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COMMENTARY

Causation in Australian Shareholder Class Actions Uncertain

Key Points

- The provisions that allow shareholders to seek compensation for contravention of the continuous disclosure regime and prohibitions on misleading conduct, *Corporations Act 2001* (Cth) ss 1041I, 1317HA and 1325, require proof of causation.
- However, the manner of proving causation is uncertain, with the plaintiffs pleading that reliance was not necessary or that causation may be satisfied by indirect reliance or through the fraud on the market theory.
- The Supreme Court of Victoria in *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357 ruled that, in the context of an interlocutory application to strike out the statement of claim, the plaintiffs' approach should be allowed to go forward. The requirements for causation will remain unsettled until subject to a trial and judgment.
- The proceedings followed on from an earlier settlement with some but not all potential group members prior to the commencement of a class action. A settlement within the class action framework may have averted supplementary claims and achieved certainty for the defendant. Settlement of multiple claims requires a considered strategy as to the best way to achieve finality.

Background

The plaintiff, Camping Warehouse Australia Pty Ltd commenced proceedings in the Supreme Court of Victoria alleging that the defendant Downer EDI Limited breached its continuous disclosure obligations under s 674 of the *Corporations Act 2001* (Cth) (the "Act") and the prohibition on misleading or deceptive conduct in s1041H of the Act.

The plaintiff alleged that the defendant had failed to disclose in a timely manner a number of matters in relation to the design, manufacture and delivery by the defendant to RailCorp NSW of 624 new double-deck passenger rail cars, known as the Waratah train project, including delays and additional costs.

The defendant sought to strike out the pleading on a number of grounds, including that it failed to plead reliance and inconsistencies in the group definition.

Reliance

The provisions that allow shareholders to seek compensation for contravention of the continuous disclosure regime and prohibitions on misleading conduct contain the statutory wording "resulted from", "because" and "by", which have been interpreted as necessitating proof of causation.[1] However, the pleadings initiating shareholder class actions have sought to prove causation in a number of ways: through direct reliance, indirect reliance and the fraud on the market theory.[2]

Here, the plaintiff argued that it was not necessary for individual holders of securities to show that particular representations were made to them, or that they "relied" upon them. Particular emphasis was placed on the remarks of Finkelstein J in *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061, where the role of the efficient market hypothesis and the existence of a rebuttable presumption of reliance in United States "fraud-on-the-market" cases was explained:

> It seems the way the case will be put is based on the hypothesis (in some quarters an article of faith) that had the Corporations Act and ASX listing rules been complied with the market in Multiplex securities would have been open and efficient and the price of the securities would be determined on the basis that all material information regarding the company was publicly available. The consequence of this hypothesis is the premise that the market price of the securities would have been negatively affected if there had been proper and not misleading disclosure about the Wembley Stadium project.
>
> It may also be argued that there is a rebuttable presumption of reliance (if it is necessary to establish reliance) on the existence of an open and efficient market for Multiplex securities. In the United States this is referred to as the fraud-on-the-market theory. In *Basic Inc v Levinson* (1988) 485 US 224 the Supreme Court of the United States held that securities class action plaintiffs are entitled to a presumption of reliance that the market for the securities in question was efficient and that the plaintiffs traded in reliance on the integrity of the market price for those securities….

By reference to the text of the Act, the context of the legislation and relevant case law, the plaintiff submitted that it was not necessary to plead reliance. Although the judgment refers to the plaintiff relying on fraud on the market, it would also seem that statutory interpretation is relied on to support some form of indirect reliance.

The defendant referred to the decisions of the New South Wales Court of Appeal *Digi-Tech (Australia) v Brand* (2004) 62 IPR 184 and *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 73 NSWLR 653. It argued that as the plaintiff was not a passive investor, but actively acquired shares, direct reliance was necessary because the inducement of the plaintiff forms a link in the causation chain. Without such inducement, there was no link between the misleading conduct or failure to disclose and the plaintiff's loss. However, neither case dealt specifically with the statutory provisions in issue.

Justice Sifris stated:[3]

> I have not been referred to and have been unable to find any case precisely on point or that deals with causation in the context of a breach of the continuous disclosure requirements set out in Div 6CA of the Act. The obligations are different in nature to those proscribing misleading or deceptive conduct and there is much to be said for the view expressed by Finkelstein J in *P Dawson*. Reliance may well be artificial in cases of this kind. The extent to which the provisions differ and the precise formulation and matters that underpin or evidence the causation requirement are matters of some complexity that require comprehensive and detailed analysis, undesirable in the case of a strike out application.

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1 *Corporations Act 2001*(Cth) ss 1041I, 1317HA, 1325; *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525.

2 See *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061 at [11]; *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029 at [15]-[17]; *Hobbs Anderson Investments Pty Ltd v Oz Minerals Ltd* [2011] FCA 801 at [9]-[10]; *Kirby v Centro Properties Ltd (No 6)* [2012] FCA 650 at [4]; *Pathway Investments Pty Ltd v National Australia Bank Limited (No. 3)* [2012] VSC 625 at [11]-[12].

3 *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357 at [59]-[60].

> The plaintiff has pleaded that the conduct in breach of the Act caused the loss in the sense of the reduced value of the shares. The essence of the claim is that the shares when acquired were overpriced directly because of such conduct. It cannot be accepted that this formulation is plainly hopeless or bound to fail.

As a result, the Statement of Claim was not struck out, and the proceedings were allowed to proceed.

Group Definition and Prior Settlements

The Statement of Claim defined the group as follows:

> This proceeding is commenced by the plaintiff on its own behalf and on behalf of all persons who acquired shares in the defendant on or after 25 February 2010 and who were at the commencement of trading on 1 June 2010 holders of any of those shares and who have valid, lawful and enforceable claims for loss or damage caused by the conduct of the defendant in the period 25 February 2010 to 31 May 2010 which is alleged in the statement of claim. (Group Members).

The group definition was in a standard form for a shareholder class action except that it included the words "valid, lawful and enforceable claims". The defendant contended that these additional words did not enable the objective existence of the group to be ascertained. The plaintiff responded that the words were intended to exclude from the group those members who participated in an earlier proposed class action that was compromised before proceedings were commenced. The earlier settlement was confidential, including the names of the group members bound by that settlement. The plaintiff nonetheless informed the court that the words would be deleted from the group definition.

While the disagreement over the group definition was resolved, the reason for the words "valid, lawful and enforceable claims" raises a more significant issue. The settlement of nascent class actions prior to commencement means that unknown group members cannot be bound by the settlement, opening the way for further claims in the future. The current proceedings are proof of that risk.

While class actions are mainly negative for defendants, one of the few positives is that they can provide a mechanism for resolving all claims in relation to a particular cause of action. This is because the group definition can include all persons with a claim, and then a judgment or settlement can bind all claimants except those that affirmatively opt out of the proceedings.[4] Consequently, the class action can provide a high degree of certainty for defendants that they have resolved all claims. Settlement of multiple claims requires a considered strategy as to the best way to achieve finality.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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4 *Matthews v SPI Electricity Pty Ltd* [2013] VSC 17 at [26]-[39], discussing the authorities on closing the class and the extinguishment of the claims of group members who do not participate in the settlement.