorised such an issue, in the already prescribed manner similar to misstatements to make them liable to pay compensation to the aggrieved party in relation to the civil liability; and, with regard to criminal liability, to make any person who has authorised the issue of the prospectus, be guilty of an offence punishable by a conviction to a fine not exceeding five hundred thousand rupees or to an imprisonment for a term not exceeding two years, or to both, as decided by a competent authority, similar to that of the criminal liability for misstatements.

Companies Act No 17 of 1982, Directorate of Printing at Government of India Press, Delhi

Companies Act No 7 of 2007, Department of Government Printing, Sri Lanka

Companies Act No 18 of 2013, Directorate of Printing at Government of India Press, Delhi

Financial Services and Markets Act 2000 c.8ff, The Stationery Office Limited, UK

Securities Act 1933, USA



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