SHAREHOLDER CLASS ACTIONS – SOME KEY CONCEPTS

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1. A company's non-disclosure to the market of material information affecting its share price is the central element of any shareholder class action. But what is "information" in this context? How do you assess its materiality? What is required to show that it was known by the company? And is it otherwise "generally available"? And if not, how is its non-disclosure tied to causation and ultimately the loss suffered by each individual investor? And by what methods do you calculate damages?

2. An analysis of the issues relevant to these questions is the principal focus of this paper. I will also explain US "event studies" techniques for assessing materiality and loss, and their application to the Australian context. More generally, these questions will be addressed in the class action setting.

3. The principal statutory provision relevant to shareholder class actions is Section 674 of the *Corporations Act* 2001 ("the Act"), which is the continuous disclosure provision. But some actions also involve misleading and deceptive conduct allegations invoking Section 1041H of the Act and Section 12DA of the *Australian Securities and Investments Commission Act* 2001 ("the ASIC Act"). Misleading and deceptive conduct claims focus on material published by the company that contains misleading or deceptive content or, in context, amounts to misleading or deceptive conduct by omission. In this paper I do not propose to discuss such claims, except for making some brief observations on causation. Rather, my primary focus is on Section 674.

4. The elements of Section 674 in sequence are:

   (a) The company must be a "listed disclosing entity" (Section 674(1));

   (b) The company has to be bound by continuous disclosure obligations under applicable listing rules, relevantly here the ASX Listing Rules (Section 674(1));

   (c) The company has to have information that the Listing Rules require be disclosed to the ASX (Section 674(2)(b));

   (d) And in elaboration of (c) and relevant to Listing Rule 3.1:

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(i) There has to be "information";

(ii) The company must be "aware" of it;

(iii) A reasonable person must expect the information to have a material effect on the price or value of the shares; and

(iv) No exception to disclosure under Listing Rule 3.1A must apply.

(e) Moreover, assuming that Listing Rule 3.1 requires disclosure, nevertheless if the information is "generally available", then no disclosure is required (Section 674(2)(c)(i));

(f) Finally, but overlapping the Listing Rule 3.1 requirement referred to in sub-paragraph (d)(iii) above, Section 674(2)(c)(ii) expressly states that a reasonable person must expect the information to have a material effect on the price or value of the shares as elaborated by Section 677.

5. Now each of these elements is a common question for any shareholder class action. In the next section I will elaborate on some of these areas.

6. One feature concerning Section 674 is that it includes an express accessorial provision (Section 674(2A))[1]. Accessorial liability is relevant to claims against individual directors or officers involved in the non-disclosure conduct. But usually claimants only bring proceedings against the company; it is usually listed and therefore taken to be sufficiently financially sound to meet any claim; there is then no need to bring claims against individual officers. Sometimes, though, directors are joined. If the company has counterclaimed or made a third party claim, say, against the auditors, the auditors might then in turn join the directors (the Centro class actions are examples). I do not propose to discuss accessorial liability further.

7. Another feature to note is that Section 674 does not contain any proportionate liability provision. This may be contrasted with the misleading and deceptive conduct provisions (see Sections 1041H and 1041L-N). A nice question arises, when you have an action where claims under both Sections 674 (1317HA) and 1041H (1041I) are made, as to whether you can use the "aggregation" provision of Section 1041L(2) to indirectly apply the proportionate liability

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[1] Interestingly, Sections 1317E(1)(ja) and 1317HA do not, but Section 1325(1) does. Section 674(2A) creates a separate contravention; Section 1317E(1)(ja) also so treats it. Contrastingly, Section 1325(1) takes the company's contravention and imposes a remedy for that contravention on all accessories.

provisions across all causes of action, including the Section 674 (1317HA) cause of action. I doubt it. But again, this is descending to an unnecessary level of detail for this paper.

8. Principally, I will address the following themes:

   (a) Is disclosure of the relevant information required by Section 674? In that context I will discuss:

      (i) The requirement for the company to be a "listed disclosing entity".

      (ii) Whether Listing Rule 3.1 requires disclosure of the relevant information.

      (iii) The concept of information being "generally available".

      (iv) The requirement that a reasonable person would expect the information to have a material effect on the price or value of the relevant shares.

   (b) Causation, and in that context:

      (i) Objective materiality, in terms solely of the effect of the non-disclosure on price or value (as distinct from a reasonable person's expectation of materiality).

      (ii) US quantitative techniques.

      (iii) The legal and forensic tests for causation, including individual claimant causation.

   (c) Some loss and damage issues.

   (d) Several class action structural questions.

9. There is a useful discussion of the legislative history of Section 674 by Gilmour J in *ASIC –v- Fortescue Metals Group Ltd (No 5)* [2009] FCA 1586 at [218]-[226][2].

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[2] This decision was overturned on appeal ([2011] FCAFC 19) on the short point that statements to the market that FMG had entered into "binding agreements" with the Chinese should be taken to be conveying (or understood as conveying) statements of fact rather than opinion (see Keane CJ at [117] and [119]). And as they were statements of fact, FMG's announcements were misleading or deceptive under Section 1041H of the Act ([177]) and the failure to correct contravened Section 674 of the Act ([181], [187] and [189]).

A. IS DISCLOSURE OF THE INFORMATION REQUIRED BY SECTION 674?

I: Step 1 – Is the company a "listed disclosing entity" (Sections 674(1) and 2(a))?

10. This requirement is not usually contentious. ASX listed companies satisfy that criterion. And normally, shareholder class actions are only brought against ASX listed companies.

11. Section 674(1) requires the company to be a "listed disclosing entity" (see also subsection (2)(a)).

12. Part 1.2A of the Act deals with what is meant by a "disclosing entity" (Section 111AA(a)).

13. Section 111AC(1) provides that if any "securities" of a body are "ED securities" then the company is a disclosing entity. "Securities" include shares in a company (Section 92(1)(b)).

14. Securities of a company are ED securities, if, inter alia, they are ED securities under Section 111AE. Section 111AE(1) provides that if the company is included in the official list of a "prescribed financial market" and that market's listing rules apply to the securities, then the securities are "ED securities". The ASX is a "prescribed financial market" (Regulation 1.0.02A of the Corporations Regulations 2001) and ASX Ltd. is a prescribed market operator (Regulation 7.1.01(a)).

15. Section 111AL(1) provides that a disclosing entity is a "listed disclosing entity" if the ED securities are quoted ED securities.

16. In summary, and by this tortuous modern drafting technique, a company which is on the official list of the ASX and whose shares are quoted is a "listed disclosing entity".

17. There is a further requirement for Section 674(2), namely, that provisions of the Listing Rules require the entity to notify the market operator of relevant information (Section 674(1)). An ASX listed company satisfies such a requirement because of the disclosure obligations of Chapter 3 of the Listing Rules, particularly Listing Rule 3.1.

18. I have set out the above provisions not to reflect that the Section 674(1) requirement is a major issue in shareholder class actions, but rather to demonstrate that in this area, no statutory word or phrase is to be passed over lightly.

II: Step 2 – Does the company have information that Listing Rule 3.1 requires be disclosed to the ASX (Section 674(2)(b))?

19. The second element of Section 674(2) requires it to be established that:

    (a) the company has "information";

    (b) the Listing Rules require the company to notify the market operator of that information.

Information

20. What is "information"? And is the concept of "information" co-extensive with that concept as used in Listing Rule 3.1? Alternatively, is the statutory concept to be informed by the Listing Rule concept?

21. "Information" is not defined for the purposes of Section 674. But "information" is defined, for the purposes of the insider trading provisions, to include matters of supposition and matters relating to intentions[3]. But there is no similar definition for the purposes of Section 674. In that context, "information" may be given a more restrictive interpretation[4]. And this may be consistent with the philosophy underpinning Australian securities law that disclosure of speculation is not required and is to be avoided[5].

22. But one element of the third condition of the exception in Listing Rule 3.1A refers to excluding information which "comprises matters of supposition or is insufficiently definite to warrant disclosure". That might suggest that the Listing Rule 3.1 general context does prima facie use "information" as embracing speculation or insufficiently definite information, but leaves the work to the carve-out to operate to exclude supposition or indefinite information. But leaving it to the carve-out to operate has its difficulties. Each of the requirements of Listing Rules 3.1A.1 and 3.1A.2 also need to be satisfied before the exclusion operates to exclude information which "comprises matters of supposition ...". Accordingly, it does make a

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[3] Section 1042A.

[4] See the discussion in Ford's *Principles of Corporations Law* at [10.310], referring to the argument in the specific context of s674, with its reference to "*information about specified events or matters*". See also D. Reichel, *Continuous disclosure in volatile times* (2010) 28 C&SLJ 84 at 98 (note 66).

[5] *Australian Consolidated Investments Ltd v Rossington Holdings Pty Ltd (No 2)* (1992) 35 FCR 226 at 228; *Pancontinental Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463. See also *AAPT Ltd v Cable & Wireless Optus Ltd* (1999) 32 ACSR 63, in which Austin J referred to *Pancontinental* and held, in the takeover context, that an offeree should not be told about incomplete negotiations, saying at 102 [158]: "*the Part A statement should illuminate the issues rather than confuse them, and a degree of selectivity is permitted in order to confine the information to that which is really useful.*" See also D. Reichel, *Continuous disclosure in volatile times* (supra) at 98. But this may all justify why the Listing Rule 3.1A exception exists rather than reading down the concept of "information" per se.

difference as to whether "information" does or does not include supposition and indefinite information.

23. In my view, the Section 674(2) concept and the Listing Rule 3.1 concept of "information" prima facie include supposition and indefinite information.[6] But if you had such information, it may not require disclosure because:

(a) Section 674(2)(c)(ii) may not be satisfied (i.e. a reasonable person would <u>not</u> expect such information to have a material effect ...);

(b) the similar prefatory words of Listing Rule 3.1 may not be satisfied; or

(c) you may establish the three cumulative conditions of the carve-out in Listing Rule 3.1A: for Rule 3.1A.1, a "reasonable person would not expect the information to be disclosed"; for Rule 3.1A.2, such information in most cases is likely to be confidential; and for Rule 3.1A.3, you would satisfy the element dealing with supposition and insufficiently definite information.

24. More generally on the "information" question, you may need to distinguish between:

(a) a fact;

(b) an opinion:

(c) a belief or state of mind, say, held by the CEO.

Each of these three possibilities can be "information". They are also related. For example, a state of mind held by a CEO can be a fact; further it may constitute an opinion. And an opinion may be a fact, albeit of a secondary variety.

25. I will proceed on the assumption that you are dealing with "information" that falls within that concept as used in Section 674(2)(b) and Listing Rule 3.1. Does the Rule require its disclosure such that the Section 674(2)(b) element is satisfied?

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[6] I note that the words of Section 674(1) use the phrase "specified events or matters" which might suggest precision. But this is a generic provision concerned to identify relevant provisions of the Listing Rules as to whether they exist. Further, "specified" is not a direct qualifier of "information". Further, the word "about" injects vagueness.

Awareness of Information

26. Listing Rule 3.1 only requires disclosure of information of which the entity is "aware". This is similar in concept to "has" in the expression "the entity has information" as used in Section 674(2)(b). What is required to show such knowledge? Actual knowledge? Constructive knowledge? And if the latter, how far down the five levels of knowledge? Listing Rule 19.12 elaborates on the concept of "aware" to include constructive knowledge. So a company is "aware" if a director or executive officer "has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as director or executive officer of that entity"; but this does not extend to other employees. This also does not proceed past Peter Gibson J's level four type knowledge in *Baden –v- Societe Generale* [1992] 4 All ER 161. Other interesting questions also arise in terms of the attribution of the knowledge (or its possession) of individual directors, other officers, servants or agents to the company. A useful guiding principle is that if such knowledge was gained qua such a capacity, then attribution would usually follow. Given the broader context of my paper, I will not elaborate further on this topic, except to elaborate on two aspects concerning "information" in the form of an opinion.

27. Assume that the "information" in question is an opinion. Assume also, for example, that it relates to the construction and effect of an agreement where there are two equally open but opposite opinions that could be held, namely, construction A and construction B. But assume that the company or its CEO only holds the opinion as to construction A and discloses it; assume also that the company does not disclose construction B. Does, nevertheless, the company need to disclose construction B? The answer given by Gilmour J in *ASIC –v- Fortescue Metals Group Ltd (No 5)* (supra) at [253]-[263] and [465]-[467] is "no". If the opinion as to construction A was reasonably and honestly held by the company, but no such opinion was held for construction B, then there is no obligation to disclose construction B. The opinion as to construction B was never held by the company. There was no actual awareness. Moreover, there may be no constructive awareness, because the opinion as to construction A was honestly and reasonably held, which may negate (on my assumption) the opposite construction. But you can logically have two conflicting views, each of which it may be reasonable to have, therefore arguably invoking the extended meaning of "aware" under Listing Rule 19.12 for construction B. The Full Court in *ASIC –v- Fortescue Metals Group Ltd* (supra) overturned Gilmour J, but it side-stepped these interesting questions by treating the relevant information as to the effect of the agreement as being fact rather than opinion; further

the Court concentrated more on the misleading and deceptive conduct case and left the Section 674 claim in the "failure to correct" category.

28. One other but related issue concerns the relevance of the company taking legal advice concerning its disclosure obligations and acting upon that legal advice. Strictly, that does not alter the ambit of the disclosure obligation (*James Hardie Industries N.V. -v- ASIC* (2010) 274 ALR 85 at [479]); it may though create a defence for a person knowingly involved (see Section 674(2B)) and so too, perhaps arguably, for the company (see Section 1317S). But the taking of legal advice may be tangentially relevant where the information in question is an opinion, which opinion relates to a legal question and may be informed by expert legal advice. If the legal advice is not about the broader continuous disclosure obligations of the company, but has a narrower ambit, it may inform the question as to whether the company was "aware" of information in the form of an opinion.

Expectation of Material Effect

29. Second, assume that the company has or is aware of information. Listing Rule 3.1 prima facie only requires disclosure if "a reasonable person would expect (it) to have a material effect on the price or value" of the shares. This is clearly looked at through an ex ante lens. Now there are several interesting features to note at this point, namely:

    (a) The Listing Rule does not elaborate further on this concept. But contrastingly, the Act does. The second element of Section 674(2)(c) provides that it be shown (in order for the statutory disclosure obligation to apply) that the information is such that "a reasonable person would expect, if it were generally available, to have a material effect on the price or value ...". This mirrors the Listing Rule requirement in terms of a positive element required to be satisfied in order for disclosure to be required. Now Section 677 elaborates on this concept, unlike the Listing Rule. Section 677 provides that "a reasonable person would be taken to expect information to have a material effect ... if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of" the shares. How does this concept interact with the Listing Rule? Is the Section 677 elaboration what you would ordinarily read into the Listing Rule expression in any event? If yes, then nothing further need to be said. The Listing Rule 3.1 concept can be taken as co-extensive with the Section 674(2)(c)(ii) concept as illuminated by Section 677. If not, then what is the consequence?

(b) Let me assume this latter scenario. If Section 677 narrows the ordinary meaning of the concept used in Section 674(2)(c)(ii), then although Listing Rule 3.1 may be satisfied for disclosure, nevertheless, the statutory obligation of disclosure under Section 674(2) may not be triggered, because of the narrower concept of Section 674(2)(c)(ii) as "read down" by Section 677. Contrastingly, if Section 677 broadens the ordinary meaning of the concept, then you may not get to the "additional breadth" scenario, because you may not have satisfied the hypothesized narrower concept in Listing Rule 3.1 and therefore have not satisfied the earlier element of Section 674(2)(b).

(c) Now it seems to me that Section 677 does not narrow the ordinary meaning of the concept. It is not expressed in the language "if and only if". Moreover, it doesn't appear to change the ordinary meaning of the concept. Moreover, reading the Listing Rule 3.1 concept to implicitly (although not expressly) embrace the elaboration in Section 677 avoids the difficulties referred to in sub-paragraph (b). The Listing Rule 3.1 concept should be taken to implicitly embrace the Section 677 concept. Such a conclusion is supported by Martin CJ in *Jubilee Mines NL –v- Riley* (2009) 253 ALR 673 at [34], [54]-[62] and by Gilmour J in *ASIC –v- Fortescue Metals Group Ltd (No 5)* (supra) at [238]. And such a conclusion appears also to have been embraced by the publishers of the Listing Rule, who refer to Section 677 as part of the explanatory notes to the Listing Rule; see also paragraph 20, Guidance Note 8 to the Listing Rules. Listing Rule 19.3 may also be seen to assist.

(d) One other useful feature to note is that Section 677 also elaborates on the genus and perspective of the "reasonable person". It is "persons who commonly invest in securities". However, no distinction is made between the sophisticated and the unsophisticated, between the small and the large, or between the retail and the wholesale investor.

30. In terms of the reasonable person expectation, another feature to note is that the Listing Rule contains both a positive element and a negative element. For Listing Rule 3.1 to require disclosure, it has to be positively established that a reasonable person would have the relevant expectation. But the first limb of the Listing Rule 3.1A carve-out is that "(a) reasonable person would not expect the information to be disclosed". Now you might think that there is a paradox. You might think that if you satisfy the positive element, you necessarily negate the negative element so that you can never satisfy the Listing Rule 3.1A carve-out. But this would be a mis-reading. There is no paradox. They are dealing with different expectations. The Listing Rule 3.1 expectation is about "a material effect on the price or value" of the shares.

The Listing Rule 3.1A carve-out concerns a broader concept relating to what a reasonable person would expect to be disclosed. Even if a reasonable person expected the information to have a material effect on the price or value, nevertheless that person might, in all the circumstances, not expect the information to be disclosed.

31. There is another point that I want to make. Both Listing Rule 3.1 and Section 674(2)(c)(ii) look at the question of materiality through the perspective of the reasonable person's expectation. But materiality can also be addressed in a pure objective sense relevant to causation, namely, whether the information had a material effect on price or value, i.e. whether the share price was inflated or deflated by reason of the non-disclosure. Although that purely objective concept is not expressly required by any of the elements of Listing Rule 3.1 or Section 674, nevertheless it is essential in order for a claimant to establish causation under Section 1317HA. If the information or its non-disclosure cannot be shown to have had such a material effect, in the sense of producing share price inflation or deflation, causation is not established; I discuss this further in the section on causation.

32. Finally, I will elaborate on the reasonable person expectation further at step 4 dealing with Section 674(2)(c)((ii).

The Listing Rule 3.1A exception

33. Listing Rule 3.1A contains an exception to Rule 3.1. Three conditions need to be cumulatively satisfied. The **first** condition is that a reasonable person would not expect the information to be disclosed. An example might be a case where disclosure might be expected to prejudice the company's or the shareholders' interests in a manner unreasonably disproportionate to the benefit flowing from transparency and a fully informed market with disclosure. The **second** condition is, in essence, that the information is confidential. Now this condition does not mean that there cannot be limited and controlled dissemination of information to third parties such as advisers, regulators or negotiating parties. But selective disclosure, say, to favoured analysts may result in this condition not being satisfied. Further, where rumours are circulating in the market or there is media comment concerning the information, this may evidence a loss of confidentiality, particularly if the rumours or the comment are sufficiently specific. So too, if there are unexplained changes to the share price; this may indicate a loss of confidentiality. The **third** cumulative condition is that one or more of the following scenarios apply:

- It would be a breach of a law to disclose the information.

- The information concerns an incomplete proposal or negotiation.

- The information comprises matters of supposition or is insufficiently definite to warrant disclosure.
- The information is generated for the internal management purposes of the entity.
- The information is a trade secret.

I do not propose to elaborate further in the context of this paper.

III: Step 3 – Is the Information "generally available" (Section 674(2)(c)(i))?

34. Disclosure of information is not required if the information is "generally available" (see Section 674(2)(c)(i)).

35. The expression *"generally available"* is elaborated on in Section 676 of the Act in the following terms:

Sections 674 and 675 – when information is generally available

(1) This section has effect for the purposes of Sections 674 and 675.

(2) Information is generally available if:

(a) it consists of readily observable matter; or

(b) without limiting the generality of paragraph (a), both of the following subparagraphs apply:

(i) it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information; and

(ii) since it was so made known, a reasonable period for it to be disseminated among such persons has elapsed.

(3) Information is also generally available if it consists of deductions, conclusions or inferences made or drawn from either or both of the following:

(a) information referred to in paragraph 2(a);

(b) information made known as mentioned in subparagraph (2)(b)(i).

36. The two primary limbs of Section 676(2) are to be read disjunctively[7]. Sub-section (3) is a third but secondary means by which information may become generally available.

"readily observable matter" **– the first primary possibility (Section 676(2)(a))**

37. The first limb of the test in Section 676(2)(a) stands as an independent basis upon which information may be found to be *"generally available"*[8]. It does not involve a consideration of whether the market has had a reasonable time to absorb the information[9].

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[7] *James Hardie Industries NV v ASIC* (supra) at 198 [544].
[8] *James Hardie Industries NV v ASIC* (supra) at 198 [543]-[544].
[9] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35 at 107 [552].

38. The term "*readily observable matter*" is not defined in the Act[10]. Extrinsic material relating to the enactment of the cognate provisions proscribing insider trading explained the expression "*readily observable matter*" as "*facts directly observable in the public arena*"[11].

39. Whether information is "*readily observable matter*" is a question of fact to be determined objectively and hypothetically[12].

40. It does not matter how many people actually observe the relevant information; information may be readily observable even if no one has observed it[13]. The test of whether material is readily observable is not whether the particular matter *was* widely observed but whether it *could* have been[14].

41. Ready observability is also not limited to perceptibility by the unaided human senses. In considering the factual question involved, modern means of communication such as telephone, telex, facsimile, television and the internet can be taken into account[15].

42. The section does not define the class of persons by whom the matter is to be "*readily observable*". It is not confined to existing shareholders in the relevant entity or even existing traders of shares on the ASX[16].

43. Ready perceptibility "*by those in Australia*" is not an explicit or implicit part of the statutory definition[17] ; such a limitation would wrongly suggest or infer that the *readiness* of the perceptibility is to be judged from the viewpoint of individuals located in Australia using their natural senses and would fail to recognize that television, the internet (including e-mail) and other means of telecommunication such as the phone and fax are part and parcel of how Australians generally and investors in particular readily perceive events[18].

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[10] G. North, *The insider trading "generally available" and "materiality" carve-outs: Are they achieving their aims?* (2009) 27 C&SLJ 234 at 236.
[11] Explanatory Memorandum to the *Corporations Legislation Amendment Bill* 1991 (Cth), paragraph [328]: see *R v Firns* (2001) 51 NSWLR 548 at 560 [56].
[12] *R v Firns* (supra) at 565 [83]; *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (supra) at 106 [546]; *ASIC v MacDonald (No 11)* (2009) 256 ALR 199 at 363 [1079].
[13] *R v Firns* (supra) at 564 [77], 565 [88].
[14] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (supra) at 107 [551].
[15] *R v Firns* (supra) at 564 [787].
[16] *R v Firns* (supra) at 563 [70]. See s.19F of the *Securities Markets Act* 1988 (NZ), which concerns continuous disclosure, uses the expression "*generally available to the market*": see K. Kendall and G. Walker, *Insider Trading in Australia and New Zealand: information that is "generally available"* (2006) 24 C&SLJ 343 at 350-5.
[17] *R v Firns* (supra) at 564 [79].
[18] *R v Firns* (supra) at 564 [81].

44. Some information has the capacity, through its first mode of communication, to generate its own dissemination. Its initial disclosure may be limited, yet the type of information involved and the initial group of persons to whom it is disclosed may ensure that it gets broader dissemination. You would expect information dispatched to the ASX to have this capacity[19]

45. Generally, the following instances provide some guidance on the general concept:

(a) Material notified to the ASX becomes generally available[20] on the basis that it is readily observable matter;

(b) Material stated in a financial report released by a company is readily observable matter[21];

(c) The combination of the filing of an affidavit in a court, a newspaper article and a letter to the stock exchange may render the relevant information generally available[22];

(d) A published judgment of the Supreme Court of Papua New Guinea may be readily observable matter[23] - it was available, understandable and accessible to a significant group of the public[24].

46. By contrast, information on an ASIC register that might, on payment of a fee, enable a complex series of filings by a private company (that had changed its name on a number of occasions) to be searched, which might reveal relevant information if the searcher was

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[19] *R v Firns* (supra) at 563 [75].
[20] The Crown accepted that this was so in *R v Firns* (supra) at 553 [26].
[21] *James Hardie Industries NV v ASIC* (supra) at 198 [541]-[545]. In that case, ASIC accepted, and the Court also appeared to accept, that the information contained in the 4th quarter financial report released by the defendant was readily observable, but the omission from the report of one important aspect of the information requiring disclosure meant that the defendant breached its obligation. ASIC also accepted that when the omitted information was included in the annual report released subsequently, that was sufficient disclosure: 180[433], 198 [545].
[22] *Kinwat Holdings Pty Ltd v Platform Pty Ltd* [1982] Qd R 370 at 372. In that case, Connolly J noted that it may be that the news story on its own was sufficient to make the information generally available, but it was unnecessary to decide the point because the other forms of dissemination placed the matter beyond doubt. The case concerned the expression "*generally available*" in s.128 of the *Securities Industry (Application of Laws) Act* 1981 (Qld) (concerning insider trading) which did not contain any further elaboration on the meaning of the expression.
[23] *R v Firns* (supra) at 564 [78]. In that case, it was held that a judgment of the Supreme Court of Papua New Guinea was readily observable matter for the purposes of an allegation of insider trading said to have occurred in New South Wales. Mason P held that ready perceptibility "*by those in Australia*" was not an explicit or implicit part of the statutory definition: 564 [79].
[24] *R v Firns* (supra) at 563 [76].

sufficiently astute to consider name changes and conducted a search for the ABN of the private company, is not readily observable matter[25].

47. Further, if information has become *"generally available"*, one would expect to find it in contemporary analysts' or brokers' reports[26]. Lack of general availability of information may be evidenced by the absence of any information in relation to it in press reports, media releases and brokers' or analysts' reports of the kind that might have been expected to have discussed or revealed it had the information been generally available[27].

The information has been "*made known*", with a "*reasonable period*" for its dissemination – the second primary possibility (Section 676(2)(b))

48. The term *"persons who commonly invest"* is not defined in the Act[28]. Further, the section does not provide any guidance on the manner in which information must be disseminated[29].

49. Extrinsic material relating to the comparable provisions proscribing insider trading explained this element of the second limb of the test as requiring that the information:

> "be made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in securities of bodies corporate of a kind whose price or value might be affected by the information. This provision is intended to define the term 'generally available' in terms appropriate to closely held and unlisted companies as well as listed companies with dispersed shareholdings. It would not be sufficient for information to be released to a small sector of the investors who commonly invest in the securities. The information must be made known to a cross section of the investors who commonly invest in the securities; ... ."[30]

This implies that disclosure to a select group of institutional investors would not be sufficient to meet the test, but the situation may be different if that group of institutional investors

[25] *ASIC v MacDonald (No 11)* (supra) at 372 [1133]. The second primary possibility (Section 676(2)(b)) would not apply either ([1134]).
[26] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (supra) at 108 [558] referring to *R v Hannes* (2000) 158 FLR 359 at 403 [257]. In that latter case, Spigelman CJ held that the information in the brokers' reports and newspaper articles were deductions, conclusions and inferences made from matter that was generally available, but was of little assistance on the facts: 403 [258]. See G. North (supra) at 238 for further discussion.
[27] *R v Rivkin* (2004) 184 FLR 365 at 397 [179]. In that case, the Court also noted that in proving the lack of general availability, the Crown had to exclude the existence of deductions, conclusions or inferences: 397 [178].
[28] G. North (supra) at 236.
[29] G. North (supra) at 237.
[30] Explanatory Memorandum to the *Corporations Legislation Amendment Bill* 1991 (Cth), paragraph [328]: see *R v Firns* (supra) at 560 [56].

represented a significant proportion of the shareholder population of the particular company in both value and number[31].

50. Consideration must be given to available technology in applying the test. For example, a press release that previously may not have been practically accessible until published in the daily press the following day, may now be considered accessible immediately if posted on an appropriate internet site[32].

51. It has been held that a statement containing information made to market analysts, who routinely reported on a company, was made to the very people who were likely to bring it to the attention of persons who commonly invested in securities of a kind whose price or value might be affected by the information[33]. Dissemination to professional investors may also be sufficient on the basis that this allows rapid "inclusion" of the relevant information into the share price[34].

52. The term "*reasonable period*" is also not defined in the Act[35].

53. Extrinsic material relating to the provisions proscribing insider trading explained this element of the second limb of the test as follows:

> "This provision is designed to prevent an insider, who is aware of information prior to its release, getting an unfair head start on other market participants, not to require an embargo on trading of such duration that it constitutes an impediment to the efficient operation of the market (subparagraph (b))."[36]

54. Legislators have generally declined to provide bright line guidance on the required period of time. The means of dissemination, the complexity of the information, trading volumes, investor interest in the relevant security, and market conditions all impact on the speed and accuracy of the absorption of information into share prices.

"*deductions, conclusions or inferences*" from the primary sources – the third (but secondary) possibility (Section 676(3))

55. Extrinsic material relating to the provisions proscribing insider trading noted that it was not intended that the provisions would regard, as "inside" information, such things as deductions

[31] K. Kendall and G. Walker (supra) at 348.
[32] K. Kendall and G. Walker (supra) at 348, n 34.
[33] *ASIC v MacDonald (No 11)* (supra) at 364 [1092].
[34] G. North (supra) at 237.
[35] G. North (supra) at 236.
[36] Explanatory Memorandum to the *Corporations Legislation Amendment Bill* 1991 (Cth), paragraph [328]: see *R v Firns* (supra) at 560 [56].

and conclusions which investors, brokers or other market participants may make based upon independent research of generally available information[37].

56. Accordingly, the third (but secondary) means by which information may become "*generally available*" is if the information consists of "*deductions, conclusions or inferences*" based upon information that is either readily observable or publicly disseminated.

57. A party seeking to prove the lack of general availability of information must negative the existence of relevant deductions, conclusions or inferences[38].

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[37] Explanatory Memorandum to the *Corporations Legislation Amendment Bill* 1991 (Cth), paragraph [327]: see *R v Firns* (supra) at 560 [56]. In *R v Hannes* (supra) at 405 [275], Spigelman CJ held that the information in the brokers' reports and newspaper articles were deductions, conclusions and inferences made from matter that was generally available.

[38] *R v Rivkin* (supra) at 397 [178].

IV: Step 4 – Would a reasonable person expect the information to have a material effect on price or value (Section 674(2)(c)(ii))?

58. As stated earlier, this requirement overlaps with the Listing Rule 3.1 requirement. Moreover, it is illuminated by Section 677.

59. A number of forensic questions may arise.

60. First, what evidence of reasonable expectation is or can be adduced? Ultimately the assessment of reasonable expectation is a matter for the judge. On one view, no direct investor evidence is required. But usually evidence will be sought to be adduced in the following manner:

    (a) You will have the direct evidence of the claimant to establish his individual causation case.

    (b) You will have evidence, at least on the causation question, on the purely objective materiality question i.e. whether the information and its non-disclosure actually produced share price inflation or deflation (discussed later). Alternatively expressed, if on the day the information is disclosed to the market there is a statistically significant movement in the share price that you can attribute to the disclosed information, then this provides some evidence of materiality. But the absence of such evidence does not mean that you cannot establish the relevant Section 674(2)(c)(ii) expectation as illuminated by Section 677. As Keane CJ noted in *ASIC –v- Fortescue Metals Group Ltd* (supra) at [188], Section 677 is not a "high threshold". The terms of Section 677 "do not invite any inquiry as to whether any change in the price of securities has occurred … caused by an announcement". Nevertheless "(w)hat happened in the market, in terms of movements in share price, may assist the Court in applying the 'likely influence' test"; such an analysis is an ex post analysis, albeit that the expectation issue is an ex ante one (see also Gilmour J at first instance at [474]-[629] and *James Hardie Industries NV –v- ASIC* (supra) at [531]-[540]). Now all of this is to be understood in the context of Section 677; but when looking at causation in terms of damages claims, you need to go further.

    (c) You may have evidence from large institutional or wholesale investors (including fund managers) as to their expectation of materiality; this is relevant given the genus of the class referred to in Section 677.

(d) You may have expert evidence from brokers, analysts, investment bankers and capital market researchers opining on the question of materiality and expectation; this is more indirect than category (c) evidence, but is still useful.

(e) Finally, the company's own views on materiality are not irrelevant, but carry little weight.

61. Second, what is meant by "material effect" in Section 674(2)(c)(ii)? As stated earlier, Section 677 illuminates this concept and also identifies the genus of the class of "persons who commonly invest in securities". It refers to the concept of whether "the information would, or would be likely to, influence (such) persons ... in deciding whether to acquire or dispose of" the relevant shares. The two categories of evidence ((c) and (d)) referred to in the preceding paragraph are usually directed to the Section 677 language. The concept of "materiality" in terms of its capacity to influence a person whether to acquire or dispose of shares must refer to information which is non trivial at least. In the medical negligence field, it has been held that a risk is "material" if a person would be likely to attach significance to it (*Rogers –v- Whitaker* (1992) 175 CLR 479 at 490-491; *Rosenberg –v- Percival* (2001) 205 CLR 434 at 458). The Section 677 illumination seems to embrace an analogous concept of "materiality". What if the information concerns an event that has a speculative or contingent component to it? Materiality may also then depend upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event on the company's affairs (*Basic Inc –v- Levinson* 485 US 224 (1988) at 238-239; see also *TSC Industries Inc –v- Northway Inc* 426 US 438 (1976)). Finally, the accounting treatment of "materiality" may not be irrelevant if the information is of a financial nature that ought be disclosed as well in the company's accounts. But accounting materiality does have a different, albeit not completely unrelated, focus.

B. CAUSATION

62. Complex causation issues arise in shareholder class actions. Also intertwined with causation is the question of materiality of the information in terms of its purely objective content and effect on share price[39].

63. Causation in shareholder class actions usually involves the following elements for the "inflationary" case:

(a) A company is said to have contravened the continuous disclosure requirements of Listing Rule 3.1 and Section 674 of the Act, by not disclosing material adverse information to the market.

(b) As a result of such non-disclosure, the listed price for the company's shares is said to have been inflated i.e. above the price that it would have been if the material information had been disclosed.

(c) Investors have then purchased shares at the inflated price and held them after the time when the price ceased to be so inflated, i.e. when the material information became known to the market. Accordingly, such investors have suffered loss and damage by reason of the contravention.

Other possibilities arise for the "deflationary" case. There could be share price deflation as a result of the non-disclosure of material positive information, i.e. the directors may have withheld favourable information. A cause of action may arise for a shareholder who sold his shares during the deflationary period when the share price was lower than what it would have been if such positive information had been disclosed to the market.

64. As stated earlier, in addition to any breach of the continuous disclosure requirements, there may be an overlay of misleading or deceptive conduct allegations under Section 1041H of the Act or Section 12DA of the ASIC Act. These may focus on announcements, reports or accounts published by the company that contain misleading or deceptive content. Alternatively, there may be misleading or deceptive conduct by omission in the light of the disclosed "positive" content. Now such announcements, reports or accounts can be looked at

[39] I am distinguishing that latter concept from the reasonable person's expectation as to material effect (see Sections 674(2)(c)(ii) and 677).

in two causation connections. First, they may feed into what material was available to and in the market place, and which therefore was factored into the share price; so they may relate to the Listing Rule 3.1/Section 674 case. Second, they may be the subject of separate focus as to whether their contents came to the attention of, or were read by, actual or potential investors in the company's shares, and therefore had a more direct causal effect on such investors' behaviour, so providing a foundation for the misleading or deceptive conduct case.

I: Materiality – Is the Information Material?

65. A factual issue that arises at a general level is the materiality of the information not disclosed; I am talking here of the pure objective content and effect of the information on share price rather than a reasonable person's expectation as to material effect. Assume that the relevant information is disclosed by the company and contemporaneously the share price falls. By those observable facts you might infer the fact of materiality and, accordingly, that the share price had been inflated. Equally, if there has been no share price change at the time of formal disclosure, you might conclude an absence of materiality and consequently no inflation. Alternatively, you might conclude that the market became aware of the information at an earlier time and had already factored it into the share price. So you might have to go back to an earlier time to look at materiality and to assess the inflationary component in the share price.

66. But this type of "analysis" is at best intuitive perception; it may not be sufficiently rigorous; post hoc, ergo propter hoc reasoning is inadequate. As explained in *Dura Pharmaceuticals Inc –v- Broudo* 544 US 336 (2005) at 342-3, there may be a "tangle of factors" affecting share price, including changed economic circumstances, investor expectations, and industry or firm specific facts which may account for price change rather than just the material information disclosed, but which ought to have been disclosed earlier. Moreover, when a company decides to announce material information which ought previously to have been disclosed, the announcement usually contains other information, particularly if a company is aware of the forensic benefits flowing from "mixed" announcements. For example, say a company announces at the one time two types of negative information: first, the negative information that should have previously been disclosed but wasn't; second, further negative information that has been disclosed in a timely fashion. Say that as a result of such a "mixed" announcement there is a share price fall. Which part of the fall is referable to the first type of information the subject of the contravening conduct? Take another scenario where the "mixed" announcement contains new positive information (disclosed in a timely fashion) with the negative information which ought previously to have been disclosed. Say that as a result of

the announcement there is no share price fall. How do you then work out materiality and the inflationary component in the share price solely referable to the tardy disclosure of the negative information?

67. There are two ways to establish purely objective materiality, namely:

(a) an assessment of the relevant information, where the expert's qualitative opinion is then overlaid; or

(b) a statistical analysis of the movements in the share price when disclosure is made.

68. Preferably, the assessment of materiality should use quantitative techniques involving event studies. These are studies that quantify the effects of information on share price[40].

69. The essential elements of such studies are the following[41]:

(a) First, you take a market and/or industry share index and obtain data for the movement in that index over a relevant period.

(b) Second, you look at the movement of the share price for the particular company over that same relevant period.

(c) Third, you model the normal relationship of the share price movement for the particular company against the movement of the index that you have chosen over the relevant period. You hope to produce a statistically significant linear trend using regression analysis, so that you can then make predictions as to the company's share price based upon the movement in the index.

(d) Fourth, you take the day when (and immediately after) the information is disclosed to the market. At that time you, of course, have the actual share price for the particular company immediately after disclosure.

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[40] These techniques have been used since 1969 in US securities fraud litigation. Many US courts have required such studies, e.g. *In re N. Telecom Securities litigation* 116 F Supp 2d 446 at 460, *In re Imperial Credit Industries Securities litigation* 252 F Supp 2d 1005 at 1015-6, *In re Executive Telecard Securities litigation* 979 F Supp 1021, *Miller –v- Asensio & Co* 364 F 3d 223 at 232 and *In re Oracle Securities litigation* 829 F Supp 1176 at 1181. These studies establish US "loss causation". They are not, though, required at the class certification stage (*Erica P. John Fund Inc v Halliburton Co* 563 US (6 June 2011)).

[41] Tabak, D. and Dunbar, F: *Materiality and Magnitude: Event Studies in the Courtroom* (April 1999) (NERA), reproduced in *Litigation Services Handbook: The Role of the Financial Expert* (3rd Ed, 2001), edited by Weil, R., Wagner, M. and Frank, P. (J. Wiley and Sons) and Bruegger, E. and Dunbar, F: *Estimating Financial Fraud Damages with Response Coefficients* (July, 2009) (NERA).

(e) Fifth, you compare this actual share price with what you can predict for the share price based upon the relationship with the movement of the index as referred to in sub-paragraph (c). In essence, you are looking at what you would have predicted for the change in share price on the day by reference solely to normal background or market conditions (economic, general investor market confidence etc.). You then compare this predicted share price with the actual share price immediately after disclosure. The difference between the predicted and actual price is then taken to be attributable to the information that was disclosed. If the actual price falls from what you would have predicted (based on normal market movements), then you have established that the share price was inflated by reason of the non-disclosure (but then deflated when full disclosure was made). If the actual price rises from what you would have predicted, then you have established that the share price was deflated by reason of the non-disclosure (but then inflated when full disclosure was made).

70. Now this is the simple case. But at this point there are various things to note:

(a) First, event studies rely on the "semi-strong" version of the efficient market hypothesis, which states that share prices in an actively traded security reflect all publicly available information and respond quickly to new information.[42] Moreover, share price impacts of an event can only be revealed if the following conditions are present:

(i) The event is a well-defined news item.

(ii) The time that the news reaches the market is known.

(iii) There is no reason to believe that the market anticipated the news.

(iv) It is possible to isolate the effect of the news from market, industry, and other firm-specific factors which also simultaneously affect the company's share price.

If you are not able to proceed on the efficient market hypothesis and to satisfy these conditions, then you cannot assume that the difference between your actual share price and the predicted share price (based on the relationship of the movement with the index) will give you your inflation/deflation.

[42] David Tabak (NERA) elaborates on this in his article "Use and Misuse of Event Studies to Examine Market Efficiency" (30 April 2010): www.nera.com.

(b) Second, as will be apparent from my simple description, you can only perform the study looking at the time when the announcement is made and you have the actual share price post announcement. You cannot use this "simple" technique if there is nothing announced, and by definition there is no actual share price after the announcement.

(c) Third, you cannot use this simple method where on the day of the announcement there are other idiosyncratic circumstances (i.e. other than the particular information disclosed on that day) that affect only the company's share price, but not the market generally and therefore the market index. The simple method assumes that the only unusual circumstance on the day is the announcement of the particular information disclosed (which ought to have been disclosed sooner) and nothing else. It attributes the difference between the actual share price and the index predicted share price to the information disclosed and nothing else. But:

  (i) If something else has occurred on the day specific to the company and not the market, then this will confound the analysis. The actual share price change (as compared with the index) will be produced by two or more idiosyncratic features which may not be able to be separated.

  (ii) Equally, if the announcement is a "mixed" announcement of the type previously suggested, then this will also confound the analysis.

(d) Fourth, you may have a situation where there has been a pattern of non-disclosure over time, where it is found that for successive accounting periods there is an accumulation of undisclosed negative information. Assume that, finally, the true position is revealed and that the corrective disclosure is for the cumulative period. Doing an event study on the final price reaction will not give you the effect of a particular non-disclosure or the inflationary component solely referable thereto. This may have significance for group members who are acquiring and disposing of shares at different times during the extended period.

(e) Fifth, there is a further note of caution for the simple method. Let us assume that you have shown a price difference between the actual and predicted prices. Nevertheless that may not be sufficient. There may be significant volatility in share price movements, including for the shares of the company in question. The particular price movement for the company in question at the time of the announcement must be

analysed to see whether it is statistically significant or whether the movement is within normal random variations for the share price. Undoubtedly, the more volatile the share price for the particular company, the less likely that you are to show a movement on the day of the announcement which is of sufficient statistical significance to be attributable to the announcement, as distinct from movement within the random volatility parameters for the shares in question. Equally, if the stock market itself is going through a particular period of volatility, you may have a problem on the other side of your equation.

71. Earlier I have referred to assessing the index over the relevant period and determining the relationship of the movement in the company's share price to the movement in the index. What "relevant period" do you use? Some methods would just use an index for a period before the announcement and look at the relationship of the movement in that index against the movement in the company's share price over that time. Other methods would actually also include data after the corrective disclosure to anchor the index with the company's "true" share price; at that time the share price will have the inflation or deflation removed. Another aspect to consider is whether you use any data at all for the period of the contravention. Some models use only data for the index and data for the company's share price before the contravening non-disclosure period.

II: Forensic Tests for Causation

72. In shareholder class actions, there are various causation possibilities including:

(a) establishing reliance;

(b) satisfying a form of indirect causation; or

(c) invoking the US "fraud on the market" causation theory.

I am proceeding here on the assumption that the information is material in the sense that its non-disclosure has produced share price inflation or deflation which is objectively ascertainable.

73. In terms of the legal causation test relevant to misleading or deceptive conduct, Section 1041I requires establishing "loss or damage **by** conduct of another person". It has a similar focus to Section 82 of the *Competition and Consumer Act* 2010 ("CCA")[43]. The word "by":

[43] I will ignore the recent formal modifications that now enshrine part of the remedies in the Australian Consumer Law concerning the successor provision to the old section 52.

(a) expresses the notion of causation without defining or elucidating it (*Wardley Australia Ltd –v- W.A.* (1992) 175 CLR 514 at 525);

(b) may embrace practical or common sense concepts of causation of the type discussed in *March –v- E & MH Stramare Pty Ltd* (1991) 171 CLR 506, but must yield to the primacy of the ordinary meaning of the statute (*Wardley* at 525);

(c) only requires that the contravention be **a** cause of the loss, in the sense of the contravention materially contributing to the loss, rather than **the** cause or the predominant cause (*Henville –v- Walker* (2001) 206 CLR 459 at [14], [61], [69] – [70], [106], [109] and [163] and *I & L Securities Pty Ltd –v- HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109 at [62]).

For the Section 674 contravention, the legal causation test requires the connecting feature of "resulted from" (see Section 1317HA). But how are these legal tests to be applied forensically?

74. The first causation mechanism, establishing direct reliance, is the conventional means for establishing causation in misleading or deceptive conduct claims. That is, did the relevant shareholder read (or have communicated to him) and rely upon the content of the various published announcements, reports or accounts? And many cases have looked at such reliance questions, which are not common issues but rather specific to individual investors. Now reliance may be a sufficient condition for establishing causation, but is it a necessary condition? This is an open question in shareholder class actions, particularly where the conduct involves non-disclosure to the market or misleading or deceptive conduct by omission. But at least the following can be said:

(a) First, the statutory language of "by" does not in and of itself suggest that it is a necessary condition.

(b) Second, although past cases in the misleading or deceptive conduct sphere focus on establishing reliance, that experience does not establish the induction that all such cases must establish it; one explanation for the de facto position may be that reliance was the **only** causation theory advanced in those cases due to the misplaced bias in favour of importing into the statutory test concepts from common law causes of action.

(c) Third, the "passing off" scenario cases do not suggest that the person having the cause of action need establish any reliance for himself, albeit that the potentiality for third

party reliance is not irrelevant. More generally, cases in other contexts have accepted that reliance is not a necessary condition for causation, including *Campbell –v- Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [footnote 59] and [143].[44]

(d) Fourth, and contrary to (a) – (c), Grave et al have argued that policy considerations support the view that reliance remains the appropriate test in market-based shareholder class actions.[45] They state that "(i)f the purpose of implementing the continuous disclosure regime was to assist people to evaluate their investment alternatives and encourage greater research by investors, dispensing with the need to prove reliance would not appear to be consistent with these objectives". This has support from *Ingot Capital Investments Pty Ltd –v- Macquarie Equity Capital Markets* (2008) 252 ALR 659 at [21] – [22], viz, "[the predecessor section to Section 1041H] should not be given a scope whereby an investor entering into a transaction could recover even if it knew the truth of the underlying misrepresentation, or was indifferent to its truth, and proceeds nonetheless". But Section 1041I(1B) of the Act and Section 12GF (1B) of the ASIC Act (the "contributory negligence" style defences) may suggest a policy of not reading down the primary liability causation provisions to necessarily require reliance. But you can flip this argument.

(e) Fifth, a difficulty in the thesis that you need to show reliance arises directly in the misleading or deceptive conduct context where **silence** is the principal focus (see for example *Demagogue Pty Ltd –v- Ramensky* (1992) 39 FCR 31). How can a shareholder be said to rely upon unaware undisclosed information? But perhaps this issue can be finessed by saying that you can rely on conduct and circumstances in which the information not disclosed was material, so leading to reliance on the half-truth (*Grave* et al). But you can see the conceptual difficulties in asserting that reliance is a necessary condition. And this is even more acute when you get into the direct territory of Listing Rule 3.1 and Section 674, which is beyond the half-truth scenario. The investor may have read nothing at all but merely assumed that in paying the market price, such a price reflected all information disclosed and **disclosable** to the market under Listing Rule 3.1. But another way to finesse the reliance question may be to express it nebulously in terms of an investor (or his agent) "relying" upon the

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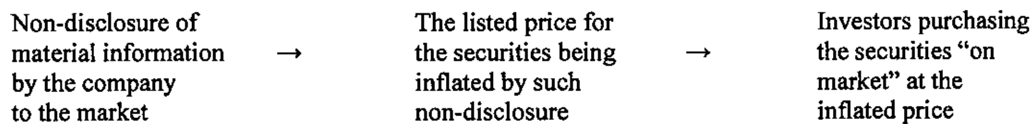
[44] See also *Janssen-Cilag Pty Ltd –v- Pfizer Pty Ltd* (1992) 37 FCR 526 at 529; *Smith –v- Noss* [2006] NSWCA 37 at [27].

[45] See the first-class article by Damian Grave, Leah Watterson and Helen Mould: *Causation, Loss and Damage: Challenges for the New Shareholder Class Action* (2009) 27 C & SLJ 483 at 487-8. I have also had the benefit of valuable discussions on these questions with Michael Garner of the Victorian Bar and Ken Adams and Damian Grave of Freehills.

integrity of the market and the market price reflecting all such information. But you are then moving into indirect territory and into areas to which the investor may not have turned his mind. But then a broad view of "reliance" may not necessarily require the formation of a positive belief[46], although the US cases assume that it does, hence their innovative device of the "rebuttable presumption"[47] (see below).

75. The second causation mechanism, the indirect causation theory, steps outside the classic reliance theory. Grave et al describe it as the "mere inflation theory", but their label undersells it. It involves the following reduced causation chain (for the inflation scenario):



Now various points:

(a) First, it is difficult to see how such a causation theory is necessarily excluded by the plain meaning of the statutory language for causation. The language for misleading and deceptive conduct causation is "by". For a Section 674 contravention and the Section 1317HA remedy, the wording is "resulted from", although nothing turns on this difference. Moreover, textual and contextual analysis of the broader statutory framework is not inconsistent with such a theory. And broadening the scope further, gleaning the legislature's hypothesised singular purpose from this textual and contextual analysis or even beyond that horizon does not establish a purpose that is inconsistent with the or an indirect causation theory being embedded within the statutory language.[48] The statutory language, subject, scope and purpose so permit.[49]

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[46] I am reluctant to travel down this creative path; the remotely analogous fiction of "general reliance" in the negligence field was not dealt with kindly by Gummow J in *Pyrenees Shire Council –v- Day* (1998) 192 CLR 330 at [163].

[47] If they didn't so assume, the device may have been unnecessary.

[48] There is no bright line between a textualist approach and the modern purposive approach to construction; to suggest otherwise is to assert a false dichotomy (cf *Application by Energex Ltd (No 4)* [2011] A CompT 4 at [7]-[22]). Rather, to begin with the text is a necessary "bottom up" approach to ascertaining purpose. A "top down" approach of starting with non-textual material has nothing to commend it. Starting with the text is self-evidently advantageous, so long as the broader context and extrinsic material are always considered, rather than being artificially filtered out if textual ambiguity or uncertainty is not shown; sometimes it is only knowledge of the extra-textual that reveals the latent ambiguity or uncertainty in the text. Moreover, the "bottom up" approach is not sensibly described using vacuous epithets such as "strict" or "literalist". Rather, all that is being identified is the starting point rather than the finishing point to determine purpose.

[49] See *Travel Compensation Fund –v- Robert Tambree* (2005) 224 CLR 627 at [45] and [49] (per Gummow and Hayne JJ) and *Allianz Australia Insurance Ltd –v- GSF Australia Pty Ltd* (2005) 221 CLR 568 at [99] – [101] (per Gummow, Hayne and Heydon JJ).

(b) Second, if reliance is not a necessary condition for causation, it implies the inclusion of some indirect causation theory within the statutory language.

(c) Third, if it matters, the indirect causation theory is not inconsistent with a "but for" approach (albeit non-comprehensive) or a "common sense" approach (albeit nebulous).

(d) Fourth, now it might be said that it is anomalous to entertain an indirect causation theory which permits recovery by investors who knew or ought to have known the true position of the company's affairs. But actual knowledge may break the chain of causation. Moreover, for misleading or deceptive conduct claims, you do have Section 1041I(1B) and Section 12GF(1B) available, which consider actual and constructive knowledge.

(e) Fifth, it might also be said that permitting such a theory means that, strictly, an investor may have a right to recover even if they did not hold **any** belief as to the integrity of the market price (rather than had knowledge or constructive knowledge of the true position). But practically, most investors, if asked, would say that they held such a belief (or at least that their broker or agent held such belief) at the time of acquisition. For those that didn't have such a belief or would have purchased at the same price even if they knew the true position, again, such circumstances may break or negate any causation chain.

76. All these questions are yet to be worked out. But even an indirect causation theory, if good, may still give rise to individual specific causation questions relating to knowledge, constructive knowledge and "contributory negligence" style defences.

77. Finally, the third causation mechanism is the US "fraud on the market" doctrine. The doctrine embodies a rebuttable presumption that investors have relied on the integrity of the market price when deciding to purchase on market (*Basic Inc. –v- Levinson* 485 US 224 (1988)).[50] The idea is that "the market is performing a substantial part of the valuation process [which would otherwise be] performed by the investor in a face-to-face transaction" (*Basic Inc.* at 244). Of course, the doctrine could only apply to "on market" purchases or "off market" transactions where the market price was the sole price input without any other negotiating influences.

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[50] On one view it is simply an idiosyncratic US rule of evidence. This is a different concept to inferred reliance: see *Gould –v- Vaggelas* (1985) 157 CLR 215 at 238 discussing the drawing of "natural" inferences in deceit cases.

78. But several points:

(a) First, in shareholder class actions with which I have been involved (Telstra, Centro and Oz Minerals shareholder claims), plaintiffs' lawyers have not relied on this theory, but rather the indirect causation theory.

(b) Second, the US doctrine, if applied in Australia, would impermissibly rewrite the statutory causation tests. Moreover, why would an Australian court create a new common law evidential presumption, even if strictly "permitted" to do so (see Section 9 of the Evidence Act 1995 (Cwlth) and its Victorian equivalent)?

(c) Third, Grave et al have described the need for the US doctrine's creation as being an artefact of both the requirement to show reliance under Section 10(b) of the *Securities Exchange Act* 1934 (and rule 10b-5 thereunder) and the restrictions placed upon the commencement of class actions under rule 23(b)(3) of the US Federal Rules of Civil Procedure. A problem had to be solved. Plaintiffs were required to prove a predominance of common issues to get class certification. But reliance is an individual question and necessarily has to be proved in each individual case. Consequently, having to prove reliance on an individual basis results in a predominance of individual issues. Hence, you could not get certification for your class action. Solution? Create the device of the rebuttable presumption. A "commonality of reliance" is then created. Problem solved. But there is no such problem under Part 4A of the *Supreme Court Act* 1986 ("the SC Act"). Class actions automatically proceed if Section 33C is satisfied. The balancing between common and non-common issues is at most a Section 33N question. Moreover, the statutory causation tests do not necessarily require reliance. The US problem does not arise. The US doctrine is irrelevant.[51] Plaintiffs' lawyers in Australia have prudently not pushed the envelope of their causation theories so far.

[51] Finkelstein J in *P. Dawson Nominees Pty Ltd -v- Multiplex Ltd* (2007) 242 ALR 111 at [11] gives the argument for the application of the US doctrine to the Australian context an air of respectability, but without any reference to these distinguishing US contextual features.

C: LOSS AND DAMAGE

79. There are various methods[52] for determining the inflationary component, which is relevant to calculating damages, including:

    (a) the event study method;

    (b) the percentage price inflation method;

    (c) the dollar price inflation method.

80. For the event study method, you take the difference between the predicted price based on the market/industry index and your actual price as the inflationary component of the company's share price. Moreover, in terms of calculating inflation in the share price from the time when the information first ought to have been disclosed, the divergence of the company's actual share price from the trend ascertainable from the regression based on the market/industry index over that period will give you the inflationary component.

81. For the percentage price inflation method, you look at the percentage price drop of the company's share price at the time of the disclosure of the information. This is then assumed to be the percentage inflation per share for every day of the class period. But this method only works "well", if at all, in a single disclosure case with no inflation build-up over time. Moreover, it is inadequate because it does not separate out other confounding effects. For the dollar price inflation method, you look at the dollar price drop of the share price at the time of disclosure and take this price decline component as the assumed inflation per share for every day of the class period. Again, this only works, if at all, in the simplified scenario of a single disclosure with no inflation build-up over time. Moreover, it has the same inadequacy in ignoring other confounding effects.

82. Finally, in addition to these quantitative methods, there are other quantum issues including:

    (a) The legal method for quantifying damages and whether it should be:

        (i) the difference between the price paid and the true value of the shares at the time of purchase (the classical approach in *Potts –v- Miller* (1940) 64 CLR 282 at 297-300 (per Dixon J));

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[52] There is a discussion of these methods in Dunbar, F. and Sen, A.: *Counterfactual Keys to Causation and Damages in Shareholder Class-Action Lawsuits* (2009) Wisconsin Law Review 199 at 217.

(ii) the difference between the price paid and the "but for" market price for the shares that would have prevailed if disclosure had been made, which may be different from the true value[53]; this difference between the actual and "but for" prices is the inflationary component discussed earlier; or

(iii) the difference between the price paid and whatever is left in hand after sale of the shares or, if the shares continue to be held through to trial, the difference between the price paid and the true value or market price at the time of trial[54].

(b) Whether the loss of an opportunity to make an alternative investment can be claimed, particularly where an investor, but for the contravening conduct, would not have invested at all in the company's shares, as distinct from investing in them but at a lower price.

(c) Whether off-setting benefits should be taken into account. Say an investor has several share parcels, and one parcel was bought before the period of the company's contravening conduct, but was sold during the inflationary period with the investor receiving the "benefit" of the inflation on this parcel. Should this benefit be offset against the losses claimed by the investor on his other share parcels which were purchased at the time when the company ought to have made, but failed to make, the relevant disclosure, and were then held by that investor beyond the inflationary period?[55]

(d) More generally, considering how the number and timing of multiple transactions made by each individual investor impact on damages, and applying for each investor:

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[53] True value may look at the underlying financials of a company to generate a discounted future cash flow valuation, a multiple of earnings valuation or a net tangible assets valuation for the company and, derivatively, share value. But the market price would normally be treated as a good proxy for such underlying valuation approaches.

[54] There is a problem with (iii). Any share price fall up to the time of sale or the current time (if they continue to be held) may not just relate to the contravening conduct, and hence awarding the said difference may over-compensate the investor. Some plaintiffs/applicants have sought to address this issue by pleading and factoring out market movements unrelated to the contravention. Whether they need to do so may be debatable. At one end of the spectrum, you may have a shareholder "locked in" to an illiquid market where there may be an argument for not so factoring this out. At the other end of the spectrum, you may have an investor who deliberately chose to hold and take a further "punt", so breaking the causal nexus between the contravention and any damage flowing from any further share price fall after that decision. It is difficult to generalize on any proposition in this area.

[55] Where the investor bought shares during the inflationary period and sold them within that period (assuming the inflationary component to be the same) then there would appear to be no loss. But even this is debatable.

(i) the "last in, first out" method; i.e. the last purchases being treated as the first sold;

(ii) the "first in, first out" method; i.e. the first purchases being treated as the first sold; or

(iii) the "netting" method; i.e. netting off all sales against all purchases without regard to order.

D. STRUCTURAL QUESTIONS – SHAREHOLDER CLASS ACTIONS

83. It is useful to discuss some of the structural issues that arise for consideration before the first stage trial for shareholder class actions.

84. First, take the position of the representative plaintiff. This person may be chosen because he has the strongest causation and damages case. Moreover, the plaintiff's lawyers will usually try to confine the first stage trial, on individual issues, to just the representative plaintiff's individual case (rather than other group members). From their perspective, it simplifies matters. Further, if they have a favourable adjudication on that one case, it practically strengthens their hand in any subsequent negotiation of other group members' individual claims.

85. But what are the theoretical permutations for general and individual causation questions that arise from the plaintiff's pleading? To what extent does the plaintiff's individual claim cover off all these permutations? Usually, the more expansive the class description, the less likely the plaintiff's individual claim covers off all these permutations.

86. Second, you also need to analyse the group description and its breadth relative to the causes of action pleaded. For example, in a shareholder class action, you might find that where the claims made are for both non-compliance with Section 674 and misleading or deceptive conduct concerning reports and announcements published by the company, then on causation questions, the group may divide into those:

   (a) who bought and sold shares in different time frames;

   (b) who read and relied upon such reports, and those who did not;

   (c) whose sole causation case rests upon an indirect market-based causation theory.

87. Third, a defendant needs to also consider whether, if an apportionable claim has been alleged, it needs to plead any proportionate liability defence. Now as stated earlier, there is no express proportionate liability provision for Section 674 claims, but there is for misleading and deceptive conduct claims. An associated question is whether the proportionate liability defence is just limited to the representative plaintiff's individual claim, or whether it covers other or all group members. Further, does the defendant need to claim contribution or indemnity against another wrongdoer in relation to any non-apportionable claims?

88. Fourth, questions will arise for the first stage trial as to:

(a) how you formulate the common issues;

(b) whether sub-groups need to be formulated;

(c) how many (if at all) individual group members' cases on causation and damage, in addition to the plaintiff's individual case on causation and damage, should be dealt with at that stage.

89. Now in formulating the common issues, you can take the approach of:

(a) adopting the articulation of these issues as set out in the plaintiff's originating process;

(b) defining the issues by exclusion rather than by inclusion – for example "a trial on all issues save and except any individual causation or damages question relating to any group member's claim other than that of the representative party";

(c) separately identifying the common issues; or

(d) adopting a hybrid of options (b) and (c).

90. The option (a) articulation is done at an early time, without the precision and focus that an imminent trial produces. Moreover, it is merely done to satisfy the formal requirements of Section 33H(2)(c) of the SC Act. Option (b) by itself is even less desirable. It involves no detailed thought, although it was used in the *Aristocrat* litigation. It is uninformative. Moreover, it may not assist the formulation of any judgment for the purposes of Sections 33Z, 33ZB and 33ZC of the SC Act. Option (c) does not have these deficiencies and is my preferred course[56]. Option (d) may also have advantages; you could stipulate the key common issues to provide guidance on the principal issues to be resolved at the first stage trial, but the formal order would also use option (b) as a necessary catch all.[57]

91. Now as to the causation common issues, you can conceptually separate general causation from individual causation. So, for example, in a shareholder class action, general causation might involve asking whether non-disclosure of material information caused an inflation of the company's share price during a particular period. Such questions are separate from individual causation claims which require linking any general causation, say share price inflation, with the actions or omissions of individuals, which are idiosyncratic to their individual claims; such individual issues may also involve questions of actual or constructive knowledge and "contributory negligence" style defences.

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[56] This option is supported by *Merck Sharp & Dohme (Australia) Pty Ltd -v- Peterson* [2009] FCAFC 26.

[57] This option has been used in the Centro litigation. It implicitly ties the common issues to the pleadings.

92. Conceptualising causation at both general and individual levels leads to the following possibilities:

(a) First, you might need to have a sufficient number and diversity of individual group members' claims (involving individual causation and damages) to be dealt with at the first stage trial. There are several potential advantages. Individual claims may raise particular legal problems that it may be desirable to rule on, so that if there is an appeal after the first trial, the appeal can embrace these other issues as well. Further, it may be desirable to have a sufficient diversity of rulings on "test cases" (even if they have no idiosyncratic legal issues of interest) so that settlement can be facilitated after the first trial[58].

(b) Second, there may be generic features of particular types and classes of individual claims that can be grouped. If so, you may need to consider forming sub-groups so that a finding on an individual group member's claim can bind the identified sub-group. If you just use option (a), you will not achieve the binding characteristic for a causation question that, although not common to the entire class, is nevertheless broader than just being applicable to an individual's claim. Now the plaintiff's lawyers are usually resistant to the formation of sub-groups. As they see it, it adds complexity. Moreover, they usually rely upon the consent requirement stipulated in Section 33Q(2) of the SC Act, which consent they then assert that they have not been able to procure. But this may be able to be "purchased" by the defendant agreeing not to seek any order for costs against the sub-group representative party beyond what that sub-group representative party was bound to pay in any event under Section 33R(2) of the SC Act in relation to the adjudication of the individual aspects of that sub-group representative party's individual claim.

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[58] Of course, each individual claim will turn on its own facts, but informal extrapolation to other individual cases is a practical way for the parties to proceed.