IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2021-404-2009
[2022] NZHC 1529

UNDER	section 532 of the Financial Markets Conduct Act 2013
IN THE MATTER	of an appeal against a decision of the Financial Markets Authority to issue a Direction Order
BETWEEN	DU VAL CAPITAL PARTNERS LIMITED First Appellant
	DU VAL GROUP NZ LIMITED Second Appellant
AND	FINANCIAL MARKETS AUTHORITY Respondent

Hearing: 31 March 2022

Appearances: D M Salmon QC and A E Murray for the Appellants
J S Cooper QC and K M Moon for the Respondent

Judgment: 30 June 2022

JUDGMENT OF GAULT J

This judgment was delivered by me on 30 June 2022 at 2:30 pm pursuant to r 11.5 of the High Court Rules 2016.

Registrar/Deputy Registrar

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Solicitors / Counsel:
Mr D M Salmon QC, Barrister, Auckland
Ms A E Murray and Mr M Bell (appellants' instructing solicitors), DLP Piper, Auckland
Ms J S Cooper QC, Barrister, Auckland
Ms K M Moon, Financial Markets Authority, Auckland

[1] The appellants (Du Val) appeal against a direction order of the Financial Markets Authority (FMA) dated 4 October 2021 in relation to Du Val's promotion of the Du Val Mortgage Fund Limited Partnership (Mortgage Fund).[1]

[2] Du Val's appeal is on questions of law only.

Factual background

[3] Du Val conducts business as a real estate development, investment and asset management group.

[4] The Mortgage Fund is a financial product offering investment by way of redeemable units in a limited partnership.

[5] In 2020/2021, the Mortgage Fund sought NZ$100,000,000 to fund the acquisition and development of Du Val projects by way of secured lending. Investors became unit holders in the Mortgage Fund, entitled to receive a fixed rate of return of 10 per cent per annum (calculated monthly but not compounding).

[6] The Mortgage Fund was open for investment by those investors who certified that they met the definition of "wholesale investor" in Schedule 1 of the Financial Markets Conduct Act 2013 (FMCA).[2] Du Val did not provide a product disclosure statement as would otherwise be required for a regulated offer, relying on the exclusion from the standard disclosure requirements for offers to wholesale investors. Instead, Du Val issued a Private Placement Information Memorandum (Information Memorandum) for the Mortgage Fund.

[7] Du Val promoted the Mortgage Fund through various channels including news websites and social media.

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1 NZBN 9429048486385.

2 Clauses 3(2) and (3), the latter including an "eligible investor" within the definition of "wholesale investor". The Mortgage Fund was also open for investment by certain Singapore and Hong Kong investors, but nothing turns on that. The earlier version of the Mortgage Fund was also open to "Small Offers", advertising for which is not permitted. When the FMA raised this, Du Val indicated it would no longer offer interests under the small offer exclusion and was offering to repay relevant investors.

[8] In correspondence with the FMA in early 2021, Du Val agreed to remove references to "high security" and comparisons with bank term deposits. However, Du Val's advertising continued to refer to "high security", "mortgage-backed security" and similar descriptions. Du Val also represented that there were no fees.

FMA's direction order

[9] The FMA considered that Du Val's promotion of the Mortgage Fund contravened the fair dealing provisions of the FMCA.[3] From late 2020, the FMA corresponded with Du Val and received submissions.

[10] On 4 October 2021, the FMA made a direction order under s 468 of the FMCA (direction order) stating that it considered Du Val's promotional material was likely to mislead or deceive potential investors in breach of s 19 of the FMCA because it included representations that:

> i. the risk associated with the investment was low when the risk associated with early stage finance for a property development project (as outlined in the Information Memorandum) is not low; and
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> ii. there were no fees associated with the investment when the General Partner was entitled to 100% of the profit after investors were paid.

[11] In a section headed "Reasons for the direction order", the FMA further explained why it considered the representations in relation to risk and the lack of any fees were likely to mislead or deceive. To the extent necessary for this appeal on questions of law, I address these further below.

[12] The FMA also stated that it considered the direction order was appropriate because (among other things) the marketing channels used by Du Val do not target experienced investors but appear to target inexperienced investors by using social media and other online channels.

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[3] The FMA says the direction order also applies to promotional material by Du Val for its Build to Rent Fund Limited Partnership and any other financial products relating to property developments, but nothing turns on this.

[13] Finally, in a section headed "Other information", the FMA said it considered it relevant to address certain submissions made on behalf of Du Val against the issue of the direction order, stating:

> 7. It was submitted that information made available to potential investors (on request) in the Information Memorandum meant that investors would not be misled by the advertisements containing the representations. We do not accept this submission. At law, a misleading advertisement cannot be cured by subsequent information. The NZ Court of Appeal (*Godfrey Hirst NZ Limited v Cavalier Bremworth Limited CA564/2013 [2014] NZCA 418 [27 August 2014]*) has confirmed the relevant question is "whether the advertisement viewed as a whole has a tendency to entice consumers into "the marketing web" by an erroneous belief engendered by the advertiser, even if the consumer may come to appreciate the true position before the transaction is concluded." In this case, we consider Du Val enticed potential investors into its 'marketing web' by making misleading representations on its website, in an online video and through social media.
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> 8. It was submitted that because the Mortgage Fund LP offer is only open to "wholesale investors" (as defined in the FMC Act) the level of seriousness of conduct and public interest in enforcement action are low. In support of this, it was further submitted that wholesale investors are inherently more sophisticated than others. We do not agree with either of these submissions. We consider the misleading representations are sufficiently serious in nature to support publication of the Direction Order and generate public interest. We also consider some "large investors" (as specified in clause 39 of Schedule 1 of the FMC Act) who fall within the scope of a "wholesale investor" are not inherently sophisticated (which we take to mean knowledgeable about particular investment products and the risks associated with them). Further, we consider that Du Val's widespread promotion of interests in the Mortgage Fund LP, particularly through social media, demonstrates that an inexperienced audience are exposed to representations made by Du Val and enticed into its marketing web.
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> 9. In respect of the representations relating to the absence of any fees, Du Val submitted that they were factually true, that the Information Memorandum makes it clear the General Partner retains all profit above the 10% return to investors, that such a profit share arrangement is not a fee in the way a 'fee' is ordinarily understood, and that given the offer is only open to wholesale investors, no investor would be under the impression that profit in excess of the 10% return to investors would not be retained by Du Val. We take a broad interpretation of the term "fee" and consider that it includes any means of payment to the General Partner by the fund. Accordingly, if Du Val is to make representations about the absence of fees, it needs to be upfront and transparent about other means by which it can generate revenue from the Mortgage Fund LP. As stated above, the Information Memorandum cannot cure a misleading advertisement.

[14] The direction order required Du Val to comply with s 19 of the FMCA and, in order to do so, to:

a. cease and desist from publishing or otherwise using, directly or indirectly, the DVCP Video,[4] and to take all practicable steps to remove the DVCP Video from all medium, including all websites and social media accounts owned or controlled by Du Val;

b. ensure that any publication promoting the Mortgage Fund LP (including any website or social media content) does not include any of the following phrases (or anything similar):

   i. mortgage-backed security;

   ii. providing investors with a level of certainty hard to come by in this market;

   iii. investors' security is registered by way of a mortgage over real assets;

   iv. investment is secured by registered mortgage;

   v. mortgage-backed security in land and bricks & mortar investment;

   vi. seeking both income and capital security on a capital investment;

   vii. high security and high return;

   viii. the best of both worlds in terms of security and return; and

   ix. the highest-ranking security that is available on behalf of investors.

c. In respect of the Mortgage Fund LP, either,

   i. ensure that any promotional material (including any website or social media content) does not include any of the following phrases (or anything similar):

      A. we do not charge fees;

      B. no management or performance fees; and

      C. no administration fees;

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[4] The DVCP Video was defined in the direction order to mean the video used by Du Val to promote investment in funds entitled “Du Val Partners: Meet Chris Paltridge”.

or

ii. include the following statement prominently and proximate to any of the representations in i. above (or anything similar) in any promotional material (including any website or social media content):

We retain any profit in excess of the 10% p.a. return to investors.

d. ensure all current and future promotional material (in whatever form) in connection with financial products relating to property development projects by Du Val or an entity within Du Val's control do not include any references or comparisons to term deposits, bank deposits or other low risk financial products; and

e. report in writing (including by email) to the FMA's Director of Capital Markets:

i. within 10 working days of the date of the Direction Order confirming (a) - (c) above have been fully complied with; and

ii. within 20 working days of the date of the Direction Order confirming how it has reviewed compliance processes around all promotional material and other marketing initiatives to ensure compliance with (d) above.

Approach on appeal

[15] The direction order of the FMA is a decision under s 468 in subpart 1 (FMA's enforcement powers) of Part 8 of the FMCA. Section 532(g) of the FMCA provides that an aggrieved person who considers that such a decision is wrong in law may appeal to the court against the decision on a question of law only. I was told by counsel this is the first appeal against a direction order made by the FMA under s 468.

[16] On appeals limited to questions of law, the role of the courts of general jurisdiction "is confined to correction of legal error"; "an appellate court whose jurisdiction is limited to matters of law is not authorised under that guise to make factual findings".[5]

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5 *Estate Homes Ltd v Waitakere City Council* [2006] 2 NZLR 619 (CA) at [198] (overturned on appeal on other grounds, see *Waitakere City Council v Estate Homes Ltd* [2006] NZSC 112, [2007] 2 NZLR 149).

[17] This was emphasised by the Supreme Court in *Bryson v Three Foot Six Ltd* in the employment context where there is a similarly limited appellate jurisdiction.[6] The Court stated:

> [25] An appeal cannot however be said to be on a question of law where the fact-finding court has merely applied law which it has correctly understood to the facts of an individual case. It is for the court to weigh the relevant facts in the light of the applicable law. Provided that the court has not overlooked any relevant matter or taken account of some matter which is irrelevant to the proper application of the law, the conclusion is a matter for the fact-finding court, unless it is clearly insupportable.
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> [26] An ultimate conclusion of a fact-finding body can sometimes be so insupportable – so clearly untenable – as to amount to an error of law; proper application of the law requires a different answer. That will be the position only in the rare case in which there has been, in the well-known words of Lord Radcliffe in *Edwards v Bairstow*, a state of affairs "in which there is no evidence to support the determination" or "one in which the evidence is inconsistent with and contradictory of the determination" or "one in which the true and only reasonable conclusion contradicts the determination".[7] Lord Radcliffe preferred the last of these three phrases but he said that each propounded the same test…

[18] That appeals from direction orders made by the FMA under s 468 are limited to questions of law no doubt reflects, as Ms Cooper QC for the FMA submitted, that direction orders are at the lower end of the enforcement spectrum and are intended to be a flexible and efficient enforcement tool, and that the FMA is an independent, specialist, regulatory body. The Court of Appeal and this Court have recognised the latter aspect in the context of general appeals against the deregistration of financial service providers.[8] Such respect for decisions of the FMA has even more relevance in the context of appeals limited to questions of law. But its decisions are susceptible to appellate review on orthodox error of law grounds as outlined.

[19] The error of law must also be material to the decision under appeal.[9]

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6 *Bryson v Three Foot Six Ltd* [2005] NZSC 34, [2005] 3 NZLR 721.

7 *Edwards v Bairstow* [1956] AC 14 (HL) at 36. Lord Radcliffe was adopting dicta of the Lord President (Normand) in *Inland Revenue v Fraser* [1942] SC 493 at 497 and Lord Cooper in *Inland Revenue Commissioners v Toll Property Co Ltd* [1952] SC 387 at 393.

8 Under s 42 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008; *Financial Markets Authority v Vivier and Company Ltd* [2016] 3 NZLR 70 (CA) at [60], approving *Excelsior Markets Ltd v Financial Markets Authority* [2015] NZHC 3334 at [124] and [126]; see also *Innovative Securities Ltd v Financial Markets Authority* [2017] NZHC 1187 at [78]-[79].

9 *Manos v Waitakere City Council* [1996] NZRMA 145 (CA) at 148.

Questions of law

[20] The questions of law in Du Val's notice of appeal dated 18 October 2021 are:

(a) What is the correct legal test that should be applied to determine whether material is likely to mislead and deceive? In the case of a fund that is only open to wholesale or eligible investors, should the legal test be whether an average wholesale or eligible investor is likely to be misled or deceived and is that a higher standard than an ordinary reasonable person?

(b) Has the FMA applied the appropriate legal test in determining that Du Val's promotional material has, or is likely to, mislead and deceive?

(c) Is retained profit properly characterised as a 'fee'?

Grounds of appeal

[21] Consistent with these questions of law, Du Val says the direction order was wrong in law because the FMA:

(a) did not correctly apply the relevant legal principles established by the Court in *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd*[10] and, in particular:

(i) failed to correctly identify the relevant class of 'consumers'. Du Val says that the FMA should have limited the relevant class of consumers to 'wholesale investors' as defined in the FMCA;

(ii) applied an inappropriately low standard by not accepting that wholesale investors are inherently more sophisticated than non-wholesale investors (for example, retail investors) and are considered to be capable of evaluating the merits of an offer or accessing necessary information; and

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10 *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd* [2014] 3 NZLR 611 (CA).

(b) incorrectly determined that the General Partner's right to retain profits made by the Mortgage Fund exceeding the 10 per cent fixed rate of return to investors amounted to a "performance-based fee".

[22] By way of relief, Du Val seeks to have the direction order set aside.

Correct legal test

[23] The main purposes of the FMCA are to promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and promote and facilitate the development of fair, efficient, and transparent financial markets.[11]

[24] The FMCA's fair dealing provisions in Part 2 include s 19(1), which provides:

> **19 Misleading or deceptive conduct generally**
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> (1) A person must not, in trade, engage in conduct that is misleading or deceptive or likely to mislead or deceive in relation to—
>
> (a) any dealing in financial products; or
>
> (b) the supply or possible supply of a financial service or the promotion by any means of the supply or use of financial services.

[25] The FMA may make a direction order if it is satisfied that, by engaging in any conduct, a person has contravened, or is likely to contravene, relevantly, a Part 2 fair dealing provision.[12] Failure to comply with a direction order may result in civil and criminal liability.[13]

[26] Section 19(1) of the FMCA is clearly analogous to s 9 of the Fair Trading Act 1986. It is common ground that units in the Mortgage Fund are a financial product[14] and that in order to determine whether Du Val's promotional material was likely to mislead or deceive in breach of s 19 of the FMCA, the correct test to apply is that set

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11 Section 3.
12 Section 468(1)(a).
13 Section 479.
14 It is unnecessary for the purposes of this proceeding to determine whether the investment units are an "equity security" (as Du Val described them in the Information Memorandum), a "debt security" or a "managed investment scheme" (as the FMA considers).

out in the Court of Appeal's judgment in *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd* (*Godfrey Hirst*).[15] That case was a focus here because this dispute largely relates to the relevant class of 'consumers' (albeit s 19 does not use that term).

[27] Before dealing with that issue, I record that it is also common ground, as the Supreme Court said in *Red Eagle Corporation Ltd v Ellis*, that whether representations are likely to mislead or deceive in the particular circumstances is to be examined objectively, with the context including the characteristics of the person or persons said to be affected.[16] This involves questions of fact.

[28] In *Godfrey Hirst*, the Court of Appeal addressed the correct approach by asking two questions before assessing the trial Judge's conclusions: first, who is the consumer and secondly, what standard of care is to be expected of the consumer?

[29] In relation to who is the consumer, the Court said:

> [20] … Where, as in this case, headlines and qualifiers in advertising target a large group of consumers, "the consumer" comprises all the consumers in the class targeted except the outliers. The "outliers" encompass consumers who are unusually stupid or ill equipped, or those whose reactions are extreme or fanciful. We expand on this in [47]–[50] below. …

[30] After considering a number of other authorities, the Court said:

> [50] We reiterate our response to the question "who is the consumer?". "The consumer" encompasses all the consumers in the class targeted by the allegedly misleading representations, except the outliers as we have explained them in [20] above. Or, if the representations are made to the public at large, it is all the public except the outliers.

[31] Mr Salmon QC submitted, and Ms Cooper QC appeared to accept, that this last sentence is to be understood in context. When stating "if the representations are *made* to the public at large" (my emphasis), the Court was referring to the situation where representations target the public at large, rather than necessarily extending the target wherever representations are available to the public. That is evident from the Court's analysis between the two summaries quoted above. In particular, it is most evident from the Court's consideration of the Australian cases of *Parkdale Custom Built*

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15 *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd* [2014] 3 NZLR 611 (CA).
16 *Red Eagle Corporation Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [28].

Furniture Pty Ltd v Puxu Pty Ltd and *Taco Company of Australia Inc v Taco Bell Pty Ltd*, which refer to "consumers likely to be "affected by" the conduct",[17] "anyone interested in purchasing",[18] and the relevant section(s) of the public "affected by" the allegedly misleading or deceptive conduct;[19] and the New Zealand Court of Appeal case of *Unilever New Zealand Ltd v Cerebos Gregg's Ltd*, which refers to "a significant section of the relevant purchasing public".[20]

[32] Having referred to the cases, the Court of Appeal in *Godfrey Hirst* said:[21]

> We see no real divergence in the way all these cases have answered the question "who is the consumer?". All the formulations seem to us to encompass most of the public, where the representation is made to the public at large, or most of the consumers in any class specifically targeted.

[33] Reading these passages as a whole, I therefore agree that the correct approach when determining whether Du Val's promotional material was likely to mislead or deceive in breach of s 19 of the FMCA is to identify to whom the representations are targeted, whether to the public at large or to a class specifically targeted,[22] and in either case to exclude outliers.

[34] In relation to the standard of care expected of the 'consumer', in *Godfrey Hirst* the Court of Appeal said:

> [51] ... Consumers must exercise a degree of care which is reasonable having regard to all the circumstances including the characteristics of the target group of consumers. By "characteristics" we refer to the consumers' level of knowledge, acumen, ability and the like.

[35] Again, outliers must be disregarded in determining the standard of care expected of the consumer.[23]

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17 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 199 per Gibbs CJ.
18 At 209 per Mason J.
19 *Taco Company of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177 (FCAFC) at 202.
20 *Unilever New Zealand Ltd v Cerebos Gregg's Ltd* (1994) 6 TCLR 187 (CA) at 193.
21 *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd* [2014] 3 NZLR 611 (CA) at [43].
22 I leave aside instances of representations made to individuals.
23 *Godfrey Hirst* at [53].

[36] The Court of Appeal also set out the principles that should guide a court in considering whether headline representations are misleading or deceptive or likely to mislead or deceive:[24]

(a) *Overall impression*: it is the "dominant message" or "general thrust" of the advertisement that is of crucial importance.

(b) *Wrong only to analyse separate effect of each representation*: as a corollary from (a), when assessing the mental impression on consumers created by a number of representations in a single advertisement, it is insufficient only to analyse the separate effect of each representation. The overall impression cannot be assessed by analysing each separate representation in isolation.

(c) *Qualifying information sufficiently prominent?*: whether headline representations are misleading or deceptive depends on whether the qualifications to them have been sufficiently drawn to the attention of targeted consumers. This includes consideration of:

(i) the proximity of the qualifying information;

(ii) the prominence of the qualifying information; and

(iii) whether the qualifying information is sufficiently instructive to nullify the risk that the headline claim might mislead or deceive.

(d) *Glaring disparity*: where the disparity between the headline representation and the information qualifying it is great, it is necessary for the maker of the statement to draw the consumer's attention to the true position in the clearest possible way.

(e) *Tendency to lure consumers into error*: applying principles (a) to (d), the question for the court is whether the advertisement viewed as a whole has a tendency to entice consumers into "the marketing web" by an erroneous belief engendered by the advertiser, even if the consumer may come to appreciate the true position before a transaction is concluded. Enticing consumers into "the marketing web" includes, for example, attracting them into premises selling the advertiser's product. Once a prospective customer has entered, he or she will often be more likely to buy. The misleading advertising would then have contributed to any sale. It must follow that rival traders would also have been prejudiced, although protecting them is not the aim of ss 9 and 13. That consumers could be expected to understand fully the limitations of the warranties by the time they actually purchased a carpet is no answer to the question whether the advertisement was misleading.

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[24] *Godfrey Hirst NZ Ltd v Cavalier Bremworth Ltd* [2014] 3 NZLR 611 (CA) at [59] (footnotes omitted).

[37] This sequencing in *Godfrey Hirst* does not suggest that the identification of the relevant class targeted, assessment of the characteristics of its members and considering whether the representations are misleading or deceptive occur in isolation. The purpose of identifying the class targeted is to identify the characteristics of the members of that class in order to assess whether the representations made are likely to mislead or deceive.

[38] Although these legal principles were agreed, Mr Salmon characterised the correct legal test to be applied as whether a reasonable wholesale investor would be misled by the representations, whereas Ms Cooper characterised the difference between the parties concerning the audience targeted as one of application, which she submitted is an issue of fact that cannot be challenged on appeal.

[39] Determining whether the class targeted was wholesale investors or the public at large (including both retail and wholesale investors) is at least in part a question of fact. However, just as the Court cannot under the guise of matters of law make factual findings, nor can an error of law be avoided merely because there are factual findings. I will address this in relation to the application of the legal principles next.

Application of the correct legal test

Target of the representations

[40] As indicated, the correct approach is to identify to whom the representations were made, whether to the public at large or to a class specifically targeted, and in either case exclude outliers. This involves a factual assessment, to be determined objectively rather than according to the representor's subjective view.

[41] Mr Salmon submitted that the class targeted is made up of wholesale investors who can take up the investment in the Mortgage Fund, rather than everyone who might see the advertising. He submitted the FMA erred in law by collapsing that distinction and failing to identify the relevant class of 'consumers' or potential investors.

[42] Ms Cooper, as well as submitting that the FMA's application of the test was an issue of fact that cannot be challenged on appeal, submitted the FMA found that the

audience to which Du Val's advertisements were directed was the public at large, including both retail and wholesale investors, but she also accepted that the direction order identified "potential investors" as the relevant class.

[43] Dealing first with whether the FMA did identify to whom the representations were made (targeted), the relevant reasons for the direction order referred to "potential investors". This may imply investors who can take up the investment; that is, wholesale investors. However, the reasons also included two statements about inexperienced investors that suggest otherwise. First, the FMA said:

> the marketing channels used by Du Val do not target experienced investors but appear to target inexperienced investors by using social media and other online channels.

[44] While this statement was made in the section of the FMA's reasons addressing why the direction order was appropriate, it indicates the FMA considered the representations targeted inexperienced investors without distinguishing between retail and wholesale investors. Even so, it is not a specific finding that Du Val targeted the public at large.

[45] The FMA's reasoning is also indicated by its second statement about inexperienced investors, when it addressed Du Val's arguments regarding wholesale investors. The FMA said:

> … we consider that Du Val's widespread promotion of interests in the Mortgage Fund LP, particularly through social media, demonstrates that an inexperienced audience are exposed to representations made by Du Val and enticed into its marketing web.

[46] This is a finding that an inexperienced audience was exposed to the representations, rather than a specific finding that it was targeted. Nor is it a specific finding that Du Val targeted the public at large. The FMA's reference to the "marketing web" followed its earlier consideration of this concept addressed by the Court of Appeal in *Godfrey Hirst* (quoted at [36](e) above) as one of the principles that should guide a decision-maker considering whether headline representations are misleading or deceptive or likely to mislead or deceive.

[47] Du Val does not dispute that its advertising was available to persons other than wholesale investors, and in any event the FMA's factual findings as to how and where the representations were published is not open to challenge on this appeal. But as Mr Salmon submitted, only wholesale investors could take up the investment in the Mortgage Fund. He submitted that the "marketing web" refers to a form of bait and switch advertising that draws consumers towards another product. Here, he submitted, there is no marketing web – no other product to which the advertising draws consumers/retail investors.

[48] Ms Cooper submitted that the FMA's phrase "enticed into its marketing web" has a broader meaning, as described in *Godfrey Hirst* and in the preceding paragraph of the direction order set out at [13] above; that is, enticing a consumer into an erroneous belief even if the consumer may come to appreciate the true position before the transaction is concluded. On that basis, she submitted, Du Val's widespread promotion of interests in the Mortgage Fund, particularly through social media, demonstrates that an inexperienced audience was exposed to representations made by Du Val and enticed into an erroneous belief.

[49] The Court of Appeal's reference in *Godfrey Hirst* to enticing consumers into the "marketing web" – under the principle headed "tendency to lure consumers into error" – is not limited to bait and switch advertising that draws consumers towards another product. The Court gave the example of attracting customers into premises selling the advertiser's product at which point they will often be more likely to buy. The misleading advertising would then have contributed to any sale. In that sense, it is a causation point and an answer to headline advertising that draws customers in even though they may come to appreciate the true position (such as warranty limitations) before a transaction is concluded.

[50] As the FMA considered, the "marketing web" concept was relevant to Du Val's argument that potential investors would not be misled because they would receive the Information Memorandum before investing. But as indicated, the "marketing web" concept is to guide decision-makers considering whether headline representations are misleading or deceptive. It addresses the tendency to lure into error in a causation sense despite subsequent correction or disclosure. The Court of Appeal did not suggest

it is relevant to, let alone determines, the prior question of identifying the relevant 'consumer'. Identifying to whom the representations are targeted is a factual question to be determined having regard to the nature of the representations and how and where they are published. For example, the nature of Du Val's bank term deposit comparisons and its broad marketing – including on social media – are relevant to that determination.

[51] In this case, unlike *Godfrey Hirst*, it is also relevant to the prior question that only wholesale investors could make an investment. Investors in the Mortgage Fund were limited to those who certified that they were wholesale investors. Even if the representations entice potential investors to request the Information Memorandum, at which point they will often be more likely to invest, they will only qualify to invest if they certify that they are wholesale investors. In that respect, the position differs from that of representations to consumers where there is no qualification requirement. The misleading advertising would not contribute to a sale to a consumer who does not qualify. I acknowledge that potential investors might be incentivised to complete a wholesale investor or eligible investor certificate despite being inexperienced investors. That may well be a relevant factor when determining to whom the representations are targeted.

[52] In any event, as indicated, identifying to whom the representations were targeted (and excluding outliers) is a factual question to be determined by the FMA. Such a factual determination could only be challenged as an error of law if it were clearly insupportable. Here there is also an initial dispute as to whether the FMA did identify the relevant class of 'consumers' or potential investors.

[53] The FMA's findings need to be ascertained from the direction order, not fresh consideration of Du Val's representations. Ms Cooper submitted that the FMA cannot be expected to give detailed reasons like a court. I accept that direction orders are at the lower end of the enforcement spectrum and are intended to be a flexible and efficient enforcement tool. However, sufficient reasons must be given for the FMA's order to serve the principle of open justice, which is essential to public confidence and the rule of law by ensuring that the decision can be scrutinised on appeal.

[54] Although the FMA did not make a specific finding that Du Val targeted the public at large, I accept it found that the representations were targeted at inexperienced investors and also did not accept that wholesale investors could be equated with experienced investors. I therefore do not consider that the FMA failed to identify the relevant class of potential investors.

[55] I also do not consider the FMA was required as a matter of law to limit the relevant class to wholesale investors such that it erred in law by not doing so. Although its reference to the "marketing web" in relation to identifying the target of the representations was inapt – a misapplication of the "marketing web" concept – and it did not address the fact that only wholesale investors could make an investment, I do not consider that fact necessarily means, as a matter of law, the representations could only target wholesale investors. As indicated, identifying to whom the representations were targeted is a factual question. The term "wholesale investor" is a collection of categories of investor in relation to whom there is exemption from disclosure. The FMA would have been entitled to consider whether it was an adequate descriptor when determining to whom the representations are targeted. This factual assessment overlaps with the assessment of the characteristics of the class, which I consider below. Even if it were an error of law not to limit the relevant class to wholesale investors, the materiality of that error depends on the characteristics of the class. Unless the characteristics differ, the error would not be material.

[56] I mention two other matters raised by Ms Cooper. First, she submitted that the FMA's approach is consistent with the Australian Securities & Investments Commission's regulatory guide on Advertising financial products and services.[25] This guide states that in determining whether an advertisement is misleading or deceptive, the legal principles that generally apply include that the audience is not the audience that the promoter would like, but the audience the advertisement actually reaches.[26] An earlier section on media specific guidance notes that mass media has the capacity to reach a wide audience, often beyond the promoter's target market.[27] Provisions on target audience include statements that promoters should consider the

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25 Australian Securities & Investments Commission *Advertising financial products and services (including credit): Good practice guidance* (Regulatory Guide 234, November 2012).

26 RG 234.164.

27 RG 234.133.

characteristics of the actual audience that is likely to see the advertisement,[28] and that the target audience might be different from the actual audience but the actual audience must be taken into account.[29] Where the features or complexity of a product is such that it will only be appropriate for a limited group of people, promoters should do their best to ensure that the advertisement only targets that group and not a wider audience.[30]

[57] These statements appear consistent with the New Zealand approach set out in *Godfrey Hirst*. They also do not specifically address the situation where only some members of the actual audience qualify to invest. In that situation, it may not be feasible to advertise in a way that targets only wholesale investors. In any event, as indicated, the identification of the class targeted is a factual assessment for the FMA.

[58] Secondly, Ms Cooper also cited a recent Australian case, *Australian Securities and Investments Commission v Mayfair Wealth Partners Pty Ltd (No. 2)*, where the Federal Court found that representations to consumers that (among other things) promissory notes were comparable and of similar risk profile to bank term deposits were misleading and deceptive.[31] The representations were widely available on websites, brochures, newspaper and email advertisements, sponsored link internet advertising and AdWords or keywords via Google AdWords. Ms Cooper submitted that the promissory notes were only available to the equivalent of wholesale investors under Australian securities law. The Court did not identify a targeted class of wholesale investors. In that sense, it is consistent with the FMA's approach of treating the class of potential investors as wider than wholesale investors. However, that case was undefended, involved breaches of consumer law as well as securities law and there is no indication that the Court considered whether the representations were made to a specifically targeted class of consumers.

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28 RG 234.105.
29 RG 234.106.
30 RG 234.109.
31 *Australian Securities and Investments Commission v Mayfair Wealth Partners Pty Ltd (No. 2)* [2021] FCA 247.

Characteristics of the persons said to be affected

[59] I turn to the characteristics of the persons said to be affected, assuming for this purpose that only wholesale investors were targeted.

[60] Applying the approach from *Godfrey Hirst*, investors (like consumers) must exercise a degree of care which is reasonable having regard to all the circumstances including the characteristics of the target group – their level of knowledge, acumen, ability and the like. Again, outliers must be disregarded in determining the standard of care expected. It follows that, where wholesale investors are targeted, unusually stupid or ill-equipped wholesale investors, or those whose reactions are extreme or fanciful, must be excluded as outliers.

[61] The FMA stated in the reasons for the direction order that it did not agree with Du Val's submission that wholesale investors are inherently more sophisticated than others. It also said:

> We also consider some "large investors" (as specified in clause 39 of Schedule 1 of the FMC Act) who fall within the scope of a "wholesale investor" are not inherently sophisticated (which we take to mean knowledgeable about particular investment products and the risks associated with them).

[62] Mr Salmon submitted the FMA erred in law by not accepting that wholesale investors are inherently more sophisticated than non-wholesale investors (for example, retail investors) and are considered to be capable of evaluating the merits of an offer or accessing necessary information, and by saying that "some" large (wholesale) investors are not inherently sophisticated, rather than applying the outlier test. He acknowledged that some members of the targeted class may be unsophisticated, but he submitted they do not control the class since the correct approach is to disregard outliers. He submitted the FMA needed to decide if the "some" wholesale investors it referred to were outliers. He accepted this involves some factual questions but emphasised the statutory definitions of wholesale and eligible investors. He acknowledged that these definitions relate to disclosure requirements but submitted the statutory reason for disclosure reflects recognition of the level of sophistication of that category of investor. As a result, he submitted the FMA applied too low a

threshold in relation to what would mislead or deceive members of the correct consumer group.

[63] Ms Cooper submitted that, even if the relevant class were limited to wholesale investors, there are varying degrees of sophistication and experience among wholesale investors, and unsophisticated or inexperienced wholesale investors should not be disregarded as outliers.

[64] The issue raised is effectively whether, as a matter of law in this FMCA context, wholesale investors are inherently sophisticated and are considered to be capable of evaluating the merits of an offer or accessing necessary information.

[65] In relation to an offer of financial products, "wholesale investor" is defined in clause 3(2) and (3) of Schedule 1 of the FMCA:

> (2) A person is a wholesale investor if—
>
> (a) the person is an investment business (see clause 37); or
>
> (b) the person meets the investment activity criteria specified in clause 38; or
>
> (c) the person is large (see clause 39); or
>
> (d) the person is a government agency (see clause 40).
>
> (3) A person is also a wholesale investor, in relation to an offer of financial products, if—
>
> (a) the person is an eligible investor (see clause 41); or
>
> (b) in relation to an offer of financial products for issue or sale,—
>
> (i) the minimum amount payable by the person on acceptance of the offer is at least $750,000; or
>
> (ii) the amount payable by the person on acceptance of the offer plus the amounts previously paid by the person for financial products of the issuer of the same class that are held by the person add up to at least $750,000; or
>
> (iii) it is proposed that the person will acquire the financial products under a bona fide underwriting or sub-underwriting agreement; or

(c) in relation to an offer of a derivative for issue or sale, the notional value of the derivative is at least $5 million (see clause 49).

[66] Relevantly also:

(a) the "investment activity criteria" in clause 38 include a person who owns, or at any time during the 2-year period before the relevant time has owned, a portfolio of specified financial products of a value of at least $1 million (in aggregate);

(b) "large" in clause 39 includes a person if, as at the last day of each of the 2 most recently completed financial years of the person before the relevant time, the net assets of the person and the entities controlled by the person exceeded $5 million;

(c) "eligible investor" in clause 41 requires the person (A) to certify in writing, before the relevant time that A has previous experience in acquiring or disposing of financial products that allows A to assess—

(i) the merits of the transaction or class of transactions (including assessing the value and the risks of the financial products involved); and

(ii) A's own information needs in relation to the transaction or those transactions; and

(iii) the adequacy of the information provided by any person involved in the transaction or those transactions; and

(iv) that A understands the consequences of certifying himself, herself, or itself to be an eligible investor.

In addition, A's certificate must state the grounds for this certification, and a financial adviser, a qualified statutory accountant, or a lawyer

must sign a written confirmation of the certification in accordance with clause 43.

[67] Ms Cooper advised that most investors in the Mortgage Fund were "eligible" investors.

[68] Mr Salmon also referred to the FMA's own guidance on its website:

> Wholesale investors are defined in law and, broadly speaking, are people or organisations who have sufficient previous investing experience that means they don't require disclosure.

[69] The statutory scheme provides for exemption from the disclosure requirements in relation to wholesale investors, which indicates a general statutory intention that wholesale investors have sufficient investing experience so as not to require disclosure. But it does not follow that Parliament considered that wholesale investors are inherently sophisticated such that, as a matter of law in the abstract, any unsophisticated investors are deemed to be outliers when assessing whether representations targeted at wholesale investors are likely to mislead or deceive in breach of s 19 of the FMCA. As Ms Cooper submitted, the fair dealing provisions are intended to protect all investors. The statutory criteria for the wholesale investor disclosure exemption are indicative of, but do not determine, the characteristics of a reasonable wholesale investor for the purpose of assessing Du Val's promotional material.

[70] The FMA is best placed to make a factual assessment as to the characteristics of a reasonable wholesale investor. I accept Ms Cooper's submission that there are varying degrees of sophistication and experience among wholesale investors. The FMA was entitled to reject Du Val's submission that wholesale investors are inherently more sophisticated than others and to conclude that some "large investors" who fall within the scope of a "wholesale investor" are not inherently sophisticated. As Ms Cooper submitted, a large investor may simply have inherited a large sum of money or may own several residential properties. Similarly, a person may meet the investment activity criteria by owning managed investment products (excluding a retirement scheme such as KiwiSaver) and/or listed shares worth more than $1 million. A person may look to invest more than $750,000 simply because they have sold a

business or farm. Ms Cooper may be correct that unsophisticated or inexperienced wholesale investors should not be disregarded as outliers, or at least not all of them.

[71] However, here too, the question is what the FMA decided in its direction order and whether it erred in law. While the direction order does not indicate that the FMA specifically addressed the need to exclude outliers, it is implicit that it at least considered that some unsophisticated wholesale investors should not be disregarded as outliers. That conclusion was open to the FMA.

[72] Also, it is necessary to have regard to the characteristics of the target group as part of the assessment as to whether the representations are misleading or deceptive, not as an abstract exercise in itself.

[73] For these reasons, I do not consider the FMA erred in law by declining to accept that wholesale investors are inherently more sophisticated than non-wholesale investors and are considered to be capable of evaluating the merits of an offer or accessing necessary information.

Fee

[74] The final question is whether retained profit is properly characterised as a 'fee'.

[75] The Mortgage Fund is a limited partnership in which investors can invest, and the General Partner (Du Val Capital Partners Ltd) undertakes activities on behalf of the Mortgage Fund including making various investments in Du Val projects. Du Val provides investors with a fixed return of 10 per cent per annum (calculated monthly but not compounding) regardless of the performance of the investments made by the Mortgage Fund. The General Partner absorbs any profit or loss on the return of the Mortgage Fund's investment activity.

[76] In the direction order the FMA found that Du Val's representations that it would not receive fees were misleading and described the General Partner's right to all profits made by the Mortgage Fund as "effectively a performance-based fee". The FMA said: "We take a broad interpretation of the term "fee" and consider that it includes any means of payment to the General Partner by the fund".

[77] Mr Salmon submitted that a right to retain profits exceeding a fixed rate of return is not a performance-based fee because it does not fit within the definition of that term in the Financial Markets Conduct Regulations 2014 (the Regulations), the ordinary meaning of fee does not include retained profits and a reasonable wholesale investor would not be misled by the representations. He submitted that a reasonable investor would understand that Du Val is carrying on business to make profits, not out of kindness, and that the fixed rate of return means that the General Partner bears the risk of the Mortgage Fund's return being lower than 10 per cent and retains profits over and above the 10 per cent. He submitted that Du Val does not charge fees, and that the obverse would mislead.

[78] Ms Cooper submitted that the right to retain profits amounts to a fee. Even if it were not strictly a fee, the representation of no fees would still be misleading because Du Val earns any and all returns above the fixed return to investors. The FMA acknowledges that the General Partner also carries the risk of loss but does not consider this is relevant.

[79] I consider the reference to performance-based fees in the Regulations does not assist either way. Although the FMA's direction order stated that it considers the right to retain any and all profit is "effectively a performance-based fee", it did not rely on the Regulations. The relevant Schedule in the Regulations relates to the product disclosure statement requirements for retail offers in respect of managed funds. Where they apply, as Ms Cooper submitted, performance-based fees are based on performance of the fund and are generally calculated as a proportion of return above a hurdle rate. She submitted that here the hurdle rate would be 10 per cent and the proportion of return above the hurdle rate would be 100 per cent. But as Mr Salmon submitted, the 10 per cent return is not linked to the performance of the Mortgage Fund; it is not a hurdle rate in that sense. There is also no frequency of calculating and paying the fee. In any event, the relevant Schedule does not apply here.

[80] Du Val's two further submissions, that the ordinary meaning of "fee" does not include a right to retain profits and that a reasonable wholesale investor would not be misled, stray into challenging the FMA's factual findings. The term "fee" is used in the representations, so whether what it meant to potential investors was misleading is

really a question of fact. It is not a term in a statute or instrument with a legal construction. The other submission directly challenges the FMA's conclusion on what is really a factual assessment. As indicated, such a factual determination could only be challenged as an error of law if it were clearly insupportable.

[81] The FMA said it takes a broad interpretation of the term "fee". As Ms Cooper acknowledged, reference to fee was a red-herring. The FMA's direction order provided for two alternative prescriptions: either omit representations that there are no fees or include proximately to such representations a statement that "We retain any profit in excess of the 10% p.a. return to investors" or similar. That indicates the concern at least in part was the lack of clarity concerning the General Partner's remuneration. It is also evident from the earlier correspondence that the FMA does not accept an analogy with bank term deposits, where no such statement is required. While reference to a fee may well have been inapt, I consider this is not one of those rare cases in which there is no evidence to support the FMA's determination or in which the only reasonable conclusion contradicts the determination. In such circumstances, it is not for this Court on appeal to impose its own view as to whether the representations are likely to mislead or deceive in the particular circumstances of the representations, their target audience and the investment product structure.

Conclusion

[82] For these reasons, although I have considered some of the FMA's reasons were inapt, I do not consider the FMA's direction order contains a material error of law.

Result

[83] The appeal is dismissed.

[84] Having ultimately succeeded, the FMA is entitled to costs which I expect can be agreed. If not, I will receive memoranda not exceeding three pages within 20 working days and determine costs on the papers.

Gault J