THE CASE FOR MARKET-BASED CAUSATION

ANDREW WATSON* AND JACOB VARGHESE**

I INTRODUCTION

As shareholders increasingly seek remedies through the Federal Court's class action regime, the question of how causation is to be proven for a class of plaintiffs seems to have become the most contentious issue in this field of litigation. Advocates for defendants have claimed that causation is necessarily an individual issue, requiring each plaintiff to prove that he or she took a course of action, resulting in a loss, in reliance on the alleged misconduct of the defendant company. As such, this argument holds, causation is not an issue susceptible to resolution through a class action.

Advocates for plaintiff classes, including the present authors, have argued that causation can be an issue common to all members of the class where it can be demonstrated that the effect of the alleged misconduct was to cause the market as a whole to inflate the price of traded securities. We call this approach 'market-based causation'.

This paper argues that market-based causation:

(a) involves an application of existing legal principle to the particular statutory context relied upon in shareholder cases, specifically laws concerning companies' obligations to make continuous disclosure of material information and to refrain from misleading and deceptive conduct;

(b) is not dependent on acceptance of the Efficient Market Hypothesis ('EMH'), as some commentators have suggested; and

(c) meets the policy goals of the *Corporations Act 2001* (Cth) ('*Corporations Act*') and helps to ensure a more appropriate allocation of the resources of litigants and the courts.

* Principal, Maurice Blackburn Lawyers.

** Associate, Maurice Blackburn Lawyers. The authors gratefully acknowledge the beneficial input on the ideas presented in this paper from the shareholder class action team at Maurice Blackburn (including Bernard Murphy, Ben Slade, Rebecca Gilsenan, David Niven, and Martin Hyde) and the Counsel engaged on the *Aristocrat* class action (including Stephen Gageler SC, Kristine Hanscombe SC, Michael Lee and Lachlan Armstrong).

II BACKGROUND

Australia has had a modern legislation-based class action regime since the introduction of Part IVA of the *Federal Court of Australia Act 1976* (Cth) ('*FCA Act*') in 1992. In the Second Reading Speech on the introduction of the Federal Court of Australia Amendment Bill 1991 (Cth), which introduced Part IVA, the then Attorney-General specifically adverted to the use of the new procedure by groups of shareholders.[1] Notwithstanding, it was not until 1999 in *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)*[2] that such a case was initiated under Part IVA. In the ten years since the commencement of *King v GIO*, shareholder class actions have grown in their frequency so that at the time of writing they comprised the single most numerous category of extant Part IVA cases.[3] It needs to be noted though that this represents an evolutionary growth rather than the explosion sometimes referred to in media reporting. The authors are aware of seven shareholder class actions actually pending,[4] seven including GIO which have settled in the 10 years since 1999,[5] with perhaps a similar number announced as being under investigation, though how many of this latter category will actually be issued remains to be seen.

An issue that commonly arises in shareholder class actions is whether the putative misconduct, usually a failure to comply with continuous disclosure obligations or engaging in misleading or deceptive conduct, can be said to have caused shareholders loss. Where a share is traded on an exchange such as the

---

1 Second Reading Speech, Federal Court of Australia Amendment Bill 1991 (Cth), House of Representatives, 14 November 1991 (Michael Duffy, Commonwealth Attorney-General).

2 Commenced as *King v GIO Australia Holdings Ltd*, Federal Court of Australia, Matter N 955 of 1999 ('*King v GIO*'), settlement judgment *King v AG Australia Holdings (formerly GIO Australia Holdings Ltd)* [2003] FCA 980 (Unreported, Moore J, 17 September 2003).

3 Excluding the multiplicity of actions (some representative proceedings, some not) arising out of the Westpoint collapse, at the time of writing the authors are aware of six shareholder class actions, four competition class actions, two product liability class actions, one industrial law class action, and two others under the provisions of Part IVA of the *FCA Act*, with a further shareholder class action under the corresponding Victorian class action procedures established by Part 4A of the *Supreme Court Act 1986* (Vic).

4 *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd*, Federal Court of Australia, VID 1380/2006; *Watson v AWB Ltd*, Federal Court of Australia, NSD 449/2007; *Kirby v Centro Properties Ltd*, Federal Court of Australia, VID 326/2008; *Kirby v Centro Retail Ltd*, Federal Court of Australia, VID 327/2008; *Vlachos v Centro Properties Ltd*, Federal Court of Australia, VID 366/2008; *Clime Capital Ltd v Credit Corp Group Ltd*, Federal Court of Australia, NSD1994/2008; *Rod Investments (Vic) Pty Ltd v Abertayne*, Supreme Court of Victoria, No. 2011 of 2005.

5 *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980 (Unreported, Moore J, 17 September 2003); *Taylor v Telstra Corporation Ltd* [2007] FCA 2008 (Unreported, Jacobson J, 13 December 2007); *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2009] FCA 19 (Unreported, Stone J, 21 January 2009); *Vernon v Village Life Ltd* [2009] FCA 516 (Unreported, Jacobson J, 12 May 2009); *Cadence Asset Management Pty Ltd v Concept Spots*, Federal Court of Australia, VID 1605/ 2004 (commenced as a class action, converted to multi-plaintiff action and then settled); *Re Downer EDI Ltd* (settled before issuing); *Re Sons of Gwalia*, see Diane Jones, *Sons of Gwalia Conditional Settlement – 4 Sep 09* (2009) IMF Australia Ltd <http://www.imf.com.au/announcements/Sons%20of%20Gwalia%20Conditional%20Settlement%20-%204%20Sep%2009.pdf> at 11 October 2009.

Australian Securities Exchange ('ASX'), the revelation of bad news regarding a company will often see its share price fall substantially. If the bad news is 'new bad news' there will generally be no actionable wrong.[6] Where it can be shown that the information that caused the share price to fall[7] was information which should have been released by the company at an earlier time pursuant to its continuous disclosure obligations or, alternatively, was information in respect of which the company had previously engaged in misleading or deceptive conduct, various statutory norms will have been contravened and the shareholder will have rights to recover loss or damage sustained by reason of those contraventions. The question arises whether class members may rely on the fall in the market price of the share to establish causation of loss, on the basis that the fall in price establishes that the shares were overpriced during the period of contravening conduct.[8] For plaintiffs, there are obvious advantages in establishing market-based causation, whilst for defendants there are obvious advantages if causation can only be proved by some individual mechanism, such as reliance.

Part IVA of the *FCA Act* does not require that common issues of fact or law *predominate* in order for a class action to be commenced.[9] There must be common issues of fact or law as a matter of substance but these need not predominate. This may be contrasted with the situation that pertains to class certification in the United States. Thus in the Australian context, it is not necessary that a common causation mechanism be found in order for a matter to be commenced as a class action. Whilst the Court has powers under section 33N of the *FCA Act*, which defendants have sought to invoke on the basis that individual issues will predominate or overwhelm common issues, those applications have tended not to be successful.[10]

In practice, even without a common causation mechanism it is likely that, even if they do not settle beforehand, most class actions will settle following the trial of common issues of fact and law. This is because, once common issues have been resolved, there is generally little utility in a respondent facing ongoing

---

6 A timely announcement of bad news might be actionable as, for example, a breach of directors' duties. In practice such claims are rarely, if ever, brought in Australian shareholder class actions. Presumably this is because of the difficulties regarding the status of shareholders to sue for such a breach (though s 1324 of the *Corporations Act 2001* (Cth) may provide an avenue for such a suit) and the practical difficulties involved in surmounting the business judgment rule.

7 Shareholders can seek recovery of losses for a failure to reveal good news at an earlier point in time where this meant a sale at a lower price than would otherwise have been obtainable. For an example of such a case ultimately unsuccessful on whether a contravention of the relevant continuous disclosure provisions had been established: see *Jubilee Mines NL v Riley* (2009) 253 ALR 673. Losses have not been sought on this basis in any Australian shareholder class action.

8 In the United States and Canada an 'event study' is utilised to establish that the fall was not merely market-related and to quantify the quantum of the fall referable to the misconduct. The same technique was used in the only Australian class action to ever run to trial, *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2009] FCA 19 (Unreported, Stone J, 21 January 2009). A detailed discussion of the event study technique is beyond the scope of this paper.

9 *FCA Act* s 33C.

10 See, eg, *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255; *Bright v Femcare Ltd* (2002) 195 ALR 574.

exposure to costs in the determination of individual questions.[11] Nonetheless, if it were to occur, hundreds or thousands of mini-trials on causation after common issues of liability had been established is something that would likely involve an unnecessary waste of resources for the parties and for the courts. Quite apart from this prospect, uncertainties regarding the likelihood of all members of a class being able to establish individual reliance are likely to be relied upon by defendants for making lower offers of settlement in shareholder class actions.

The resolution, therefore, of whether and to what extent class action members may rely on a common causation mechanism is a matter of significant practical and theoretical importance in the development of shareholder class action jurisprudence.

III STATUTORY NORMS IN SHAREHOLDER CLASS ACTIONS

Shareholder class actions tend to plead contraventions of:

(a) *Corporations Act* section 674 (the continuous disclosure provision);

(b) provisions proscribing misleading or deceptive conduct, usually section 1041H of the *Corporations Act* and section 12DA of the *Australian Securities and Investment Commission Act 2001* (Cth) (though sometimes state *Fair Trading Act* provisions are also pleaded);

(c) prospectus provisions: *Corporations Act* section 728; and

(d) a miscellany of other provisions, for example, sections 670A and 1041E of the *Corporations Act*.

This paper focuses on the two most common forms of statutory contravention alleged: continuous disclosure contraventions and misleading and deceptive conduct contraventions.[12] For reasons that are discussed below, care needs to be taken not to assume that the test for causation will be the same in relation to contraventions of different statutory norms.

Section 674 of the *Corporations Act* requires listed companies to notify the market operator of information that they have:

(a) that is not generally available; and

(b) is 'information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value' of securities issued by the company (the materiality element).

---

11 An exception to this general proposition might arise where a defendant regards itself as having a good defence on individual issues in relation to a particular group member or group members. Even in such a case, once common issues are resolved it is quite likely as a matter of practice that such a defence will be taken into account as part of an overall settlement.

12 Whilst the question of market-based causation will be less common in relation to contraventions of prospectus provisions it may still arise: see, eg, *Cadence Asset Management Pty Ltd v Concept Sports Limited* (2005) 55 ACSR 145, 148 (Finkelstein J).

Section 677 of the *Corporations Act* provides that for the purposes of section 674 the materiality element will be satisfied if the information would be likely to influence persons who commonly invest in securities in deciding whether to acquire or dispose of the securities.

Section 1317HA of the *Corporations Act* permits recovery of damages that 'resulted from' a breach of section 674. The question of what suffices to establish causation of loss in claims for breach of the continuous disclosure provision therefore turns on what can be said to 'result from' a breach of section 674.

Section 1041H of the *Corporations Act*, which for present purposes may be taken as representative of the various misleading and deceptive provisions, relevantly proscribes misleading or deceptive conduct in relation to financial products (which include securities traded on the ASX). Section 1041I of the *Corporations Act* permits recovery of loss or damage 'by' conduct contravening any of sections 1041E–1041H. The language of sections 1041H and 1041I clearly echoes the language of the much litigated sections 52 and 82 of the *Trade Practices Act 1974* (Cth) ('*TPA*').

IV GENERAL PRINCIPLES REGARDING STATUTORY CAUSATION

Where a statute provides a remedy allowing recovery of loss for contraventions of a statutory norm, questions of the circumstances in which causation of loss will be established are first and foremost a particular application of the general rules of statutory construction. The now settled approach to statutory construction is to construe relevant provisions so that they are consistent with 'the language of the instrument viewed as a whole'[13] having proper regard to its purpose and object.[14]

Whilst the principles of construction may be settled their application will often give rise to difficult questions. As the High Court has recently noted in *ACQ Pty Ltd v Cook*[15] regarding causation under section 10(1) of the *Damage by Aircraft Act 1999* (Cth):[16]

> The words of the legislation are brief and general. The circumstances to which arguably they may or may not apply are very numerous and diverse. The

13 *Cooper Brookes (Wollongong) Pty Ltd v Commissioner of Taxation (Cth)* (1981) 147 CLR 297, 320; see also *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 381–2; *Bropho v Western Australia* (1990) 171 CLR 1, 20; *Commissioner of Taxation (Cth) v Ryan* (2000) 201 CLR 109, 145–6.

14 *Singh v Commonwealth* (2004) 222 CLR 322, 366–7.

15 *ACQ Pty Ltd v Cook*; *Aircair Moree Pty Ltd v Cook* (2009) 237 CLR 656 ('*ACQ*').

16 *Damage by Aircraft Act 1999* (Cth) s 10 provides '[t]his section applies if a person or property on, in or under land or water suffers personal injury, loss of life, material loss, damage or destruction caused by: (a) an impact with an aircraft that is in flight, or that was in flight immediately before the impact happened; or … (d) something that is a result of an impact of a kind mentioned in paragraph (a), (b) or (c)'.

> arguments of the parties raised for consideration many factual possibilities other than the one before the court. This is, it seems, the first case in which it has been necessary for curial analysis to be given to the construction of the legislation. The field of debate, causation, is one of the most difficult in the law, and one about which abstract discussion is seldom valuable for courts and those who practise in them. It is thus undesirable to deal with possible applications of the legislation which are not essential for the decision of this case. Most cases on [the legislation] are likely to be intensely fact-specific. Certainly the present one is. Hence no endeavour should be made to resolve other cases while deciding this one.[17]

With that warning in mind it is nonetheless possible to distil some general principles which do emerge from the decided cases regarding the proper approach to questions of causation arising under statutes giving remedies for the recovery of loss:

(a) consideration of causation involves a normative analysis of the subject, scope and object of the statute which has been contravened;[18]

(b) common law rules or analogies should not be used to limit the circumstances in which causation will be established where to do so would be contrary to the clear language of a statutory provision;[19]

(c) it will rarely be the case that an event has a single cause. Metaphysical concepts such as 'proximate cause' or 'immediate cause' should be avoided;[20]

(d) the 'but for' test whilst often useful as a negative condition, without which causation will not be established, is not in and of itself sufficient to establish causation;[21] and

(e) appeals to 'commonsense' when analysing causation under statutory norms appear less popular with the current High Court.[22]

As the above shows, the starting point of analysis is the subject, scope and object of the statutory provisions. This is important because much discussion in

---

17 *ACQ* (2009) 237 CLR 656, 661. On the facts in that case, a plane had collided with power line causing it to drop from a height of 6.2m to a height of 1.5m above the ground. An employee of a power company was injured as a result of an electric arc between himself and the power line. In the result the High Court held at 63 that the injury was caused by something that is the result of an impact between an aircraft and the power line.

18 *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, 639 (Gleeson CJ), 642–3 (Gummow and Hayne JJ), 653 (Callinan J); *Allianz Australia Insurance Ltd v GSF Australia Pty Ltd* (2005) 221 CLR 568, 586 (McHugh J), 597 (Gummow, Hayne and Heydon JJ).

19 *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 510 (McHugh, Hayne and Callinan JJ), 529 (Gummow J); *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, 653 (Callinan J).

20 *Henville v Walker* (2001) 206 CLR 459; *Allianz Australia Insurance Ltd v GSF Australia Pty Ltd* (2005) 221 CLR 568, 586 (McHugh J).

21 *Medlin v State Government Insurance Commission* (1995) 182 CLR 1, 6; *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, 638 (Gleeson CJ).

22 *Allianz Australia Insurance Ltd v GSF Australia Pty Ltd* (2005) 221 CLR 568, 596–7 (Gummow, Hayne and Heydon JJ); *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, 642–3 (Gummow and Hayne JJ); *ACQ* (2009) 237 CLR 656, 665 referring to *March v Stramare (E & MH) Pty Ltd* (1991) 171 CLR 506.

this area[23] has proceeded on the at least implicit assumption that the test for causation is the same whether one considers contraventions of continuous disclosure provisions, misleading or deceptive conduct or prospectus provisions. Whilst it is possible that the end point of analysis will be a similar conclusion in each context, in light of established authority it is plainly inappropriate that there be an *a priori* assumption made in this regard. In particular, it ought not be assumed that cases dealing with causation in misleading and deceptive conduct or prospectus contexts apply to causation in claims for breaches of the continuous disclosure provision.

Further, it is also important to bear in mind that this paper contends for market-based causation – that is causation in the specific context of an information effect in an actively traded sharemarket. It is not an argument for 'indirect' causation generally. Adapting the words of the High Court in *ACQ*[24] quoted above, the arguments of defendants, in this context, raise for consideration many possibilities other than the one for which this article contends. Whether misrepresentation to a due diligence committee in a prospectus context is sufficient to establish causation on particular facts is an issue about which there may be legitimate debate, but the resolution of that debate is not determinative of the separate question as to whether, in the context of different legislation, market-based causation is appropriate.

V MISLEADING AND DECEPTIVE CONDUCT

As noted above, the language of section 1041H of the *Corporations Act* echoes the much litigated section 52 of the *TPA* and the use of the word 'by' in section 1041I of the *Corporations Act* similarly echoes section 82 of the *TPA*. It is clearly established in the context of the *TPA*, and its state *Fair Trading Act* analogues, that reliance is not a necessary element (though it will be sufficient) to establish causation of loss and the recovery of damages.[25] Any doubt regarding this issue has been recently dispelled by the decision of the High Court in *Campbell v Backoffice Investments Pty Ltd*[26] where in the reasons of Gummow, Hayne, Heydon and Kiefel JJ it is stated:

> With considerations of these kinds in mind, Giles JA was right to point out that reliance is *not* a substitute in the context of the *Fair Trading Act* for the essential question of causation. Moreover, it is also right to observe, as Giles JA said, that

23 See, eg, Ashley Black, 'Commentary on All Four Papers' in the Hon Justice K E Lindgren (ed), *Investor Class Actions*, Ross Parsons Centre of Commercial, Corporate and Taxation Law (2009) 101, 101 ff.

24 (2009) 237 CLR 656.

25 See, eg, *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526 ('*Janssen-Cilag*'), 529–30; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 528 (Gummow J); *McCarthy v McIntyre* [1999] FCA 784 (Unreported, Hill, Sackville and Katz JJ, 11 June 1999); *Alexander v Perpetual Trustees WA Ltd* (2004) 216 CLR 109; *Derring Lane Pty Ltd v Fitzgibbon* (2007) 16 VR 563; *Smith v Noss* [2006] NSWCA 37 (Unreported, Beazley, Giles and Ipp JJA, 8 March 2006) [25]–[28] (Giles JA); *HIH Insurance Ltd (in liq) v Adler* [2007] NSWSC 633 (Unreported, Einstein J, 22 June 2007) [73]–[75].

26 (2009) 257 ALR 610.

> '[i]t may be artificial to speak of reliance in determining what action or inaction would have occurred if the true position had been known'.[27]

These principles have been directly applied in an investment context by a Full Court of the Federal Court in *Australian Breeders Co-operative Society Ltd v Jones*,[28] where it was held that causation was established in relation to a valuation not relied on by the investors but without which the relevant scheme would not have gone ahead:

> One further point should be made about causation. We make it because of the circumstance that there is no evidence that any of the investors (as distinct from MANL) made any decision in reliance on the ABCOS valuation. In cases where a representation is said to constitute misleading conduct for the purposes of s 52 of the *Trade Practices Act*, typically it is claimed that the applicant relied on the truth of the representation, and thereby suffered loss. But this is not the only situation in which s 52 is available to an applicant. It is sufficient that the loss was 'brought about by virtue of the conduct which is in contravention of s 52': see per Lockhart J in *Kabwand Pty Ltd v National Australia Bank Ltd* (1989) 11 ATPR 50,367 at 50,378. … In the present case, as it seems to us, there is no difficulty in demonstrating, on the probabilities, what would have happened in the absence of ABCOS' misleading valuation. MANL would not have completed the transaction, the syndicate would not have proceeded and the Investors would not have incurred the losses they sought to recover in proceeding NG 711 of 1991.[29]

Notwithstanding the emphatic rejection of reliance as a *necessary* element in causation in the misleading and deceptive conduct context, in two NSW Court of Appeal cases, *Digi-Tech (Australia) Pty Ltd v Brand*[30] and *Ingot Capital Investments Pty Ltd (ACN 006 538 147) v Macquarie Equity Capital Markets Ltd (ACN 001 374 572)*,[31] arguments in support of 'indirect' causation were rejected and a distinction was drawn between cases where loss is said to be the 'natural consequence' of the misleading conduct (into which category are placed cases such as *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd*) and those cases in which a plaintiff is induced to enter a transaction by misleading or deceptive conduct. In the second category of case, it is said, reliance must be proved.[32]

Whilst both *Digi-Tech* and *Ingot Capital* arose in the context of decisions by investors, in neither was the argument for 'indirect causation' dependent on market reaction to misleading or deceptive conduct. *Digi-Tech* was a case dealing with section 52 of the *TPA* in relation to an investment scheme involving two telecommunications products.[33] On appeal, the trial judge's findings as to reliance were held to be erroneous on two bases and remitted for a re-trial.[34] The investors separately argued in the appeal that proof of reliance was not necessary because had the forecasts of revenue and gross margin for the investment not been misrepresented the scheme would not have been promoted and would not

27 Ibid 647 (emphasis in original).
28 (1997) 150 ALR 488.
29 Ibid 529–30.
30 (2004) 62 IPR 184 (*'Digi-Tech'*).
31 (2008) 252 ALR 659 ('*Ingot Capital*').
32 *Digi-Tech* (2004) 62 IPR 184, 211–2; *Ingot Capital* (2008) 252 ALR 659, 668 (Giles JA), 765 (Ipp JA).
33 *Digi-Tech* (2004) 62 IPR 184, 169–91.
34 Ibid 208.

have gone ahead.[35] This argument was rejected on the bases referred to above, that in cases where a plaintiff is induced to enter a transaction reliance must be proved[36] and because the 'indirect' causation case had not been pleaded.[37]

Ingot Capital concerned allegations of misleading or deceptive conduct in relation to the issue of convertible notes. At trial the case was primarily run as a case of positive reliance. This case failed because the relevant decision maker was held to have had actual knowledge of the relevant information.[38] The indirect causation case advanced by the appellants was that a Due Diligence Committee had misrepresented certain matters to the Board of New Cap Reinsurance Holdings Ltd ('NCRH'), and that without those misrepresentations the Board would not have issued a prospectus for the notes or the notes themselves. This case failed because:

(a) the relevant representations were held not to have been pleaded or not to have been misleading;[39]

(b) the Board of NCRH was held not to have been misled;[40] and

(c) the appellants themselves had not relied and this was a case of misrepresentation inducing a transaction where reliance was necessary.[41]

The following points may be made regarding *Digi-Tech* and *Ingot Capital*:

(a) each case was run exclusively or primarily at first instance as a case of positive reliance. Those cases failed. On appeal arguments of 'indirect' causation were run in circumstances which were not supported by either the pleaded case or the evidence led at first instance;[42]

(b) each was a case where the comments regarding causation were obiter dicta; the cases having been determined on other bases,[43] a fact much relied upon by all of the defendants in their successful resistance to the grant of special leave to appeal to the High Court in *Ingot Capital*;

(c) the reasoning is problematic because it substitutes the proper enquiry under the statutory provisions as to whether or not causation is established with a different enquiry for which there is no warrant in the legislative provisions; and

35 Ibid 210.
36 Ibid 212.
37 Ibid 213.
38 *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd (No 6)* (2007) 63 ACSR 1, 119–28.
39 *Ingot Capital* (2008) 252 ALR 659, 760, 767–71 (Ipp JA).
40 Ibid 764, 767 (Ipp JA).
41 Ibid 667, 670 (Giles JA), 764–6 (Ipp JA).
42 *Digi-Tech* (2004) 62 IPR 184, 213; *Ingot Capital* (2008) 252 ALR 659, 665–71 (Giles JA).
43 In *Digi-Tech* on the basis that the trial judge finding of no reliance was in error and the case should be remitted for determination of that (and other issues): *Digi-Tech* (2004) 62 IPR 184, 208; and in *Ingot Capital* on the basis that there was no relevant contravening conduct: *Ingot Capital* (2008) 252 ALR 659, 695 (Ipp JA).

(d) the suggested distinction between 'passive' suffering of loss and inducement to enter a transaction is illusory. In the *Janssen-Cilag* style case, a competitor loses business because third persons are induced to enter transactions based on the misleading and deceptive conduct of the defendant. The loss in that case is no more or less a 'natural' consequence than any other, requiring an assessment of the effect or likely effect of the contravening conduct and evidence of that effect or likely effect on other persons.

In any event, market-based causation of the kind for which this article contends:

(a) was not under consideration in either *Digi-Tech* or *Ingot Capital*, certainly neither considered the continuous disclosure provision; and

(b) is not inconsistent with the majority reasoning in *Ingot Capital* and the reasoning in *Digi-Tech*.

Market-based causation in this context can be viewed as a species of the 'natural consequence' category in the *Ingot Capital* taxonomy. The case of investors does not require proof of inducement to enter a particular transaction but rather proof that the 'natural consequence' of the contravening conduct was an inflated market price and that *any* transaction entered into without the contravening conduct would have been entered at a lower price.

A further reason to reject 'reliance' as the test of causation in shareholder claims is its incongruity in the context of claims for misrepresentation by silence. Shareholder class actions as often as not plead misleading and deceptive conduct by reference to what was not said or revealed (for example, a failure to disclose risks to the profit forecast) as distinct from a positive misrepresentation (an overstatement of profit).

In relation to section 52 of the *TPA*, in *Demagogue Pty Ltd v Ramensky*,[44] Black CJ said:

> Silence is to be assessed as a circumstance like any other. To say this is certainly not to impose any general duty of disclosure; the question is simply whether, having regard to all the relevant circumstances, there has been conduct that is misleading or deceptive or that is likely to mislead or deceive. To speak of 'mere silence' or of a duty of disclosure can divert attention from that primary question.[45]

44 (1992) 39 FCR 31.

45 Ibid 32.

Silence may be misleading or deceptive even if a corporation through its directors and officers did not have knowledge of the undisclosed facts that render its conduct misleading or deceptive.[46]

As Giles JA (with whom other members of the Court of Appeal agreed) said in *Smith v Noss*,[47] '[i]t is not a natural use of the notion of reliance to say that there was reliance on the failure in disclosure, but causation can be found if disclosure would have caused inaction or action other than that which was taken.'

Section 1041H is in a part of the *Corporations Act* headed 'Market Misconduct and Other Prohibited Conduct Relating to Financial Products and Financial Services'. Sections 1041A to 1041H are all directed to protecting the integrity of the market. In this context there is nothing unorthodox in relying on the effect of contravening conduct on the market price of a share to establish causation of loss.

VI CONTINUOUS DISCLOSURE

The case for market-based causation in claims for losses resulting from a breach of section 674 of the *Corporations Act* is particularly strong.

Three points may immediately be made regarding this regime:

(a) the materiality element of section 674 presupposes that certain information does have a causative effect on the price or value of traded securities. Indeed, no claim can proceed without proving that the information concerned was, objectively, this type of information;

(b) information which will, objectively, affect buying and selling decisions of persons who commonly invest in shares is deemed to satisfy the materiality element; and

(c) the fact that the disclosure is to be made to the market operator (for example, the ASX) makes it clear that the provision is designed to ensure that material information is, at all times, available to the market as a whole. (The ASX, for example, provides a web-based service in which

46 See *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 ('*Fraser*'), 467; *Johnson Tiles Pty Ltd v Esso Australia Pty Ltd* (2000) 104 FCR 564 ('*Johnson Tiles*'), 591–2 (French J). Note there are some single instance authorities in the Federal Court which notwithstanding *Fraser* and *Johnson Tiles* (which were Full Court authorities) suggest that for silence to be misleading it must be intentional: see, eg, *Costa Vraca Pty Ltd v Berrigan Weed & Pest Control Pty Ltd* (1998) 155 ALR 714; *Lindsey v Philip Morris Ltd* [2004] FCA 9 (Unreported, Kenny J, 21 January 2004), [33]. Even these authorities do not appear to require intention where (as in the case of listed entities) there is a duty to disclose or the silence is one element of a course of conduct. Further and in any event, these cases rest on the peculiarities of the definition of 'conduct' in the *TPA* which is materially different to the definition in s 9 of the *Corporations Act 2001* (Cth).

47 [2006] NSWCA 37 (Unreported, Beazley, Giles and Ipp JJA, 8 March 2006) [25].

> statements provided to it by listed-companies are promptly made available to the general public.)[48]

The subject and purpose of the provision is therefore clear: it is intended to ensure that the market has all the information about a company that the market requires to determine the price or value of securities in the company, or as it was put in the Treasury Paper *CLERP Paper No 9: Proposals for Reform – Corporate Disclosure*:

> The primary rationale for continuous disclosure is to enhance confident and informed participation by investors in secondary securities markets. … Continuous disclosure of materially price sensitive information should ensure that the price of securities reflects their underlying economic value. It should also reduce the volatility of securities prices, since investors will have access to more information about a disclosing entity's performance and prospects and this information can be more rapidly factored into the price of the entity's securities.[49]

This purpose is given effect by looking at the effect of the contravention on the market and its collective pricing of the relevant security. There is no need to also look at the effect that the contravention had on any individual investors and their states of mind.

Detailed analysis of the language of the provision makes this even clearer. A contravention of section 674 of the *Corporations Act* may be established if the non-disclosed information is material to *price* or *value*. Forensically, this provides two paths to proving causation:

(a) showing that the disclosure of the information would have affected the price of securities such that investors that purchased securities during the period of the non-disclosure paid an inflated price; or

(b) showing that the disclosure of the information would have affected the value of the securities such that investors that purchased shares during the non-disclosure period paid a greater price for the securities than the true value of those securities.

In either scenario, an investor who purchases securities while a breach of section 674 of the *Corporations Act* is on foot can be said to have suffered a loss resulting from that breach simply by purchasing the over-priced securities.[50] Unless they have actual knowledge of the material information themselves and therefore actual knowledge that the price was inflated, their state of mind is not

---

48 See Australian Securities Exchange, *Company Announcements Publication Process* <http://www.asx.com.au/research/announcements/process.htm> at 11 October 2009.

49 Australian Treasury, *CLERP Paper No 9: Proposals for Reform – Corporate Disclosure* (2002) pt 8.

50 It is well-established that a measure of loss in actions for the tort of deceit is the difference between the price paid for the property and the true value of the property at the time of the purchase had the deception not occurred: see *Potts v Miller* (1940) 64 CLR 282. In misleading and deceptive conduct cases the *Potts v Miller* approach will be available where an asset is purchased 'over value' but a flexible approach applies and other approaches may be utilised in order to satisfy the overriding compensatory principle: see *HTW Valuers (Central Queensland) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640. The question of the appropriate measure of loss in claims for breaches of the continuous disclosure provisions remains untested. However, it seems likely that the flexible approach applied in misleading and deceptive conduct cases will inform the approach to compensation under s 1317HA.

relevant to the inquiry into causation. Loss is a natural consequence of the breach, suffered by any person with the misfortune to purchase securities in the period in which the company withheld material information.

The fact that 'price' and 'value' have been separately provided in the language of the statute lends further support to this interpretation. Without the inclusion of 'price', 'value' might have been taken to imply a subjective, mental element. The value of any information about a company does have subjective elements. For example, the impact of news about the health of a company's CEO will be more or less valuable to an investor depending on their own view of the CEO's importance to the company.

Price, however, is an independent and objective factor, not subject to the state of mind of any single investor. It is determined by the market as a whole, through the many decisions that investors make to buy, sell or hold securities at any given time. Its specific inclusion in the continuous disclosure provision strongly implies that the causation can be proven without recourse to the mental states of individual investors.

Further, section 9 of the *Corporations Act* requires that unless the context otherwise requires, 'result' in section 1317HA includes 'result indirectly', thus there is, as a matter of textual analysis, little scope for arguments such as those advanced by the defendants in *Dorajay Pty Ltd v Aristocrat Leisure Limited*,[51] or apparently adopted in *Digi-Tech*[52] and *Ingot Capital*[53] that causation must be 'direct'.

There is no warrant from an analysis of the subject, scope or object of the continuous disclosure provision for the imposition of any 'reliance' requirement to establish causation. Further, as has been noted in the context of misleading and deceptive provisions, reliance is a particularly inapt tool of analysis in cases of a failure to provide information.[54]

VII EFFICIENT MARKETS

In the United States, since *Basic Inc v Levinson*,[55] where a security can be shown to have traded in an efficient market it is presumed (though the presumption may be rebutted) that investors have relied on the integrity of the market price. This is known as the 'fraud on the market' doctrine. *Basic* is in some respects an unusual case because the Supreme Court approved the 'fraud on

51 [2009] FCA 19 (Unreported, Stone J, 21 January 2009) ('*Aristocrat*'). This is the settlement approval judgment of so far the only Australian shareholder case to go to trial. It settled after trial and before judgment.

52 (2004) 62 IPR 184.

53 (2008) 252 ALR 659.

54 *Smith v Noss* [2006] NSWCA 37 (Unreported, Beazley, Giles and Ipp JJA, 8 March 2006) [25]; *Campbell v Backoffice Investments Pty Ltd* (2009) 257 ALR 610, 647 (French CJ, Gummow, Hayne, Heydon and Kiefel JJ).

55 485 US 224 (1988) ('*Basic*').

the market' doctrine explicitly relying on the EMH, a theory of financial economics.

It has been suggested, perhaps because of *Basic*, that recent critiques of the EMH in the economist community, especially since the recent global financial crisis, are an Achilles heel for market-based causation.[56] This is misguided. The EMH is a sufficient but not a necessary condition for market-based causation.

The EMH suggests that markets in exchange-traded securities are efficient such that, at any time, the price of a security reflects the known information about that security. According to this theory, investors react quickly to any new information about an exchange-listed company by buying or selling (depending on the content of the information), ensuring that the price of its securities reflects their true value.[57]

The notion of efficient markets has gained High Court approval in the context of real property. In a passage cited with approval in *Walker Corp Pty Ltd v Sydney Harbour Foreshore Authority*,[58] McHugh J in *Kenny & Good Pty Ltd v MGICA (1992) Ltd*[59] said, 'market for the property is, therefore, assumed to be an efficient market in which buyers and sellers have access to all currently available information that affects the property.'[60]

If the EMH is accepted in its strong or semi-strong forms,[61] it is almost impossible to deny the availability of market-based causation. If information about a company was the sole factor determining the value of a security, it follows that unlawfully misinforming the market (through misrepresentation or non-disclosure) brings, as a natural consequence, a loss to investors who purchase securities under misinformation. In this scenario, the misinformation causes an incorrect valuation by the market, which in turn causes the investor to pay an inflated price.

Market-based causation can, however, be accepted even if the EMH is not. For example, market-based causation should be available if the plaintiffs have proven that the market in the particular security in question during the particular period in question was efficient. Expert economic evidence can be led on the question as it relates to a specific security, using both qualitative measures and statistical tests that measure both correlation between changes in information and changes in the security price and whether, as the EMH predicts, daily stock price

56 See Black, above n 23, 105.

57 Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *Journal of Finance* 383.

58 (2008) 233 CLR 259, 276–7.

59 (1999) 199 CLR 413.

60 Ibid 436.

61 Fama, above n 57, describes markets operating in strong, semi-strong and weak forms. In the strong form, the traded price of a security incorporates, at all times, all known information about a company, whether that information is available to the general public or not. In the semi-strong form, the price of a security incorporates only that known information that is available to the general public. In the weak form, the price of a security only incorporates all information that can be gleaned from its historical prices.

changes follow a 'random walk'.[62] In the United States, where securities litigation is more developed, litigants tend to lead economic evidence addressing five criteria for an efficient market, known as the 'Cammer factors', after a judicial decision.[63] In the *Aristocrat* class action the economic experts engaged by both parties agreed that the respondent's securities were traded in an efficient market.[64] If a plaintiff has led convincing evidence that a given market is efficient, defendants would be ill-advised to rely simply on philosophical or theoretical objections to the EMH without challenging that evidence directly.

Even if the market is not efficient, losses to investors through over-payments may still be the natural consequence of misinforming the market. It is one thing to show that a market falls short of efficiency and another to prove that it operates so inefficiently that information about the company has no bearing on its price or value. If the plaintiff can show that, market inefficiencies notwithstanding, as a matter of fact the misinformation had an inflationary effect on the actual price of the security, it has established market-based causation.

The continuous disclosure provision, with its materiality element, already presupposes that that there is a causative link between certain information and the price or value of securities. Before causation is even addressed, establishing breach requires that the information be such that it would be objectively expected to have a material effect on price or value. Irrespective of the question of efficiency, in many cases a causal link between the information and the price of the securities is evident simply on the historical record of trading prices: when the information eventually becomes available, the price of the security typically falls. In other cases, more complex economic or valuation evidence may be required to establish market-based causation. In all cases, the availability of market-based causation is a question of fact.

Market efficiency can have an important role to play in quantifying loss. Proof of an efficient market is necessary for the use of an event study, a rational and precise econometric method of estimating of the quantum of inflated prices. This involves a statistical recreation of the counterfactual scenario of a timely announcement based on the actual market reaction to the untimely announcement. However, even if a market is inefficient, courts and litigants have at their disposal other forensic tools to estimate the difference between the price paid by investors and the true value of the security they purchased, such as company valuation.

---

62 A 'random walk' is the name given in financial economic literature to the random pattern in the day-to-day movement of share prices which is to be expected if the only factor contributing to changes in prices is new information, given that new information arises unpredictably. See Eugene F Fama, 'The Behavior of Stock-Market Prices' (1965) 38 *Journal of Business* 34.

63 The 'Cammer factors' are: (1) a high average weekly trading volume; (2) a significant number of security analysts; (3) numerous market makers and the existence of arbitrageurs; (4) eligibility to file a certain registration form with the United State Securities and Exchange Commission; and (5) empirical facts showing a cause and effect relationship between unexpected company news and immediate changes in the share price: *Cammer v Bloom*, 711 F Supp 1264, 1285–7 (DNJ, 1989).

64 Transcript of Proceedings, *Dorajay Pty Ltd v Aristocrat Leisure Limited* (Federal Court of Australia, NSD 324 of 2004, 25 October 2007), lines 43–7.

VIII POLICY CONSIDERATIONS

There are also compelling policy considerations that militate against reading an element of individual reliance into the statutory provisions.

First, the market-based approach gives best effect to the broader purposes of the *Corporations Act*. As discussed above, the scope, content and purpose of the continuous disclosure provision are directed toward ensuring that investors have access to all the information they are likely to need to be able to make informed decisions about their trading activities and that it is directed to protecting the market as a whole through market operators. The history of the provision confirms that it is directed to protecting the integrity and efficiency of markets in securities. This history was canvassed at length by Lindgren J in *Australian Securities and Investment Commission v Southcorp Ltd (No 2)*.[65] Justice Lindgren referred to the Companies and Securities Advisory Committee report that recommended the introduction of continuous disclosure provisions in 1991 and which included among its rationales 'ensuring that securities prices more closely, and quickly, reflect underlying economic values' and to 'promote capital market efficiency'.[66] Justice Lindgren also referred to the Second Reading Speech of the then Minister for Administrative Services, who said in support of the original continuous disclosure provision, '[i]n essence, a well informed market leads to greater investor confidence and in turn to a greater willingness to invest in Australian business'.[67] Having considered this history, Lindgren J held that an important consideration in determining a civil penalty for a breach of the continuous disclosure provision was the extent to which the breach was apt to generate 'loss of faith' and 'loss of confidence' in the market.[68]

Similarly there are some grounds to hold that the purposes of the misleading and deceptive conduct provision (section 1041H) include protection of the market as a whole. For example, section 1041H falls within Part 7.10 of the *Corporations Act*, which also deals with other forms of 'market misconduct' such as market manipulation, false trading and market rigging and insider trading.

Given the legislature's focus on market protection in the *Corporations Act*, it is appropriate to adopt an approach to causation which directs its attention to the harmful effect that misinformation has on the market as a whole and investors as participants in that market. To put the market to the side and require causation to be made out purely by reference to the effect of misinformation on each individual mind is not just a fiction, it is contrary to the logic and purpose of the *Corporations Act*.

---

65 *Australian Securities and Investment Commission v Southcorp Ltd (No 2)* (2003) 130 FCR 406 ('*Southcorp*'), 408–11 (Lindgren J). See also *Re Chemeq Ltd (ACN 009 135 264); Australian Securities and Investment Commission v Chemeq Ltd* (2006) 234 ALR 511, 522–3 (French J).

66 *Southcorp* (2003) 130 FCR 406, 409.

67 Second Reading Speech, Corporate Law Reform Bill (No 2) 1992 (Cth), Legislative Council, 26 November 1992 (Nick Bolkus, Minister for Administrative Services).

68 *Southcorp* (2003) 130 FCR 406, 419.

Second, the market-based approach provides a less costly, less time-consuming and more accessible method for administering justice. A requirement for each plaintiff to prove individual reliance would limit the ability of courts to resolve disputes through the efficient means of representative proceedings. Market-based causation would allow a single trial of common issues in a representative proceeding to deal with almost all of the subject matter relevant to a large, potentially universal, group of complainants. In contrast, proof of individual reliance would require each complainant to bear the costs, risks and time associated with trials into their own state of mind. The additional court resources that would be expended in this scenario are obvious.

Lastly, from a normative perspective, there is no reason to fear that the market-based approach would lead to compensation for undeserving investors. When a public company misinforms the market, it abuses the trust that all investors have in the market, which is expressed through their decisions to invest. Whether investors are fundamental or technical analysts, 'buy-and-hold' strategists, 'day-trading' tacticians or arbitrageurs, they implicitly assume that all other market participants are playing by the rules. If they suffer a loss because one market participant has breached those rules, assuming they have obtained no collateral benefit that cancels out that loss and they were not actually aware of or complicit in the breach, there seems to be no normative reason that they should be excluded from the compensatory remedy that the statute provides.

IX CONCLUSION

Where the facts of a dispute support it, market-based causation is a rational, efficient and normatively appropriate method of dealing with the question of causation in shareholder class actions alleging contraventions of the continuous disclosure and misleading and deceptive provisions of the *Corporations Act*.

Moreover, for the reasons we have stated, it is already available to courts under current law and involves no judicial radicalism or adaptation of foreign law.

Contrary to some assertions, market-based causation does not require adherence to the EMH. Evidence of an efficient market is forensically advantageous, but even that is not compulsory as long as compelling alternative evidence of the link between information and price or value is provided.

If Australia wants to encourage investment in its profitable enterprises, it needs capital markets that are transparent and efficient. That requires public companies to be honest about their performance, making continuous disclosures of material information and refraining from misleading and deceptive conduct as the law requires. Breaches of these laws do not just harm investors as individuals, they harm investors as participants in a market by undermining the market's capacity to determine prices that reflect underlying value. Market-based causation gives full effect to the normative purpose of these laws by recognising the losses that accrue to all innocent investors as a result of this type of misconduct.