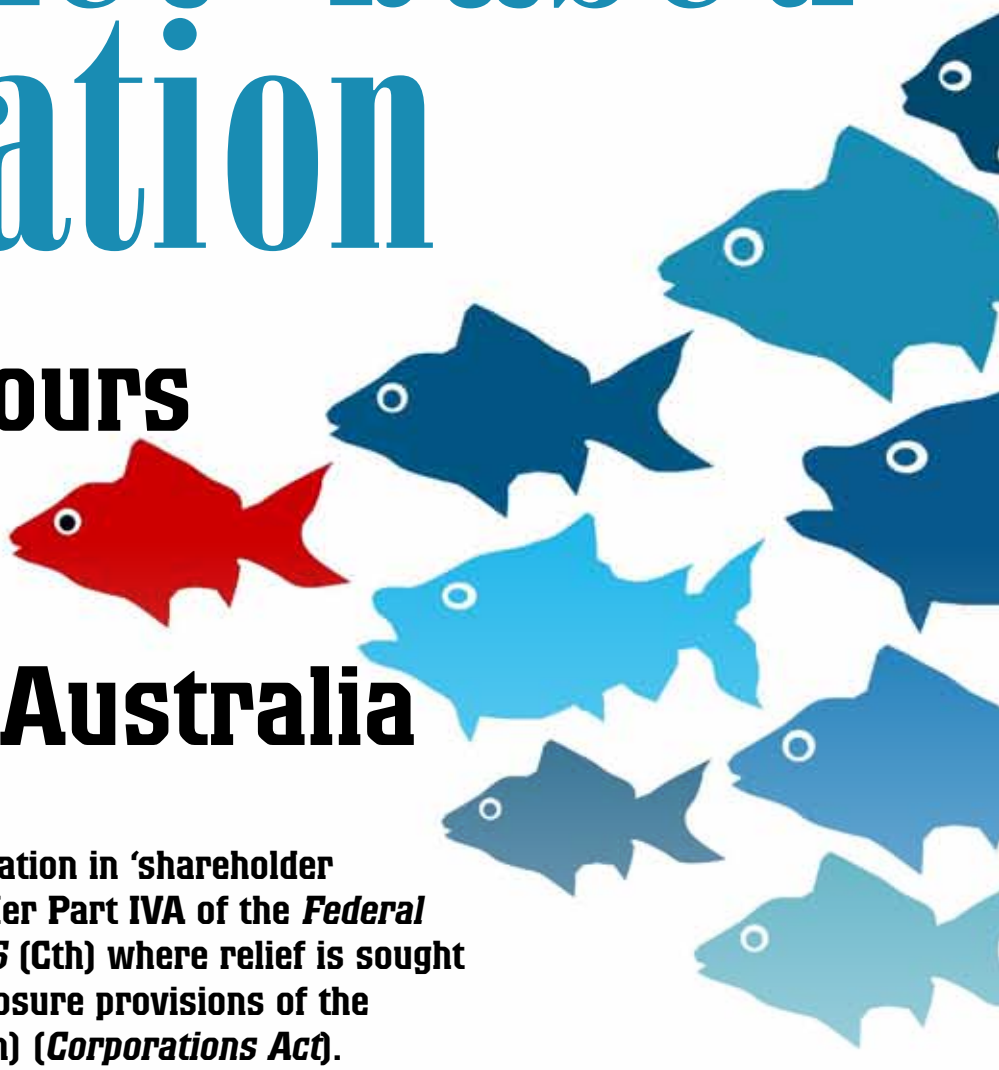
By Simon Gibbs

Market-based causation

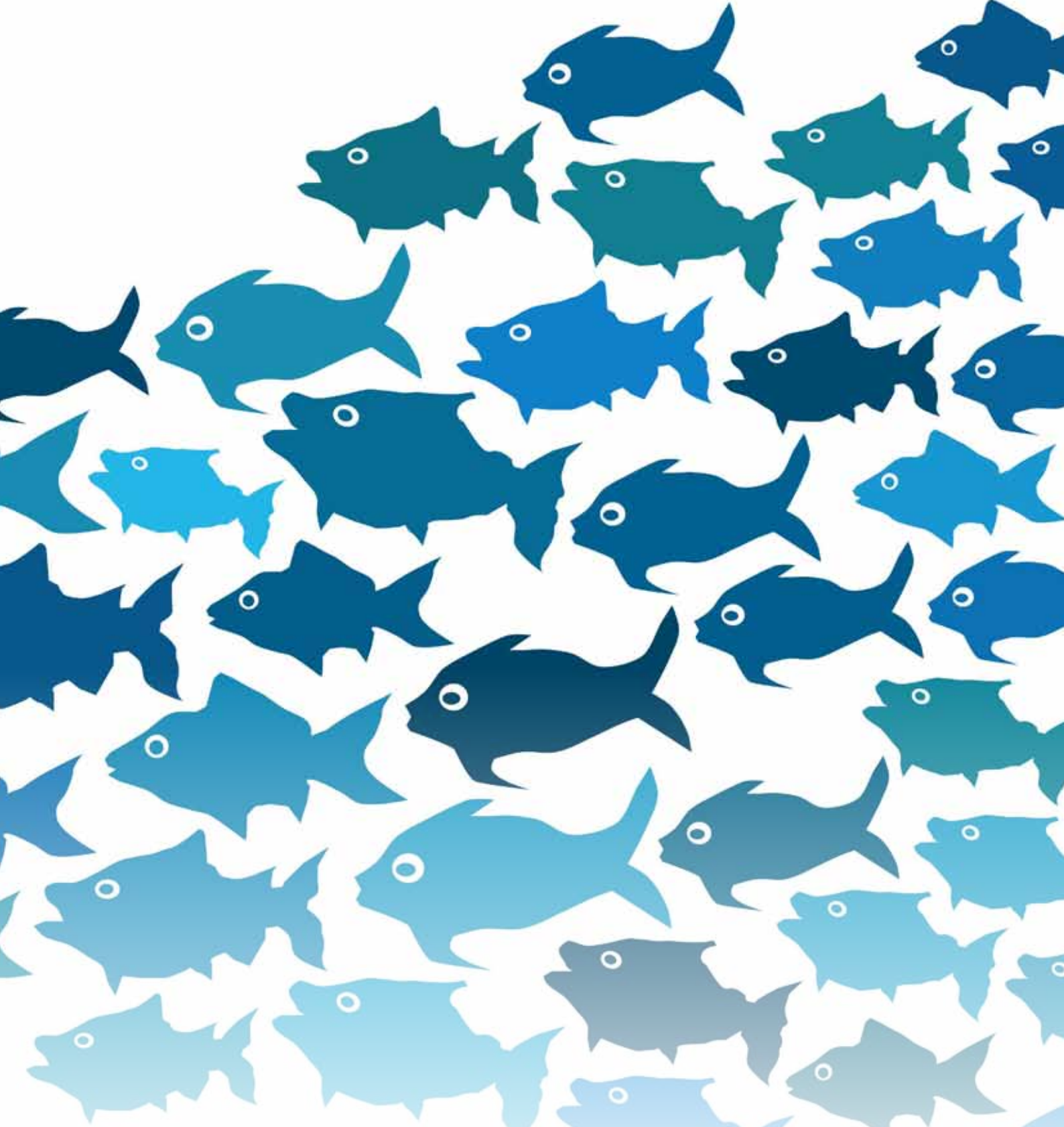
New contours of the causation debate in Australia



This article examines causation in 'shareholder class actions'[1] brought under Part IVA of the *Federal Court of Australia Act 1976* (Cth) where relief is sought under the continuous disclosure provisions of the *Corporations Act 2001* (Cth) (*Corporations Act*).

Since the introduction of the representative proceeding mechanism in Part IVA, there has been a contentious debate in the jurisprudence of shareholder class actions over what is required to prove causation for breaches of the continuous disclosure regime.[2] The debate is manifold, however, the primary contest is whether proof of reliance is required in order to establish a sufficient causative link between the alleged misconduct and resulting loss and, accordingly, whether market-based causation is available as a form of indirect causation.

The recent Federal Court decision of Beach J in *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited*[3] (*Myer*) has reset the contours of this debate. Significantly, Beach J held that a form of market-based causation, which eschews reliance as a



necessary condition to prove causation, is available as a valid causation theory for claims under the continuous disclosure regime.

By way of context, *Myer* is (at the time of publication) the first shareholder class action commenced under Part IVA which has proceeded to judgment since this procedure was introduced in March 1992. Accordingly, it assumes an historical and jurisprudential significance in the evolving law of shareholder class actions which is beyond the scope of this article. It is relevant to note that the respondent in *Myer* has stated that it intends to appeal the decision following a further hearing on the question of loss.[4]

This article will examine *Myer's* endorsement of market-based causation in order to highlight findings of significance for causation in shareholder class actions, with a specific focus on claims under the continuous disclosure

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regime and consequential findings for the 'fraud on the market' theory and the efficient capital market hypothesis.

INDIRECT CAUSATION

The availability of market-based causation requires an answer to the following question: is reliance a necessary element of the statutory causation tests that apply in shareholder class actions?[5] To answer this question, *Myer* attempts to clear the interpretive baggage that has ossified around the statutory interpretation of 'reliance' in shareholder class actions, and also to disentangle the common conflation of reliance in misleading or deceptive conduct claims under s1041H of the *Corporations Act* with reliance in continuous disclosure claims.

In addressing the above question, Beach J held that it would be an error of false statutory equivalence to treat the respective causation requirements for misleading or deceptive conduct and continuous disclosure contraventions as equivalent. They have discrete statutory contexts, and therefore the type of contravention (misleading or deceptive conduct/continuous disclosure) is 'highly relevant'[6] in order to understand 'what the statute requires to impose legal responsibility for loss and damage',[7] or what Beach J referred to as the *normative causation* that is specific to the type of contravention:

> 'So the real question is: what is the normative causation test involved in the combination of s674 [continuous disclosure requirement] with s1317HA [financial services civil penalty provisions] or the combination of s674 with s1325 [other ancillary available orders] ... The statutory text makes no reference to reliance or inducement. Moreover, it would have been conceptually incoherent to have done so. After all, one is dealing with the non-disclosure of material information.'[8]

Correctly construed in its statutory context and acknowledging that the legislative purpose of s674 is 'to produce a well-informed market leading to greater investor confidence',[9] market-based causation is a form of 'but for' causation[10] that does not require reliance as a necessary condition. Justice Beach summarised why this leads to a conclusion that merely transacting on an uninformed market can satisfy causation:

> 'The first consequence is that the market might not be trading on a fully informed basis. The second and following consequence is that the market price might be different from what it would have been in a fully informed market. The related consequence is that investors may be consummating trades at prices different to the market price that would have prevailed.
>
> … If such an investor has so consummated a trade and has suffered loss, both the text and purpose of the relevant statutory provisions are consistent with imposing legal responsibility for the loss on the company. The text does not deny it and the purpose so requires it. "But for" causation is demonstrable.'[11]

Myer is the most recent decision in a mosaic of authorities that have recognised the availability of a market-based causation theory which eschews direct reliance (although none have gone as far as *Myer*). This line of authority is commonly recognised as starting with the dicta of Finkelstein J in *P Dawson Nominees Pty Ltd v Multiplex Ltd*[12] and, prior to *Myer*, the most forceful acceptance of market-based causation has been the Supreme Court of NSW decision of Brereton J in *Re HIH Insurance Ltd (in liq)*[13] (*Re HIH Insurance*) (albeit for misleading or deceptive conduct). For a brief digest of this line of authority see the judgments of Lee J in *Perera v GetSwift Ltd*[14] and Digby J in *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd*[15] which broadly trace the acceptance of market-based causation in Australian law.[16]

The novelty of *Myer* is that it is the first decision to endorse market-based causation in a judgment for claims under the continuous disclosure legislation. The effect of this finding is significant, but equally its impact should not be overstated. *Myer* is authority for the *availability* of market-based causation and not that it must prevail in every instance. Perhaps most significantly, the decision reasons that the statutory language of the continuous disclosure regime, when it is considered in its statutory context ('resulted from the contravention'[17] and 'because of the contravener'[18]), is capable of accommodating a theory of market-based causation that does not require it to borrow, imperfectly, from traditional notions of indirect reliance derived from misleading or deceptive conduct case law, where these causes of action typically require reliance on a third-party or an inducement.

MARKET-BASED CAUSATION: COMPENSATING THE KNOWING OR INDIFFERENT INVESTOR

A common objection to market-based causation is that it impermissibly allows recovery by investors who had knowledge of the underlying misconduct, or were indifferent to its truth.[19]

This kind of objection has been raised prominently in *Digi-Tech (Australia) Ltd v Brand*[20] and *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd.*[21] Recently, these objections were echoed by Foster J in *Masters v Lombe (Liquidator)*,[22] where his Honour criticised Brereton J's approach in *Re HIH Insurance* for not adequately addressing this objection when accepting market-based causation for misleading or deceptive conduct.

Myer deals with these types of objections to market-based causation concisely: '[a]ll these questions are yet to be worked out'.[23] However, Beach J does offer some potential solutions, while eliding the problem of how these solutions may work in practice:

> 'For those that did not 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.
>
> … 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'.[24]

Market-based causation is not a totalising causation theory which is incapable of correcting for anomalous circumstances which are validly raised by its opponents; for example, in cases involving knowing or indifferent investors, proof of a break in the causal chain might be established. However, the precise way in which the court may require proof of a break in the causal chain is yet to be resolved. This was not a matter that arose for determination in *Myer,* as the applicant failed to prove its case on loss.

As mentioned above, a similar curative solution to the problem of the knowing or indifferent investor (that is, allowing individual circumstances to negate the causal chain), was posed by Brereton J in *Re HIH Insurance* (that is, the onus is placed on the defendant to prove *novus actus interveniens* in order to overcome market-based causation).[25] However, this approach was met with scepticism by Foster J in *Masters v Lombe (Liquidator)*,[26] who remarked that this approach approximated the rebuttable presumption of the US 'fraud on the market' theory and 'may well indicate a serious problem with the theory'.[27]

MARKET-BASED CAUSATION AND 'FRAUD ON THE MARKET': A COMPARISON OF US AND AUSTRALIAN EXPERIENCES

In describing the contours of market-based causation, *Myer* also seeks to conclusively foreclose on the availability of the 'fraud on the market' rebuttable presumption in the Australian context and address the conflation of the US-based doctrine with market-based causation. The significance of this finding for indirect causation is manifold; it explains the distinct statutory contexts and incompatibilities of these approaches and addresses the role of the efficient capital market hypothesis (ECMH) in proving indirect causation.

Market-based causation is not derived from the 'fraud on the market' theory and both causation theories exist in fundamentally different statutory and jurisprudential contexts. Justice Beach reasoned that the acceptance of the idiosyncratic US approach into Australian law would 'impermissibly rewrite the statutory causation tests'[28] for continuous disclosure claims. Principle among Beach J's reasons for rejecting the relevance of the 'fraud on the market' theory in the Australian context is that it requires reliance as a 'constitutive element of an actionable disclosure'.[29] This would be internally inconsistent with his Honour's finding in *Myer* that reliance is not a necessary condition under the continuous disclosure legislation.[30]

The provenance of the 'fraud on the market' theory in the US context, as an elegant solution to esoteric rules of evidence in that jurisdiction, firmly delimits the boundaries of its application in the Australian jurisdiction.[31] Despite any conceptual overlap between these approaches in treating the market as an operative causative link in the chain, the US approach offers little interpretive or explanatory force in the Australian statutory context, as it is an 'artefact' of US statutes which do not have cognates in Australia.[32]

Read in this context, *Myer* appears to conclusively foreclose on the availability of the 'fraud on the market' approach in the Australian context.

Efficient capital market hypothesis: Theory or law?

The conflation of the 'fraud on the market' theory with market-based causation also raises a related controversy in the causation debate, regarding the role of the ECMH.

Whether a market is 'efficient' or not is alleged to be fatal to market-based causation and the 'fraud on the market' doctrine. This argument has gained favour (and its use has become increasingly common) among respondents defending claims for continuous disclosure breaches as a strategy to vitiate both causation theories. However, this argument misunderstands the nuances in the ECMH and how it is applied in both the US and Australian contexts.

In general terms, the ECMH is concerned with 'whether prices at any point in time fully reflect available information',[33] and when applied in shareholder class actions seeks to describe 'the relationship between available information and the current price of a traded asset, such as a share in a publicly listed company'.[34] The conflation of the 'fraud on the market' theory and market-based causation derives from their common use of the ECMH as a framework to explain how markets absorb or assimilate information into share prices: that is, by positing a nexus between the type and quality of information flow to market participants which operates as a coefficient of share price change.

Is inefficiency fatal to causation?

The fallacy of this argument is that it wrongly assumes that the ECMH is a condition precedent to the availability of market-based causation in Australia. Justice Beach is unequivocal in stating that no such nexus between the ECMH and the availability of market-based causation exists in the Australian context:

> 'whatever misconceived views have been expressed elsewhere denying the robustness of the efficient capital market hypothesis, they hardly matter to the availability, as distinct from proof in an individual case, of market-based causation under Australian law'.[35]

While US authorities have acknowledged that there may be valid criticisms of the ECMH in the way that it describes how markets translate information into share prices and how it treats investors monolithically by assuming that price is the only driver of investment strategies,[36] they have not gone so far as to reject its forensic utility as a method of determining market efficiency. Relevantly, the Supreme Court in *Halliburton Co v Erica P John Fund Inc*[37] held:

> 'Even the foremost critics of the efficient-capital-markets hypothesis acknowledge that public information generally affects stock prices … Halliburton has not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities.'[38]

However, this is where the common application of the ECMH in the Australian and US jurisdictions diverge. In the US, market efficiency is a threshold question to the availability of the rebuttable presumption. The 'fraud on the market' theory requires proof that the market is efficient, as a prerequisite to a plaintiff having the benefit of the presumption.[39] In this way, the efficiency of a market is directly relevant to the availability of the rebuttable presumption.

By contrast, *Myer* emphasises that the ECMH operates in a fundamentally different way in the context of shareholder class actions and the continuous disclosure regime. Typically, the ECMH arises as a matter of fact in the context of expert evidence on loss under the 'event study' framework.[40] According to Beach J:

> 'The efficient capital market hypothesis is relevant to market-based causation forensically. So, if it is not a good assumption in a particular case involving a particular class of securities, factually market-based causation and the "inflation-based measure" of loss in that case may fail. But I am here dealing with the availability of market-based causation as a matter of law. It is just misconceived to take doubts about the use of a securities specific forensic economic tool, let alone doubts expressed by foreign judges, to deny or query the availability as a matter of law of a test for market-based causation in Australia.'[41]

The ECMH is a theoretical economic model which seeks to describe the phenomena of capital allocation in securities markets. The argument often advocated by respondents – that proof of the ECMH is foundational to market-based causation – wrongly elevates the ECMH to a principle of law rather than merely a 'forensic economic tool'.[42]

However, it is true that the ECMH is a constitutive element of the 'event study' framework in the context of calculating an inflation-based measure of loss. Therefore, the efficiency of a market affects the explanatory power of an event study to form valid and rigorous statistical conclusions about the inflationary impact of information (such as corrective disclosures, misrepresentations or omissions) on the price of a security.

This does not preclude a market-based causation argument based on other loss measures (true value,[43] left in hand[44] and no transaction[45]). Nor does it prohibit the use of this tool for an inflation-based measure entirely; because efficiency is a spectrum, it merely circumscribes the forensic utility or precision with which such a tool can on its own ascribe an inflation series to an identified disclosure in order to calculate damages. As Watson et al note:

> 'It is one thing to show that a market falls short of efficiency and another to prove that it operates so inefficiently that information about the company has no bearing on its price or value. If the plaintiff can show that, market inefficiencies notwithstanding, as a matter of fact the misinformation had an inflationary effect on the actual price of the security, it has established market-based causation.'[46]

In circumstances where there is genuine inefficiency in the way a market operates (via price distortions, false markets, delayed overseas trading activity and/or insider trading), economic tools are available to assess the cause and extent of the inefficiency and seek to exclude them from the analysis. It should also be considered that this issue redounds to the assessment of loss and damage.

Accordingly, when the court is assessing damages in complex circumstances, such as shareholder class actions, it must consider the principles set out in a line of authorities which include *Armour v Delamirie,*[47] *Houghton v Immer,*[48] *Henville v Walker,*[49] *Murphy v Overton Investment Pty Ltd*[50] and *McCartney v Orica Investments Pty Ltd*;[51] namely, that the court should assess damages in a robust manner relying on the presumption against the wrongdoer, and resolving any doubtful questions against the wrongdoer (for example, where the market is inefficient due the respondent's own conduct). Further, the statutory continuous disclosure regime is beneficial legislation which promotes the public interest in market transparency and the protection of individual investors.[52] Accordingly, it is to be interpreted to give 'the fullest relief which the fair meaning of its language will allow'.[53]

Theory versus reality

Importantly, market efficiency is not binary (efficient/inefficient); the ECMH describes a continuum of informational efficiency from 'weak' to 'semi-strong' to 'strong'.[54] Therefore, proponents of the argument that 'inefficiency' is fatal to market-based causation misunderstand its role in evidence. The semi-strong form of the ECMH predominates in the litigation context (both in Australia and the US) and stipulates that the price of a company's shares incorporates all publicly available information that is relevant to the valuation of that company.[55] The semi-strong form of market efficiency is persuasive, as it conveys a *broadly*[56] accurate (although not exhaustive) conception of how markets process information, but also closely approximates the regulatory framework in which the market *ought* to operate. For example, the ASX Listing Rules (which comprise the regulatory component of the continuous disclosure regime) presume that the natural state of the market is the semi-strong form. Its regulations can be understood as seeking to bring the market into conformity with the semi-strong form by stipulating disclosure rules that determine what information ought to be publicly available[57] and which ought not.[58]

The explanatory power of the ECMH to describe the way in which the market price information is the key to its relevance and continued assistance to the court in conceptualising the impact of price-sensitive information. That is not to say that its ability to describe all market movements is infallible or a necessary condition to the availability of market-based causation.

Inefficient (or less efficient) markets

Inefficiencies in markets can work in equilibrating cycles. Sophisticated investors seek to capitalise on perceived inefficiencies in the price of a share (being over/underpriced) and take advantage of this mispricing by trading strategies that attempt to 'beat the market'; in essence, betting that the market is inefficient.[59] The consequence of such trading on efficiencies is to bring the market back to a state of relative efficiency and equilibrium, as the share price eventually reflects the price impact of these strategies. Temporary and relative inefficiency are therefore not fatal but are natural conditions of the market, although they do complicate the process of precisely calculating a statistically rigorous inflation series. Indeed, there would be no need for large institutional trading houses, arbitrageurs, short-sellers and the proliferation of sophisticated market analysts if traders could generate the same returns by passively trading on the market.[60] Accordingly, the presence of such temporary inefficiencies in the price of a security cannot seriously be argued by respondents as an answer to whether market-based causation is prima facie available or not. Rather, a degree of inefficiency reflects the reality of markets and the challenge for theoretical models to describe these phenomena.

CONCLUSION

Myer is the most recent contribution to the ongoing debate about the role of market-based causation in shareholder class actions, but it certainly won't be the last. Considering the consequences for publicly-listed companies defending continuous disclosure claims of the judicial acceptance of this form of causation (albeit a single judgment of a single judge sitting in the Federal Court), the issue is likely to require resolution by the High Court before it is accepted as settled law. ■

Notes: **1** This article uses the term of common usage 'shareholder class action' to refer to claims for relief for breaches of the continuous disclosure regime under the *Corporations Act 2001* (Cth) *(Corporations Act*), comprising s674 (contravention) and s1371HA (remedy) and/or misleading or deceptive conduct under s1041H. While there is no definitive taxonomy, descriptions include 'private securities market nondisclosure class action'; 'securities class action'; and 'shareholder class action'. A useful summary of the nomenclature appears in M Duffy, 'Causation in Australian securities class actions: Searching for an efficient but balanced approach', *ALJ,* Vol. 93, 2019, 833–54, footnotes 1 and 3. **2** The 'regime' describes the statutory disclosure framework under the *Corporations Act,* comprising s674 (contravention) and s1371HA (remedy), and the regulatory framework under the ASX Listing Rules (ch3, specifically Listing Rules 3.1 and 3.1A). See also *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2016) 245 FCR 402, [92]–[92] per Allsop CJ, Gilmour and Beach JJ and *James Hardie Industries NV v Australian Securities and Investments Commission (ASIC)* [2010] NSWCA 332 *(James Hardie),* [355]–[356] for an instructive summation of the legislative purpose of the regime. **3** [2019] FCA 1747. **4** Adjourned until 19 March 2020 before Beach J. **5** Typically, although not exclusively, these comprise ss674, 1317HA and 1325 of the *Corporations Act* for continuous disclosure and/or s1041H of the *Corporations Act* for misleading or deceptive conduct. **6** *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747 *(Myer),* [1641]. **7** Ibid. **8** Ibid, [1643]. **9** Ibid, [1648]. **10** Ibid, [1653]. **11** Ibid, [1651]–[1652]. **12** *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111, [11]. **13** (2016) 335 ALR 320 (*HIH Insurance*). **14** (2018) 263 FCR 1, [31]. **15** [2016] VSC 784, footnote 26. **16** This digest is a paraphrase of cases cited in *Perera v GetSwift* Ltd (2018) 263 FCR 1 and Digby J in *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2016] VSC 784. See also Duffy, above note 1, 844–8. **17** *Corporations Act,* s1317HA. **18** *Corporations Act,* s1325. **19** *Myer*, above note 6, [1529]. *See Digi-Tech (Australia) Ltd v Brand* (2004) 62 IPR 184 (*Digi-Tech*), [159]; *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 73 NSWLR 653 *(Ingot)*, [19]–[22], [612]–[619], [662]; and most recently *Masters v Lombe (Liquidator); In the Matter of Babcock & Brown Limited (In Liq)* [2019] FCA 1720 *(Masters)*, [392] per Foster J. **20** Ibid, *Digi-Tech*, [159]. **21** *Ingot*, above note 19, [19]–[22] and [612]–[619]. **22** *Masters,* above note 19, [392]. Although Foster J's scepticism was not a direct riposte to the *Myer* judgment; the *Masters* judgment was published shortly before *Myer.* **23** *Myer*, above note 6, [1531]. **24** Ibid, [1530]–[1531]. **25** *Masters,* above note 19, [390]. **26** Ibid, [391]–[392]. **27** Ibid, [392]. **28** *Myer,* above note 6, [1534]. **29** Ibid, [1623]. **30** Ibid, [1641], [1643]. **31** Ibid, [1535] (for a summary). **32** These being: 'the requirement to show reliance under s10(b) of the *Securities Exchange Act 1934* (US) (and r10b-5 thereunder) and the restrictions placed upon the commencement of class actions under r23(b)(3) of the US Federal Rules of Civil Procedure'. *Myer,* above note 6, [1535]. **33** E Fama, 'Efficient capital markets: A review of theory and empirical work', *Journal of Finance*, Vol. 25(2), 1970, 383–417 at 413. **34** *Myer,* above note 6, [669]. **35** Ibid, [1630]. **36** *Halliburton Co v Erica P John Fund Inc,* 134 S Ct 2398 (2014) (*Halliburton*), 9. **37** Ibid. **38** Ibid, 11. **39** Ibid, 17; see also F Dunbar and A Sen, 'Counterfactual keys to causation and damages in shareholder class-action lawsuits', *Wisconsin Law Review,* 2009, 199–242 at 213. **40** *Myer*, above note 6, [20] per Beach J: 'accepted and found to be valuable event study analysis in terms of assessing materiality and share price inflation'; see also [640]–[774] (regarding the event study methodology) and [775]–[923] (regarding application to the circumstances of the case). **41** Ibid, [1629]. **42** Ibid. **43** Ibid, [1502]. **44** Ibid, [1504]. **45** Ibid, [1505]. **46** A Watson and J Varghese, 'The case for market-based causation', *UNSW Law Journal*, Vol. 32(3), 2009, 948–64 at 962. **47** (1722) 1 Stra 505; 93 ER 664. **48** (1997) 44 NSWLR 46, 59. **49** (2001) 206 CLR 459, [131]. **50** (2004) 216 CLR 388, [74]. **51** [2011] NSWCA 337. **52** *James Hardie,* above note 2, [355]. **53** Ibid, [356]. **54** E Fama, 'Efficient capital markets: A review of theory and empirical work', *Journal of Finance,* Vol. 25(2), 1970, 383–417 at 383. **55** Ibid. This is to be distinguished from the 'strong' form (in which both public and private). **56** Important caveats apply. **57** ASX Listing Rule 3.1. **58** Ibid, r3.1A. **59** *Halliburton*, above note 36, 9. See Duffy, above note 1, 853 for a discussion of how the US courts have treated this issue. **60** Z Bodie, A Kane and AJ Marcus, *Investments,* 10th ed, McGraw-Hill Education, New York, 2014, 11, 362.

Simon Gibbs is an Associate in the Class Actions department at Maurice Blackburn Lawyers. PHONE (02) 9261 1488
EMAIL sgibbs@mauriceblackburn.com.au.