The Corporations Law leaves no room for complacency in those involved in the preparation of prospectuses.

Gai McGrath focuses on the due diligence committee and its importance to underwriters.

Since the start in January 1991 of the new prospectus regime under the Corporations Law it has become common for participants in a public offer to use the due diligence committee process to protect their own interests. Specifically, the process can ensure that the statutory defences under the Corporations Law will be available should they face civil action as a result of the omission of material matter from the prospectus or the inclusion of a material statement that is false or misleading.

It is generally agreed that the due diligence committee process assists in limiting the time and cost burdens which would arise if each person with potential liability in relation to the prospectus were to undertake a separate due diligence exercise.

This article considers the position of the underwriter in relation to the due diligence committee. It reviews the underwriter's role on the committee and the legal relationship which the underwriter should have with those people who are reporting to the committee to ensure that the statutory defences in Section 1011 of the Corporations Law will be available should the underwriter face civil action in relation to the prospectus.

The due diligence committee

It is common practice for the due diligence committee to be composed of one or more representatives of each person who is potentially liable in respect of the prospectus. A typical due diligence committee will have as members:
- directors and other executives of the corporation offering the shares;
- representatives of the underwriter;
- representatives of the auditors or independent investigating accountants, or both;
- representatives of the solicitors to the issue;
- representatives of the solicitors to the underwriter.

In addition, there may be people such as experts who report to the committee but are not members of it. A general distinction is drawn between being represented on the due diligence committee and merely reporting to it.

A person represented on the committee will be represented primarily to ensure that the due diligence or reasonable inquiries defences under the Corporations Law will be available.

As a member of the committee, that person will have the benefit of the final due diligence report and will be able to rely on the due diligence process if subsequently required to argue that:
- reasonable precautions were taken and due diligence exercised to ensure that all statements to be included in the prospectus were true and not misleading;

Gai McGrath is a senior associate with the solicitors Rosenblum and Partners.
there were no material omissions from the prospectus.

As a general matter, the people who report to the committee do so by reason of their professional relationship with the corporation; members of the committee can therefore rely on the expertise of those people in carrying out inquiries on behalf of the committee. There will be some instances where a party is both a member of the committee and a person reporting to the committee. For example, the solicitors to the issue will usually conduct the legal due diligence and prepare a report on this to the committee; those solicitors will invariably also have a representative on the committee.

**Should the underwriter report?**

The question of whether the underwriter reports to the committee will be a matter for negotiation between the various parties.

Much will depend on whether the investigating accountants have the expertise to examine and report on matters such as the company’s place in the market in which it operates, the risk factors relevant to the company’s position in that market, profit forecasting, etc. If the investigating accountants do have this expertise, it is advisable for an underwriter to be a member of the committee and to confine itself to a report for s.1022 purposes (see below).

However, the underwriter may (and probably will) decide to conduct its own investigation of the corporation if for no other reason than to decide whether to commit itself to the underwriting. The underwriter should be aware that these investigations will be relevant to the underwriter’s report for s.1022 purposes.

Accordingly, if any matter material to the prospectus is revealed by the underwriter’s own investigations, the underwriter should bring this to the committee’s attention by way of the report for s.1022 purposes.

Whether or not the underwriter reports to the committee, it will not be entitled to adopt a passive role. The underwriter cannot merely rely on the advice of the reporting members of the committee. The reliance must be reasonable. The underwriter, in common with other members of the committee seeking to put themselves in a position to rely on a due diligence defence if the need arises, is responsible for the supervision of the due diligence process.

In many cases, the underwriter will

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be required to question and challenge the methodology and reports of those people who are reporting to the committee. This will be especially important in the areas in which the underwriter has particular expertise.

The underwriter may be the only true "outsider" on the committee, as the other members will often have existing commercial or business relationships with the issuer/offeror. If this is the case, the underwriter should be wary of merely accepting the assurances of the other members and should adopt an adversarial approach, questioning their methodology and reports.

If the underwriter reports to the committee in any wider capacity, it will probably assume a greater level of liability to the other members of the committee. In particular, the members of the committee will be looking for representations from the underwriter on the scope and detail of its investigations. This will assist the members of the committee to determine whether the investigations carried out on their behalf can be considered reasonable for the purposes of the defences under the Corporations Law.

**Section 1022 reports**

There is at least one situation where each of the members of the due diligence committee should be required to report to the committee. This relates to the general content requirement for prospectuses set out in s.1022 of the Corporations Law.

Section 1022(1) requires that the prospectus should contain all information as investors and their professional advisers would reasonably require, and reasonably expect to find in the prospectus, for the purpose of making an informed assessment of: the assets and liabilities, financial position, profits and losses, and prospects of the corporation; the rights attaching to the securities.

Each member of the committee should be required to provide a report to the committee stating that it knows of no information that has not been included in the prospectus but should be included to satisfy the test in s.1022(1).

Each report should go on to state what inquiries, in addition to the due diligence inquiries, have been conducted. The purpose of these reports is to satisfy the requirement in s.1022(2) that the information to be included under s.1022(1) is information known to persons including, among others, the directors of the corporation, the underwriter, the so-
As the Corporations Law extends civil liability to an underwriter where the prospectus does not comply with the law, the underwriter should be looking to off-load some of this risk.

DUE GUIDANCE: The Securities Institute has compiled a Due Diligence Guide which explains the concept of due diligence and suggests a check list for those involved in preparing prospectuses. The guide is available from SIA divisional offices for $30 a copy.