



Market-Based Causation Arguable in Australian Shareholder Class Actions

Key Points

- Shareholder class actions in Australia typically bring statutory claims that require causation to be demonstrated. There has been an ongoing debate in relation to how causation may be proved. The debate has centred on whether direct reliance is required or some other form of causal link, such as indirect reliance, is permitted.
- Indirect reliance is a form of causation where contraventions of statutory prohibitions or requirements are alleged to cause the share market, as a whole, to inflate the price of a company's securities so that group members suffer losses when they acquire shares at the inflated price.
- The Full Federal Court of Australia has found that indirect reliance in the form of market-based causation may be pleaded to satisfy the causation requirements for the statutory claims relied on by shareholders in class actions.
- It is expected that the focus in relation to causation in shareholder class actions will now turn to the particulars of indirect reliance—namely, identifying and proving how the relevant conduct affected the market price.

Background

Shareholder class actions in Australia typically bring statutory claims that require causation to be demonstrated. Direct reliance is the traditional or conventional test for causation and in the shareholder class action context would require each group member to prove that he or she relied on the misleading disclosure in deciding to buy securities. However, it has been contended that direct reliance, while sufficient to prove causation, is not necessary. Other forms of causation, such as indirect reliance, may be employed. In the current case, reference was made to “market-based causation” which was said to operate in the following manner:¹

The plea is that a misleading statement or omission in a disclosure document causes the market price for the securities to be inflated so that the investor purchases securities at a price which is greater than the investor would otherwise have paid. The investor then suffers loss including when the release of the omitted information or the correction of the misleading statements causes the market price of the securities to fall. None of these causal links requires the investor to rely on the disclosure document.

Application to Amend Pleadings

Shareholders in Arasor International Limited commenced proceedings against directors and the auditors of the company. The claims related to statements in or omissions from the following documents and related conduct:

- a prospectus dated 14 September 2006 in relation to the initial public offering of shares in Arasor in connection with its admission to the official list of the Australian Securities Exchange Ltd (“ASX”) and trading of Arasor shares on ASX’s market (September prospectus);
- a short form prospectus dated 23 March 2007 (March prospectus);
- Arasor’s 2006 financial statements and its 2007 financial statements; and
- the half-yearly financial statement dated 31 August 2007 released by Arasor to the ASX.

The pleadings alleged contraventions of:

- section 728 of the *Corporations Act 2001* (Cth) (“Corporations Act”) which prohibits the offering of securities under a disclosure document which contains a misleading or deceptive statement or from which there is an omission of material required (relevantly) by s 710 or s 712;
- section 1041H of the Corporations Act which prohibits a person from engaging in conduct in relation to a financial product or a financial service which is misleading or deceptive or likely to mislead or deceive;
- section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (“ASIC Act”) which prohibits, in trade or commerce, a person from engaging in conduct in relation to financial services which is misleading or deceptive or likely to mislead or deceive; and
- in the director proceedings, s 9 of the *Fair Trading Act 1999* (Vic) (and equivalent legislation in other states) (“FTA”) which prohibits a person from engaging in conduct in trade or commerce which is misleading or deceptive or likely to mislead or deceive.

The applicants then sought declarations of contravention of the above provisions and damages. The statutory bases for compensation claimed by the applicants are:

- under s 729 of the Corporations Act, for loss or damage “because an offer of securities under a disclosure document contravenes s 728(1)”;
- under s 1325 of the Corporations Act, for loss or damage “because of conduct of another person in contravention of [Ch 6D (including ss 728 and 729) and Pt 7.10 (including s 1041H)]”;
- under s 1041I of the Corporations Act and ss 12GF and 12GM of the ASIC Act, for loss or damage occasioned “by conduct of another person” that contravenes s 1041H of the Corporations Act and s 12DA of the ASIC Act; and
- under s 159 of the FTA, for loss, injury or damage suffered “because of a contravention of a provision of this Act”, relevantly, s 9.

The statutory wording “because” and “by” has been interpreted as necessitating proof of causation.²

At first instance, the applicant sought to amend its pleadings to delete direct reliance from two categories of causes of action: (i) those based on misleading statements or omissions in the September prospectus and in the March prospectus; and (ii) those based on misleading conduct in relation to financial products, financial services or in trade or commerce, so as to employ “market-based causation”. The Federal Court in determining whether to grant leave to amend revisited the law on causation.

Farrell J explained that causes of action in the second category were based on s 82 of the *Trade Practices Act 1974* (Cth) which had been subject to extensive judicial interpretation. The case law accepts that causation can be proved without direct reliance by the person who suffered loss, but there must be reliance in some form, usually by a third party. Her Honour went on to allow the amendment of the pleading:³

despite the strength of intermediate appellate court authority which requires reliance to be demonstrated as an element of causation where an investor has entered into a transaction to which the claim of misleading or deceptive conduct is relevant, recent High Court authority on s 82 of the TPA and the fact that market based causation claims relying on ss 1041H and 1041I and their analogues in the ASIC Act in the context of Chapter 6CA have not been considered by the High Court suggest

that the state of the law cannot be regarded as so settled that an appropriately pleaded claim would have no reasonable prospect of success.

However, in relation to the first category of claims based on a misleading prospectus, the deletion of reliance was rejected as the court found that the pleading did not set out any other causal connection and would, impermissibly, plead only a conclusion.⁴ Her Honour also expressed concern that if reliance was not pleaded, but was ultimately found to be necessary, then those group members who could prove reliance would be unable to recover.⁵

The applicants appealed Farrell J's decision to the Full Federal Court.

Full Federal Court

The primary judge's decision was appealed due to confusion over whether the applicants had been denied the ability to plead market-based causation in relation to ss 728 and 729 of the *Corporations Act 2001* (Cth), the first category of claims.

The joint judgment of Gilmour and Foster JJ found that the orders "had the effect of shutting out the applicants from pleading market-based causation in relation to their ss 728 and 729 case".⁶ Edelman J disagreed.⁷ Nonetheless, the Full Federal Court found such a pleading was arguable as it was neither futile nor likely to be struck out.⁸

The joint judgment relied on the Full Court of the Federal Court in *ABN AMRO Bank NV v Bathurst Regional Council* (2014) 224 FCR 1 which said at [1375]–[1376] that "[t]here is no bright-line principle that it is insufficient for a plaintiff to prove that some other person relied on the alleged misleading conduct and that that person's reliance led to the plaintiff suffering loss". Moreover the High Court in *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [143] noted that "reliance is not a substitute in the context of the Fair Trading Act for the essential question of causation".⁹

The joint judgment also pointed to the text of s 729 which does not refer to reliance and considered that market-based causation may also be supported by the policy behind the provision.¹⁰

Edelman J found that it was at least arguable that market-based causation could be employed as a technique of causation without reliance. His Honour referred to cases that involve misleading conduct by one trader which leads to customers being diverted from another trader: *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526. Edelman J also stated that another factor in favour of market-based causation being arguable was that s 729 permits liability in the case of an omission. Reliance on an omission was described as "a strain of language".¹¹

The Full Court also pointed to other recent decisions where pleadings of indirect reliance had been permitted to proceed or implicitly endorsed as being arguable, such as *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357; *Bolitho v Banksia Securities Ltd* [2014] VSC 8; *Earglow Pty Ltd v Newcrest Mining Ltd* [2015] FCA 328; *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2015) 104 ACSR 195.

Ramifications

The Full Court's decision in *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 continues the line of cases that has endorsed the availability of indirect reliance for proving causation without actually finding causation proved. Like *Caason*, most of the decisions have been interlocutory judgments dealing with pleading issues where the defendants bore the usual higher burden of proof compared to the standard burden applicable at the trial stage. Alternatively the decisions have been obiter statements in final judgments.

Despite indirect reliance being accepted as being available to prove causation in shareholder class actions, it still remains unclear as to how that form of reliance will actually be proved. Edelman J highlighted the need to identify how the causal mechanism was said to operate, i.e. how did the relevant conduct affect the market price, or what were the links in the chain of causation?¹²

It is to be expected that the focus in relation to causation in shareholder class actions will now turn to the particulars of indirect reliance.

Lawyer Contacts

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Endnotes

- 1 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [154] (Edelman J).
- 2 *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525 (Mason CJ).
- 3 *Caason Investments Pty Limited v Cao* [2014] FCA 1410 at [106].
- 4 *Caason Investments Pty Limited v Cao* [2014] FCA 1410 at [111], [120]-[125].
- 5 *Caason Investments Pty Limited v Cao* [2014] FCA 1410 at [116].
- 6 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [9] (Gilmour and Foster JJ).
- 7 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [92] (Edelman J).
- 8 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [65] (Gilmour and Foster JJ), [187] (Edelman J).
- 9 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [62]-[63] (Gilmour and Foster JJ). See also [153] (Edelman J).
- 10 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [68]-[71] (Gilmour and Foster JJ).
- 11 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94 at [154]-[156] (Edelman J).
- 12 *Caason Investments Pty Limited v Cao* [2015] FCAFC 94, [112], [131]-[132], [184] (Edelman J).