SECURITIES CLASS ACTIONS [1] AND THE VEXING QUESTION OF CAUSATION

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Introduction

In 2016 Justice Beach of the Federal Court made the following observation:

> Litigation funding has produced the following outcomes. First, there has been a proliferation of closed [2] proceedings. Second, the subject matter of class actions has shifted from product liability claims to securities actions (e.g. shareholder class actions). One reason is due to the economics. In terms of the aggregate claimed, this is likely to be larger for shareholder class actions. Second, it may be thought that it is easier to establish liability for material non-disclosure claims. After all, when negative news is published to the market by a listed company and its share price plummets, plaintiffs' lawyers' intuition is to question whether there has been timely disclosure and to assume that there is a ready-made *prima facie* case of breach of the applicable normative standard. A third factor is that there is perceived to be a very high settlement rate (indeed no shareholder class action as such has proceeded to judgment). This is attractive to plaintiffs' lawyers and external funders. The high settlement rate has been partly attributed to uncertainty over the viability of market-based causation. Whether such a settlement rate is maintained remains to be seen.[3]

His Honour noted that at the time of his paper the issue of causation remained unresolved. It still does.

The question of causation may be addressed, as noted by Beach J, [4] in one of three ways.

1. By adopting the '*fraud on the market'* doctrine of the US.
2. By requiring proof of actual reliance on the impugned statements or conduct.
3. By adopting an indirect or market-based causation.

A New South Wales Supreme Court decision has come down on the side of indirect or market causation, holding that actual reliance is not required (although not a representative proceeding, the reasoning is apposite to such actions.).[5] It is understood that this decision has not been appealed. This case is discussed in detail below.

The doctrine of fraud on the market

The doctrine of *Fraud on the Market* is a creation of United States jurisprudence. It owes its existence to securities fraud class actions. The doctrine received the approval of the United

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1 Some background to the Australian class action regimes is set out in the Appendix

2 Closed proceedings are those which include only putative group members who have signed up with the lawyers/litigation funders driving the litigation.

3 Structural and Forensic Developments in Securities Litigation, paper delivered at the International Commercial Law conference (Inner Temple, Inns of Court, London, June 2016). This paper can be found on the Federal Court web-site.

4 Ibid. (Under the head 'CAUSATION ')

5 *In the matter of HIH Insurance Limited (in liq) v McGrath* [2016] NSWSC 482 (20 April 2016). (Brereton J)

States Supreme Court in 1988 in *Basic Inc v Levinson* ('Basic').[6] That approval was not unanimous, however, as two of the participating Justices dissented.[7]

The facts of *Basic* are:

- Basic was a publicly traded company primarily engaged in the business of manufacturing chemical refractories for the steel industry.
- Beginning in September 1976 representatives of another company, Combustion Engineering Inc (Combustion), had meetings and telephone discussions with officers of Basic concerning the possibility of a merger.
- On 21 October 1977 Basic published a news item stating that it knew of no reason for heavy trading in its stock, and stating that no negotiations were under way with any company for a merger.
- On 25 September 1978, in response to an inquiry from the New York Stock Exchange, it said that it was unaware of any present or pending company development that would have resulted in the recent price fluctuations and heavy trading in the company's stock.
- On 6 November 1978 Basic issued a nine months report to stockholders where it stated that it was unaware of any present or pending company development that would have resulted in the price fluctuations and heavy trading in the company's stock in recent months.
- On 18 December 1978 Basic asked the New York Stock Exchange to suspend trading in its shares and issued a release stating that it had been approached by another company concerning a merger.
- On 19 December 1978 the board of Basic endorsed Combustion's offer.
- On 20 December 1978 Basic publicly announced its approval of Combustion's tender offer for all outstanding shares.

The respondents to the appeal were former Basic shareholders who sold their stock after *Basic*'s statement on 21 October 1977 and before the suspension of trading on 18 December 1978. They brought a class action against *Basic* and its directors alleging that they had issued three false or misleading statements in breach of § 10(b) of the *Securities Exchange Act of 1934* [8] (SEC Act) and Rule 10b-5 [9] promulgated under that Act by the Securities Exchange Commission.

Relevantly, section 10b [10] of the SEC Act provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

[6] 485 US 224 (1988).

[7] Blackmun, Brennan, Marshall and Stevens JJ endorsed the doctrine; and O'Connor and White JJ disapproved of it. it. Rehnquist CJ, Scalia and Kennedy JJ took no part in the decision.

[8] 15.U.S.C Chapter 2B–Securities Exchanges. §78a thereof provides the Chapter may be called the *Securities Exchange Act 1934*

[9] 17 CFR §240

[10] 15 U.S.C §78j.

…

> b. To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, … any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission [11] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 relevantly is as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> a. To employ any device, scheme or artifice to defraud,
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> b. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or,
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> c. To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,
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> in connection with the purchase or sale of any security.

The respondents alleged that they were injured by selling *Basic* shares at an artificially depressed price in a market affected by the misleading statements of Basic.

The District Court for the Northern District of Ohio accepted a presumption of reliance on the alleged misleading statements and considered that common questions of fact predominated over particular questions pertaining to individuals and so certified the case as a class action. [12]

Under the American Rules the Court must '[a]t an early practicable time after a person sues or is sued as a class representative, … determine by order whether to certify an action as a class action.' [13]

Whilst the District Court certified the action as a class action, it considered that Basic had made no materially misleading statements because there were no ongoing negotiations at the time of the first statement, and there was no certainty that the negotiations that were taking

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11 Securities Exchange Commission—see 15USC§78c(a)(15) (definition of 'Commission')

12 The practice and procedure relating to class actions is prescribed by Rule 23(a)–(h) of the *Federal Rules of Civil Procedure*. To be certified as a class action the requirements of Rules 23(a) – (b) are to be met. Rule 23(a) is as follows: (a) PREREQUISITES. One or more members of a class may sue or be sued as representative parties on behalf of all members only if: (1) the class is so numerous that joinder of all members is impracticable;(2) there are questions of law or fact common to the class;(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class. Rule 23(b)(3) provides that a class action may be maintained if the requirements of Rule 23(a) are met, along with its requirements that questions of law or fact common to class members predominate over any questions affecting only individual members.

12 Rule 23 (c)(1)(A).

12 *Basic v Levinson*, 485 US 224, 228–9 (1988)

12 Ibid. 229.

13 Rule 23 (c)(1)(A).

place at the time of the other statements would result in an agreement in principle. Accordingly, it granted summary judgment for Basic. [14]

The United States Court of Appeals for the Sixth Circuit affirmed the class certification but reversed the District Court's summary judgment. The Supreme Court majority noted the Appeals Court did so because it considered Basic's statements that no negotiations were taking place, and that it knew of no corporate developments to account for the heavy trading activity, to be misleading.[15] The Supreme Court majority also noted that the Court of Appeal rejected the argument that preliminary merger discussions are immaterial as a matter of law and held that ' " once a statement is made denying the existence of any discussions, even discussions that might not have been material in absence of the denial, are material because they make the statements made untrue.' " [16] The United States Supreme Court accepted that for statements to be material for the purposes of the SEC Act and the regulations made under it, there must be a substantial likelihood that disclosure of the omitted fact would be considered by a reasonable investor to 'have significantly altered the "total mix" of information made available.' [17] 'Materiality', therefor, depends 'on the significance the reasonable investor would place on the withheld or misrepresented information.' [18] Thus, whether merger discussions are material depends on the particular facts of the case. [19]

The United States Supreme Court majority said:

> The courts below accepted a presumption, created by the fraud-on-the-market theory and subject to rebuttal by petitioners, that persons who had traded Basic shares had done so in reliance on the integrity of the price set by the market, but because of [Basic's] material misrepresentations the price had been fraudulently depressed. Requiring a plaintiff to show a speculative state of facts, i.e., how he would have acted if omitted material information had been disclosed, … or if the misrepresentation had not been made, … would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market. [20]

The Supreme Court majority held:

- The fraud on the market theory is based on the hypothesis that the price of a company's shares in an 'open and developed securities market' is determined by 'the available material information regarding the company and its business.' [21]
- Reliance is an element of the cause of action and provides the necessary causal connection between the misrepresentation and the injury. [22]

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[14] *Basic v Levinson*, 485 US 224, 228–9 (1988)

[15] Ibid. 229.

[16] Ibid. 229.

[17] Ibid. 232.

[18] Ibid. 240.

[19] Ibid. 241. As the United States Supreme Court rejected the standard of materiality adopted by the Courts below, it remanded the case for reconsideration of the question whether the grant of summary judgment was appropriate based on its opinion as to the correct standard of materiality.

[20] Ibid. 245. (citation omitted)

[21] Ibid. 242.

[22] Ibid. 243.

- Misleading statements will defraud purchasers of shares even if they do not directly rely on them. [23]
- Indirect reliance 'may be adequately established … by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss.' [24]

Thus, the fraud on the market theory is predicated on the assumption that an investor buys or sells shares at the price set by the market in reliance on the integrity of that price. That price reflects the information publicly available regarding the affairs and business of the company, including misrepresentations about such matters. The investor, therefor, is presumed to have also relied upon any misrepresentations, and these misrepresentations have in fact destroyed the integrity of the price.

The presumption of reliance may be rebutted. This may be done by:

1. proving that the impugned statements were not 'material'; or
2. proving that the impugned statements did not adversely affect the share price; or
3. proving an investor traded or would have traded knowing the statements were false. [25]

The dissenting Justices opined that the case law hitherto developed respecting actions based on the sections of the SEC Act and the Regulations under consideration had been based on 'familiar doctrines of fraud and deceit'. [26] It was said by the dissentients that:

> [e[ven if [we] agreed with the Court that 'modern securities markets … involving millions of shares changing hands daily require that the 'understanding of Rule 10b-5's reliance requirement' be changed,… [we] prefer that such changes come from Congress in amending § 10(b). The Congress, with its superior resources and expertise, is far better equipped than the federal courts for the task of determining how modern economic theory and global financial markets require that established legal notions of fraud be modified. In choosing to make these decisions itself, the Court, [we] fear, embarks on a course that it does not genuinely understand, giving rise to consequences it cannot foresee. For while the economists' theories which underpin the fraud-on-the-market presumption may have the appeal of mathematical exactitude and scientific certainty, they are—in the end—nothing more than theories which may or may not prove accurate upon further consideration. Even the most earnest advocates of economic analysis of the law recognize this. … Thus, while the majority states that, for purposes of reaching its result it need only make modest assumptions about the way in which 'market professionals generally' do their jobs, and how the conduct of market professionals affects stock prices, …, [we] doubt that we are in much of a position to assess which theories aptly describe the functioning of the securities industry.[27]

The dissenting Justices further considered that there were two further reasons why the theory should be rejected. Firstly, Congress in considering another provision of the SEC Act dealing with civil liability for misleading statements concerning securities, [28] had rejected the notion that a plaintiff could sue under the section based solely on the fact that the securities bought

[23] Ibid. 242–3.

[24] Ibid. 245.

[25] Ibid. 247.

[26] Ibid. 253.

[27] Ibid. 254–5.

[28] *Liability for Misleading* Statements, 15 USC 75r(a).

or sold had been *affected* by a misrepresentation. The majority decision, they thought, was 'closely akin' to this rejected basis for establishing liability for securities fraud. [29] Secondly, congressional policy favoured the view that securities laws display a strong preference 'for widespread public disclosure and distribution to investors of material information concerning securities.' [30] The fraud on the market theory subverts this policy, it was said, because it allows 'monetary recovery to those who refuse to look out for themselves,' [31] and if 'a plaintiff may recover in some circumstances even though he, she or it did not read and rely on the defendants' public disclosures, then no one need pay attention to those disclosures and the method employed by Congress to achieve the objective of the 1934 Act is defeated.' [32]

The United States Supreme Court has recently reconsidered the doctrine in *Halliburton Co v Erica P John Fund ('Halliburton')*. [33] The Court affirmed acceptance of it, but again, not unanimously.[34]

The facts of the case were;

1. Between 3 June 1999 and 7 December 2001 *Halliburton* made a series of false statements regarding its potential liability in asbestos litigation; its expected revenue from certain construction projects; and the anticipated benefits from a prospective merger,
2. These statements were alleged to have been made with the intention of inflating the share price.
3. *Halliburton* later made a number of statements correcting these mis-statements.
4. The corrective statements allegedly caused the share price to fall.
5. The respondent sought to certify the action as a class action comprising all investors who purchased shares during the class period, being between 3 June 1999 and 7 December 2001.

The questions presented to the Supreme Court were whether '[the Court] should overrule or modify *Basic*'s presumption of reliance and, if not, whether defendants should nonetheless be afforded an opportunity in securities class action cases to rebut the presumption at the class certification stage, by showing a lack of price impact.' [35] ('Price impact' is the affect that the impugned statements have on the share price.)

Halliburton argued that securities fraud plaintiffs should have to prove direct reliance, that is, they *actually* relied on the misrepresentation when deciding to buy or sell shares. It advanced two principal propositions in support of this position. Firstly, it was said that the *Basic*

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29 *Basic v Levinson* 485 US 224,258. (1988)

30 Ibid. 259.

31 Ibid.

32 Ibid.

33 573 US___(2014) slip op.

34 Affirmed by Roberts CJ, Kennedy, Ginsburg, Breyer, Sotomayer and Kagan JJ; with Thomas, Scalia and Alito JJ dissenting.

35 *Halliburton Co v Erica p John Fund*, 573 US___(2014) slip op 1–2. (opinion of the Court)

presumption flew in the face of 'congressional intent.' Secondly, it was suggested that the fraud on the market theory was discredited by developments in economic theory.

The plurality said the 'congressional intent' argument had been run in *Basic* and the 'majority did not find the argument persuasive then, and Halliburton has given us no new reason to endorse it now.' [36]

Halliburton also submitted that the fraud on the market doctrine rested on two propositions that could no longer be considered sound, namely, the efficient capital markets hypothesis, and the assumption that investors invest in reliance on the integrity of the market.

The efficient capital markets hypothesis, being the foundation of the doctrine, assumes that the market price of shares traded on well developed markets, reflects all publicly available information, including any misrepresentations. Halliburton cited studies said to show that public information was often not immediately incorporated into market prices. [37] Of this the majority said:

> Halliburton does not, of course, maintain that capital markets are *always* inefficient. Rather, in its view, *Basic*'s fundamental error was to ignore the fact that 'efficiency is not a binary, yes or no question' . … The markets for some securities are more efficient than the markets for others, and even a single market can process different kinds of information more or less efficiently, depending on how widely the information is disseminated and how easily it is understood. … Yet *Basic*, Halliburton asserts, glossed over these nuances, assuming a false dichotomy that renders the presumption of reliance both under inclusive and over inclusive: A misrepresentation can distort a stock's market price even in a generally inefficient market, and a misrepresentation can leave a stock's market price unaffected even in a generally efficient one. [38]
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> …
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> To recognize the presumption of reliance, the [Basic] Court explained, was not 'conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price'. ... The Court instead based the presumption on the fairly modest premise that 'market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices'. ... *Basic*'s presumption of reliance thus does not rest on a 'binary' view of market efficiency. Indeed, in making the presumption rebuttable, *Basic* recognized that market efficiency is a matter of degree and accordingly made it a matter of proof. The academic debates discussed by Halliburton have not refuted the modest premise underlying the presumption of reliance. Even the foremost critics of the efficient-capital markets hypothesis acknowledge that public information generally affects stock price. [39]

The Court held that Halliburton had '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.' [40]

The majority then turned to Halliburton's argument that it was wrong to believe that investors relied on the integrity of the market. Here Halliburton suggested that it could identify investors who believed that some shares are either undervalued or overvalued, and traded on that basis hoping to beat the market (e.g. day traders, volatility arbitragers and value

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36 Ibid. 8.

37 Ibid. 9.

38 Ibid. 9. (emphasis in original)

39 Ibid, 10.

40 Ibid.11.

investors). Accordingly, if there were some investors who were indifferent to price the courts should not presume that investors rely on the integrity of those prices.

The majority rejected this argument by saying that *Basic* did not deny the existence of such investors, and that it was 'reasonable to presume that *most* investors—knowing that they have little hope of outperforming the market in the long run based solely on their analysis of publicly available information—will rely on the security's market price as an unbiased assessment of the security's value in light of all public information.' [41] Moreover, even the value investor, they suggested, relied, implicitly at least, on the fact that a share price will eventually reflect all material information because 'how else could the market correction on which [the investor's] profit depends occur.' [42]

Halliburton further suggested that that, by facilitating class actions, *Basic*,

1. allowed plaintiffs to extort large settlements from defendants for meritless claims;
2. punished innocent shareholders who finish up paying any settlements or judgments;
3. imposed excessive costs on business; and
4. resulted in a disproportionately large share of judicial resources being consumed.

The majority considered that these concerns were more appropriately to be addressed by Congress which had in fact done so, to some extent at least, in two pieces of legislation.—the *Private Securities Litigation Reform Act of 1995* [43] and the *Litigation Uniform Standards Act of 1998.* [44]

The majority noted that '[b]efore overturning a long- settled precedent … [the court] require[s] "special justification", not just an argument that the precedent was wrongly decided,' [45] Halliburton, they held, failed 'to make that showing.' [46]

The dissenting Justices noted that the right of private action under Rule 10b–5 was one implied by judicial fiat and was not one expressly accorded by Congress. The Court had, they said, now ended that practice and could not now create a cause of action absent statutory authorisation. — the opinion of Thomas J, concurred in by Scalia and Alito JJ.[47] He said:

> Without a statute to interpret for guidance … the Court began instead with a particular policy 'problem': for investors in impersonal markets, the traditional reliance requirement was hard to prove and impossible to prove as common among plaintiffs bringing 10b–5 class-action suits. ... . With the task thus framed as 'resol[ving]' that "'problem'" rather than interpreting statutory text, ... , the Court

[41] Ibid.11–12. (emphasis in original)

[42] Ibid.12.

[43] 15 USC §78U–4.—This is intended to reduce abusive litigation (Title 1); reduce coercive settlements (Title II); and provide for auditor disclosure of corporate fraud (Title III). It sets out certain requirements for the filing of class actions; the provision of a 'safe harbour' for forward-looking statements; and the elimination of certain abusive practices etc.

[44] 112 STAT 3227.—This seeks to prevent the circumvention of the *Private Securities Litigation Reform Act of 1995* by shifting actions to state courts.

[45] *Halliburton Co v Erica p John Fund*, 573 US.___(2014) slip op 1, 4.(opinion of the Court)

[46] Ibid.

[47] Ibid 1.(Thomas J)

> turned to nascent economic theory and naked intuitions about investment behaviour in its efforts to fashion a new, easier way to meet the reliance requirement. The result was an evidentiary presumption, based on a'fraud on the market' theory, that paved the way for class actions under Rule 10b–5. [48]

As a consequence, '[l]ogic, economic realities and … subsequent jurisprudence have underlined the foundation of the *Basic* presumption, and *stare decisis* cannot prop up the facade that remains.' [49]

Reliance, in the traditional sense, means proving that the impugned statement actually induced an investor to buy or sell the shares because the investor in fact relied upon the statement. The reality is, however, that an investor buying on a stock exchange will often not be aware of anything said or done by a company, and cannot show the purchase or sale of shares was done in reliance on any particular statement or conduct. Thus, in the context of class actions for securities fraud, it would be impossible for an investor to prove that common questions predominated over individual ones making class certification inappropriate. It was, said Thomas J, to meet this problem that *Basic* held that mis-statements had been incorporated into the market price of the shares; and that shares had been brought or sold in reliance on the integrity of the market price. [50] His Honour considered that the *Basic* assumptions were wrong because:

1. The presumption of reliance was based on 'a questionable understanding of disputed economic theory and flawed intuitions about investor behavior.' [51]
2. The rebuttable presumption was at odds with the Court's later opinions which require plaintiffs seeking class certification to 'affirmatively demonstrate' certification requirements such as the predominance of common questions. [52]
3. The presumption that investors rely on the integrity of the market price means that in practice the presumption is 'virtually irrebuttable' such that 'the 'essential' reliance element effectively exists in name only. [53]

In reality said Thomas J:

> both of the Court's key assumptions are highly contestable and do not provide the necessary support for *Basic*'s presumption of reliance. The first assumption—that public statements are 'reflected' in the market price—was grounded in an economic theory that has garnered substantial criticism since *Basic*. The second assumption—that investors categorically rely on the integrity of the market price—is simply wrong [54]

Thomas J opined that the efficient capital markets hypothesis no longer holds good:

> [a]s it turns out, even 'well-developed' markets (like the New York Stock Exchange) do not uniformly incorporate information into market prices with high speed. [F]riction in accessing public information

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48 Ibid 1- 2.

49 Ibid.

50 Ibid. 4-5

51 Ibid. 5.

52 Ibid.

53 Ibid.

54 Ibid. 6.

> and the presence of processing costs means that not all public information will be impounded in a security's price with the same alacrity, or perhaps with any quickness at all. [55]

Empirical evidence, he said, supported the view that even when public information was incorporated into the market, it oftentimes was not done so accurately with the result that share price movements seemed unrelated to such information, or indeed occurred in the absence of any information. [56]

Thomas J considered that the *Basic* Court's assumption that investors trade on a belief in the integrity of the market price of shares was contradicted by the realities—some investors trade because they believe the market has over or under valued the share price and they can use this mis-pricing to their advantage; some trade to meet changed liquidity needs; for tax reasons; or to re-balance their portfolios. [57] Thus, it cannot be said that *all* investors rely on price integrity. *Basic*, however, asserted that it was sufficient that *most* investors rely on market price integrity, an assumption said Thomas J, that rested on nothing more than a 'judicial hunch' as evidence of such a fact. [58] It was said in *Basic* that even those investors who trade because of a belief that the market is mis-priced are not indifferent to the integrity of the market price because they implicitly believe the share price will eventually reflect all material information. Thomas J said:

> Whether the majority's unsupported claims about the thought processes of hypothetical investors are accurate or not, they are surely beside the point. Whatever else an investor believes about the market, he simply does not 'rely on the integrity of the market price' if he does not believe that the market price accurately reflects public information *at the time he transacts*. That is, an investor cannot claim that a public misstatement induced his transaction by distorting the market price if he did not buy at that price while believing that it accurately incorporated that public information. For that sort of investor, *Basic*'s critical fiction falls apart. [59]

Basic permits evidence to be adduced at the certification stage that an individual investor did not buy or sell shares in reliance on the integrity of the market price. Thus, said Thomas J:

> *Basic* entitles defendants to ask each class member whether he traded in reliance on the integrity of the market price. That inquiry, like the traditional reliance inquiry, is inherently individualized; questions about the trading strategies of individual investors will not generate 'common answers apt to drive the resolution of the litigation,' ... (*Basic'*s recognition that defendants could rebut the presumption 'by proof the investor would have traded anyway appears to require individual inquiries into reliance'). [60]

Accordingly, a plaintiff who invokes the presumption of reliance is 'deemed to have shown predominance as a matter of law, even though the resulting rebuttable presumption leaves

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55 Ibid. 7.

56 Ibid. 7–8.

57 Ibid. 9.

58 Ibid. 10.

59 Ibid.11. (emphasis in original)

60 Ibid. 12. (citations omitted)

individualized questions of reliance in the case and predominance unproved.' [61] The practical effect, according to Thomas J, is that the presumption cannot really be rebutted. [62]

Thomas J also thought that the fact that Congress had not seen fit to intervene and abrogate the presumption lead to an inference that Congress had approved of it, was untenable. [63] Further, he said, the enactment of the two pieces of legislation referred to by the majority. [64] had nothing to do with 'the reliance element of the implied Rule 10–5 private cause of action or the *Basic* presumption.' [65] In the result he said:

> *Basic* took an implied cause of action and grafted on a policy-driven presumption of reliance based on nascent economic theory and personal intuitions about investment behavior (sic). The result was an unrecognizably broad cause of action ready made for class certification. Time and experience have pointed up the error of that decision, making it all too clear that the Court's attempt to revise securities law to fit the alleged 'new realities of financial markets' should have been left to Congress. [66]

The Australian market

The Australian Securities Exchange (ASX) is the major market operator, and it can be expected that most complaints will involve securities listed on it.

The other market operators are:

- Chi-X
- National Stock Exchange-NSX
- SIM Venture Securities Exchange-SIM VSE -now IR Plus
- Financial & Energy Exchange Limited –FEX
- Sydney Stock Exchange Limited -SSX
- IMB Limited-IMB
- ASX Trade 24-ASX 24

These entities operate ' financial markets ' offering clearing and settlement facilities -see sections 767A and 767B of the *Corporations Act 2001*. They are (and must be) licensed under the Act.[67]

Bases for securities class actions in Australia

The law and, in some cases, the relevant listing or operating rules mandate continuous disclosure.

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61 Ibid. 12.

62 Ibid. 14.

63 Ibid. 15–18.

64 Above nn 43,44 and accompanying text.

65 *Halliburton Co v Erica p John Fund*, 573 US___ (2014) slip op 1, 16.(Thomas J)

66 Ibid. 18.

67 *Corporations Act 2001,* Part 7.2..

If a corporation is a 'disclosing entity' as defined in *Part 1.2A* of the *Corporations Act 2001* then it must comply with the continuous disclosure obligations as required by section 674; or section 675 of the Act if it is an unlisted disclosing entity or a listed one whose listing rules make no provision for such disclosure. (Managed investment schemes may also be caught by the continuous disclosing obligations. [68] Securities issued as consideration for an acquisition under an off-market takeover bid; or a Part 5.1 compromise or arrangement also require continuous disclosure.[69])

The information to be disclosed is that which a reasonable person would expect to have a material effect on the price or value of the securities of a disclosing entity if the information would, or would be likely to, influence persons who commonly invest in securities to acquire or dispose of the securities.[70] A company listed on a market whose rules require continuous disclosure must notify the market operator of such information as soon as it arises. [71] Unlisted disclosing entities, or an entity listed on a market not having a continuous disclosure rule, must lodge a document with ASIC containing the price sensitive information. [72]

The listing / operating rules of the ASX, Ch-X. NSX and the SSX require continuous disclosure.[73] Entities listed on these markets must make continuous disclosure by force of S.674 of the Act. Entities listed on the other markets are caught by S.675 of the Act and must make such disclosure.

These continuous disclosure obligations are found in Chapter 6CA of the *Corporations Act 2001.* Section 1325 of this Act prescribes the consequences for breaching these requirements. Thus, the Court may, on the application of a person who has suffered, or is likely to suffer, loss or damage because of conduct of another person who has engaged in a contravention of Chapter 6CA, make such order or orders as it thinks appropriate, if it considers that the order or orders concerned will compensate the person who made the application, or the person or any of the persons on whose behalf the application was made, in whole or in part, for the loss or damage, or will prevent or reduce the loss or damage suffered, or likely to be suffered, by such a person.[74] The orders the Court may make include an order directing the person who engaged in the conduct, or a person who was involved in the contravention constituted by the conduct, to pay to the person who suffered the loss or damage, the amount of the loss or damage. [75]

The impugned statements may also lead to allegations of misleading and deceptive conduct in breach of the relevant provisions in the *Corporations Act 2001,* the *Australian Securities and Investments Act 2001* or the *Australian Consumer Law.*

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68 *Corporations Act 2001,*111AFA

69 Ibid. S111AG.

70 Ibid. S.677

71 Ibid. S674 (2).

72 Ibid. S674 (2), 675 (2).

73 ASX- continuous disclosure rule 3.1; NSX-listing rule 6.4; Chi-X operating rule 3.1, Operating Rules Procedure P3.1; and SSX--listing rule 11.

74 *Corporations Act 2001, s 1325 (2).*

75 Ibid. *s 1325 (5)(e).*

Section 1041H of the *Corporations Act 2001* provides that a person must not engage in conduct, in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive. Section 1041E prohibits a person from making a statement or disseminating information which is false in a material particular or is materially misleading, and which is likely to induce persons to apply for, acquire or dispose of financial products on a market; or to affect the price of those products on the market. Section 1041F prohibits the making or publishing of a statement, promise or forecast which is misleading, false or deceptive for the purpose of inducing a person to deal in financial products. Section 1041G prohibits a person who provides a financial service from engaging in dishonest conduct ('dishonest' being defined in the section) in relation to a financial product or financial service. A person who suffers loss or damage by conduct of another person that was engaged in in contravention of sections 1041E, 1041F, 1041G or 1041H may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention, whether or not that other person or any person involved in the contravention has been convicted of an offence in respect of the contravention.–section 1041I.

Relevantly, the *Corporations Act 2001* defines specific things that are financial products in section in 764A of the Act, and includes securities and both registered and unregistered managed investment schemes.

Section 12DA (1) of the *Australian Securities and Investments 2001* provides that a person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive. Section 12BAB defines when a person provides a financial service, and, relevantly, includes dealing in a financial product (12BAB (1)). Issuing a financial product is a dealing (s BAB(7)(b). A financial product in turn is defined in 12BAA (1) as a facility through which, or through the acquisition of which, a person, relevantly, makes a financial investment (12BAA (1)(a). (A 'security' is defined as a financial product (s12BAA (7)(a)). What constitutes making a 'financial investment' is defined in 12BAA (4)(1), an example being a person paying money to a company for the issue of shares in the company. Finally, s 12GF (1) provides that person who suffers loss or damage by conduct of another person that contravenes a provision of section 12DA may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.

Finally, section 18 of the *Australian Consumer Law* (ACL) [76] prohibits a person engaged In trade or commerce from engaging in misleading or deceptive conduct, or conduct that is likely to mislead or deceive. Section 236 of the ACL enables anyone who suffers loss or damage by conduct of another person in breach of section 18, to recover that loss or damage from that person.

Other statutory prohibitions which may also give rise to securities class actions are:

- Making misstatements or omissions in disclosure documents (eg. prospectuses) [77]

[76] *Competition and Consumer Act 2010, Schedule 2.*

[77] *Corporations Act 2001*. s728.

- Making misstatements in, or omissions from, takeover and compulsory acquisition and buy-out documents [78]
- Engaging in market manipulation [79]

Causation – the Australian experience

In 2007 the Multiplex group (Multiplex) was embroiled in litigation arising out of its contract to build the new Wembley Stadium in England. The complaints were that it was not completed on time and within budget, and that there had not been continuous disclosure as required by section 674 of the *Corporations Act 2001* and the ASX Listing Rules. Further, public announcements made by Multiplex were said to be misleading and deceptive in that they did not reveal the true position. Multiplex did eventually revise its forecast aggregated group profit after tax before stapling. When the true position was made known the price of Multiplex's shares fell. The applicant, in representative proceedings, complained that it had suffered a loss as a consequence of the alleged contraventions of the law. In these proceedings the respondent, Multiplex, sought an order under section 33N of the *Federal Court of Australia Act 1976,* [80] that the proceeding no longer continue as a representative one.

Justice Finkelstein noted:

> It seems the way the case will be put is based on the hypothesis (in some quarters an article of faith) that had the Corporations Act and ASX listing rules been complied with the market in Multiplex securities would have been open and efficient and the price of the securities would be determined on the basis that all material information regarding the company was publicly available. The consequence of this hypothesis is the premise that the market price of the securities would have been negatively affected if there had been proper and not misleading disclosure about the Wembley Stadium project. It may also be argued that there is a rebuttable presumption of reliance (if it is necessary to establish reliance) on the existence of an open and efficient market for Multiplex securities. In the United States this is referred to as the fraud-on-the-market theory. [81]

Having noted the fact that the applicant apparently intended to rely on the doctrine nothing further was said of it. The argument for holding that the proceeding should be adjudged unsuitable to continue as a representative proceeding centred primarily on the funding arrangements for the litigation. In the result Finkelstein J refused the respondent's application. Nonetheless, implicit in this was a tacit acceptance that the doctrine was at least arguable as being applicable in Australia.

The New South Wales Court of Appeal in 2007, and shortly after the Multiplex proceeding discussed above, considered an application for leave to appeal a decision of the Supreme

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[78] Ibid. s670A.

[79] Ibid. s1041A.

[80] S 33N prescribes those circumstances under which a Court may order that proceedings not continue as a representative one. Relevantly it provides: (1) The Court may, on application by the respondent or of its own motion, order that a proceeding no longer continue under this Part where it is satisfied that it is in the interests of justice to do so because:(a) the costs that would be incurred if the proceeding were to continue as a representative proceeding are likely to exceed the costs that would be incurred if each group member conducted a separate proceeding; or (b) all the relief sought can be obtained by means of a proceeding other than a representative proceeding under this Part; or(c) the representative proceeding will not provide an efficient and effective means of dealing with the claims of group members; or (d) it is otherwise inappropriate that the claims be pursued by means of a representative proceeding.

[81] *P Dawson Nominees Pty Ltd v Multiplex Limited* [2007] FCA 1061(19 July 2007).[10]-[11].

Court upholding a liquidator's decision rejecting a proof of debt.[82] The appellant purchased shares, allegedly as a consequence of misleading and deceptive conduct. As appears from the decision, the appellant suggested during his submissions that he could invoke the doctrine of fraud on the market, and referred the Court to the decision of Finkelstein J in the *Multiplex* case discussed above. As to this Young CJ in EQ said:

> This doctrine has not (yet) been successfully invoked locally, and has been downplayed by Blanchard J in New Zealand in Boyd Knight v Purdue … However, even if it has validity in Australia, the present case does not raise it. [83]

The suggestion that the New Zealand Court had 'downplayed' the doctrine was perhaps something of an overstatement. *Boyd Knight v Purdue* [84] was a decision of the New Zealand Court of Appeal upholding an appeal by auditors against a finding of liability for negligence against them. The auditors had provided a report for inclusion in a prospectus issued by a finance company which failed. The respondent represented a group of investors who had invested in the company. Fraud had been committed and fictitious loan accounts had been created resulting in the shareholders' funds being overstated, and total liabilities in fact exceeding the limit set by the trust deed established on behalf of investors. The auditors accepted that if they had not been negligent they would have detected the fraud, the prospectus would not have issued, the respondents would not have invested in the company and would not, therefore, have suffered any loss. At trial the respondents' case was advanced on the basis that there was no actual reliance by them, but rather indirect or general reliance. Blanchard J (with whose judgment other members of the Court expressed agreement) said:

> It would be casting upon an auditor a burden going even beyond anything suggested for the unsuccessful plaintiff in *Caparo* [85] if this Court were to hold careless auditors liable for the accuracy of figures which were not directly relied upon by plaintiff investors. Since the purpose of the legislation [NZ securities laws] is to ensure information is available to investors, so that they can make their own assessment of the prospects of the issuer, it would be exceeding the statutory scheme if the Court were to find auditors responsible for inaccuracies in information which was not utilised by an investor. There is no room in this context for an indirect reliance. … I find no attraction in the doctrine of reliance on the integrity of the market which has been developed in some jurisdictions in the United States . It is quite contrary to the position taken in *Caparo.* [86]

The Court held that the respondents had to establish actual reliance on the auditors' report in the prospectus, which they failed to do. Blanchard J considered that an audit report had no context for anyone who had not read the accounts; and without such a reading the report tells the reader nothing except the company has a set of accounts which comply with the regulations and present a true and fair view.[87] The true and fair view may be one of poverty or prosperity. [88] It was not sufficient that an investor had relied in a general way on the existence of the prospectus and regulations. There must be at least reliance on the basic features of the financial statements.

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82 *Johnston v McGrath* [2007] NSWCA 231 (4 September 2007).

83 Ibid. [38].(citation omitted)

84 [1999] 2 NZLR 278.

85 *Caparo Industries PLC v Dickman* [1990] 2 AC 605.

86 *Boyd Knight v Purdue* [1999] 2 NZLR 278, 292-3. (citations omitted)

87 *Ibid*, 292.

88 Ibid.

Caparo Industries PLC v Dickman, [89] referred to by Blanchard J, was a decision of the House of Lords, and was an appeal by a firm of auditors. The auditors were the auditors of a public company, Fidelity PLC (Fidelity), whose shares were listed on the London Stock Exchange. The auditors had prepared Fidelity's accounts in execution of its statutory duty under the relevant company law. In May 1984 the directors of Fidelity announced the company's results for the year ended 31 March 1984. Profits were less than anticipated, and the share price fell significantly. The accounts were released to the shareholders in June 1984, and approved and adopted at an AGM in July 1984. Caparo commenced purchasing shares in Fidelity following the May announcement, but before the release of the accounts to shareholders. It continued buying shares thereafter, and made a successful takeover bid for Fidelity. Caparo alleged that the shares purchased after the release of accounts in June and the subsequent bid were in reliance on the accounts which were inaccurate and misleading with the result that the reported profit should have been a loss. Caparo alleged that if the true facts had been known it would not have made a bid. The claim was one in negligence; and the outcome rested on whether auditors owed a duty of care to individual investors in the circumstances of the case. Their Lordships held they did not. The case defined the limits of the duty of care with respect to auditors, and whether the auditors owed a duty of care to potential investors such as Caparo. The fact that the report was prepared to fulfill a statutory requirement was a significant factor in defining the scope of the duty of care. Significantly, the allegation was one of express reliance on the released accounts.

There were a number of interlocutory skirmishes in the Multiplex proceedings, none of which are relevant for present purposes. The matter ultimately settled, and the settlement, being a representative proceeding, required approval by the Court.[90] It was approved by Finkelstein J.[91] One of the factors taken into account by the Judge was the uncertainty that market based causation would be accepted in Australian jurisprudence. He said:

> The applicants may not attempt to prove that they, or the class members, relied upon the published statements made by Multiplex about the state of the Multiplex business when they traded in Multiplex securities. Instead, the principal focus of their action will be on the market-based causation theory. Under this theory, causation may be made out if it can be demonstrated that the contraventions caused the market to inflate the price of the securities. The decision of the New South Wales Court of Appeal in Ingot Capital Investments Pty Ltd v Macquarie Equity Markets Ltd [2008] NSWCA 206; (2008) 73 NSWLR 653 suggests that it may not be possible in Australia to rely on the market-based causation theory. That case posits that it is necessary to prove reliance in cases where it is alleged that a contravention of the continuous disclosure provisions of the Corporations Act induce a plaintiff to enter into a particular transaction. While Maurice Blackburn consider that market-based causation involves a different categorization of the effect of the contraventions and can be distinguished from Ingot Capital, they necessarily accept that the question is uncertain. Further, the relative novelty and legal importance of the issue suggests that, even were the applicants to succeed at trial, the matter would likely go on appeal, perhaps to the High Court if special leave is obtained. This would effectively delay the resolution of the claims for several more years.[92]

In August 2014, Sifris J of the Victorian Supreme Court was confronted with an application to strike out a statement of claim in a representative proceeding. [93] One of the issues was whether the Plaintiff was required to plead reliance and specific representations regarding

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[89] [1990] 2 AC 605.

[90] *Federal Court of Australia Act 1976,* Ss.33V, 33ZF.

[91] *P Dawson Nominees Pty Ltd v Multiplex Limited (No 4) [2010] FCA 1029 (21 September 2010).*

[92] Ibid.[15]-[16].

[93] *Camping Warehouse Australia Pty.Limited v Downer EDI Limited* [2014] VSC 357 (1 August 2014).

claims of misleading or deceptive conduct and breach of obligations of continuous disclosure under the *Corporations Act 2001* (Cth). As for the need for reliance His Honour said:

> The plaintiff is entitled to the benefit of the sufficient uncertainty that exists in relation to whether reliance is necessary or is required to be pleaded in a case of this kind. Of course, causation, which has been pleaded, will need to be established. I will not strike out the Statement of Claim. In my opinion a brief review of the legislation and authorities establishes, for the purposes of a strike out application, that the matter is far from clear and the plaintiff's case is not plainly hopeless.[94]

Trial of these proceedings commenced in early 2016, and the Court was informed on the fourth day of the trial that settlement in principle had been reached. The Court had to be satisfied that the settlement was fair and reasonable for it to be effective. [95]

Of note was His Honour's comments on the question of causation. He said:

> A further risk faced by Camping Warehouse at trial arose in relation to the necessary establishment of causation. Camping Warehouse's foreshadowed case sought to rely upon market-based causation rather than seeking to establish a case which included Camping Warehouse demonstrating that it, or the other group members, were materially affected by particular representations including as to the profitability of the RSM project, and that they relied upon those representations when purchasing their shares. In February 2016, at the time the proposed conditional settlement was entered into between Camping Warehouse and Downer, there was no decided case in Australia as to whether market-based causation was a potentially effective means of establishing causation in group proceedings, although there has been some consideration of the efficacy of this mode of proof. [96]

Caason Investments Pty Limited v Cao [97] involved an application to consolidate representative proceedings and to amend the statement of claim in the consolidated proceedings. The proceedings related to claims against the directors and auditors of the company Arasor International Limited. The claims related to statements in or omissions from a prospectus, a short form prospectus, financial statements and half yearly financial statements. There were alleged contraventions of various provisions in the *Corporations Act 2001* and the *Australian Securities and Investments Commissions Act 2001* which prohibit misleading and deceptive conduct with respect to financial services and products, and in connection with the issuing of a prospectus. One of the proposed amendments was to delete an allegation that there had been reliance on the alleged representations. The effect of the proposed amendment was to raise market-based causation.

Farrell J commented as follows:

> The proposed amendments to plead market based causation raise the 'vexed question' of whether 'reliance' is a necessary 'link in the chain of causation' between the claimed loss or damage suffered 'by' or 'because of ' the contravention. The applicants submit that where a claim raises an arguably novel point of law such as market based causation, it should be allowed to proceed so as not to 'risk stifling the development of the law by summarily throwing out of court actions in respect of which

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[94] Ibid.[28].

[95] A group proceeding cannot be settled or discontinued without the approval of the Court-*Supreme Court Act 1986 (Vic), s 33V.*

[96] Camping Warehouse Australia Pty.Limited v Downer EDI Limited [2014] VSC 357 (1 August 2014).[74]-[75].

[97] [2014] FCA 1410 (23 December 2014).

> there is a reasonable possibility that it will be found, in the development of the law, still embryonic, that a cause of action does lie'. [98]

Her Honour further observed that '[n]ovelty should not be a basis for disallowing an amendment where the novel pleading has its origin in elements of received doctrine.' [99] She identified various deficiencies in the proposed amended pleadings and left it to the applicant to amend the pleadings respecting the misleading and deceptive conduct claims in accordance with her reasons, subject to presenting an acceptable timetable for any amendments. It is implicit in Her Honour's reasons that market based causation could arguably be pleaded.

Bonham v Iluka Resources Limited [100] was a case involving an application for preliminary discovery under the Federal Court Rules. [101] This was in anticipation of representative proceedings against a mining company alleging misleading and deceptive conduct, and a failure to make continuous disclosure to the market as required by the corporations law and the ASX Listing Rules. The draft pleadings put into evidence invoked the doctrine of fraud on the market. Kerr J 'concluded that I do not have to decide whether Mr Bonham's contemplated cause of action, in so far as it relies on the fraud on the market doctrine to establish reliance, is so doubtful in law that it cannot give rise to a reasonable belief that he may be entitled to relief in this Court.'[102] This was because the prospective applicant's lawyers had asserted in correspondence with the prospective respondent that their client had relied upon certain statements made by the respondent. Nonetheless, he cited with apparent approval the decision of Farrell J in *Caason Investments Pty Limited v Cao* [103] where she said:

> Despite the strength of intermediate appellate court authority which requires reliance to be demonstrated as an element of causation where an investor has entered into a transaction to which the claim of misleading or deceptive conduct is relevant, recent High Court authority on s 82 of the TPA and the fact that market based causation claims relying on ss 1041H and 1041I [of the *Corporations Act 2001]* and their analogues in the ASIC Act in the context of Ch 6CA [of the *Corporations Act]* have not been considered by the High Court suggest that the state of the law cannot be regarded as so settled that an appropriately pleaded claim would have no reasonable prospect of success... [104]

In the result the application was refused as not meeting the requirements under the Rules for preliminary discovery. (It should be noted that Kerr J's concern was with the doctrine of fraud on the market, whereas Farrell J was speaking of market-based causation. There is, a difference. Fraud on the market is a rebuttable presumption of reliance on the integrity of the market; and market-based or indirect causation requires it to be demonstrated that the contraventions caused the market to inflate (or deflate) the value of the securities.)

An answer to the question whether market-based or indirect causation could avail a plaintiff was given recently in the New South Wales Supreme Court by Brereton J in *In the matter of*

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98 Ibid. [39]-[40]. (Citations omitted)

99 Ibid. [41].

100 [2015] FCA 713 (15 July 2015).

101 See *Federal Court Rules,* Part 7, Division 7.3.

102 *Bonham v Iluka Resources Limited* [2015] FCA 713, (15 July 2015). [74].

103 [2014] FCA 1410 (23 December 2014).

104 Ibid. [106].

HIH Insurance Limited (in liq) v McGrath. [105] (HIH) Whilst not a representative proceeding, the reasoning is apposite to such proceedings. This was an appeal against the rejection by liquidators of a proof of debt. The plaintiffs alleged that those who acquired shares in HIH during a specified period did so at prices which were inflated by the misrepresentations contained in certain financial year and interim financial year reports. They did not contend that that they had read, or had directly relied upon reports of the financial results. They contended that they had acquired HIH shares in a market regulated by the ASX and the corporations law, but which was distorted by the admitted misrepresentations of the financial results, so that shares in HIH traded at prices higher than those which would have obtained had the misrepresentations not been made. Consequently, they allegedly suffered loss and damage by reason of having paid more for the shares they acquired than they should otherwise have paid. (The claim was also against two subsidiaries of HIH on an accessorial basis, and their liability was a separate issue whose resolution can be ignored for present purposes.)

HIH had entered into two re-insurance arrangements. It also entered into other arrangements which effectively made the cover illusory. The arrangements were described as 'financial re-insurance contracts' as opposed to 'conventional re-insurance contracts'. This enabled HIH to report a consolidated operating profit when in truth it should have reported a loss. Accordingly, there was not a true and fair view of the financial position of the consolidated HIH group.

HIH admitted that it had engaged in misleading and deceptive conduct contrary to section 52 of the *Trade Practices Act 1974* [106] and its then Corporations Act analogue.

Brereton J identified one of the issues for determination as whether the plaintiffs were entitled to claim damages on the basis of indirect causation without proving direct reliance on the contravening conduct. He said,

> … the contravening conduct resulted in the prices at which HIH shares traded on the ASX being higher than those which would otherwise have obtained, and that a person who acquired shares in that inflated market suffered loss because he or she paid more than would otherwise have been paid for the subject shares. In other words, it is said that loss was incurred because the contravening conduct – the release of the overstated accounts – distorted the market on which HIH shares were traded, and the causation requirement is satisfied by the facts that (1) the contravening conduct misled the market into attributing an inflated value to HIH shares, (2) the plaintiffs acquired their shares in that inflated market, and (3) the plaintiffs thus paid more than they would otherwise have paid for the same shares.[107]

The plaintiffs contended that they were able to make a claim based on indirect causation. The respondents said, that on authority, [108] where a person claims to have suffered loss by reason of entry into a transaction, that person must establish reliance. Indirect causation, it was alleged, was permissible only in cases where a third party has been induced by the misleading and deceptive conduct of another to act to the detriment of the applicant. – for example, if A

105 [2016] NSWSC 482 (20 April 2016).

106 See now, *Competition and Consumer Act 2010,* schedule 2, s18.

107 *In the matter of HIH Insurance Limited (in liq) v McGrath* 2016] NSWSC 482 (20 April 2016). [38].

108. The cases cited as authority are *Digi-Tech (Australia) Ltd v Brand* [2004] NSWCA 58 (23 March 2004); *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* [2008] NSWCA 206 (3 December 208); and *Ford Motor Company of Australia Limited v Arrowcrest Group Pty Ltd* (2003) 134 FCR 522.

and B are competitors, and B makes misleading and deceptive statements which results in consumers preferring B's products to A's to the financial disadvantage of A, then A may have a claim against B even though it has not directly relied on anything said or done by B. Here A's reliance is said to be 'passive.'–see the cases cited by Brereton J in HIH. [109]

Brereton J said:

> Two questions arise from these competing positions of the parties. The first is whether, as the defendants contend is dictated by authority, 'indirect causation' is not available in a case such as the present, and reliance must be established. The second is whether – if indirect causation is available – it has been established; as will be seen in the context of this case, that second question is intertwined with the quantification of the plaintiffs' damages. [110]

His Honour referred to the US doctrine of fraud on the market, and stated with respect to it that,

> [o]nce a plaintiff has successfully invoked the presumption, he or she is presumed to have relied on the non-disclosure. Defendants may rebut this presumption by establishing that: (a) the non-disclosures did not affect the market price; or (b) the plaintiffs would have purchased the shares at the same price had they known the information that was not disclosed; or (c) the plaintiffs actually knew the information that was not disclosed to the market. [111]

He went on to claim that the doctrine of fraud on the market did not avail the plaintiffs because 'Australian law does not authorise any rebuttable presumption of this kind.' [112] In support of this proposition he cited *Johnston v McGrath*, [113] a first instance decision of Barrett J in the New South Wales Supreme Court; *Johnston v McGrath*, [114] a New South Wales appellate decision; and the New Zealand decision of *Boyd Knight v Purdue.* [115]

The New Zealand decision has been discussed above. The New Zealand Court did not undertake any detailed examination of the doctrine of fraud on the market but simply said it found it to be unattractive and contrary to the position taken in *Caparo.*[116] *Caparo* , as noted, was all about defining the limits of the duty owed by auditors in circumstances where reliance on financial statements was alleged.

The New South Wales Court of Appeal decision in *Johnston v McGrath* [117] is also discussed above. It found it unnecessary to discuss the doctrine of fraud on the market as it had no application to the case at bar. Notwithstanding this, Young CJ in EQ observed that the

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[109] *In the matter of HIH Insurance Limited (in liq) v McGrath* 2016] NSWSC 482 (20 April 2016), [43]-[47].

[110] Ibid. [40].

[111] Ibid. [41].

[112] Ibid.

[113] [2008] NSWSC 639 (25 June 2008).

[114] [2007] NSWCA 231.(4 September 2007).

[115] [1990] 2 NZLR 278.

[116] *Caparo Industries PLC v Dickman* [1990] 2 AC 605.

[117] [2007] NSWCA 231.(4 September 2007).

doctrine had not yet been successfully invoked in Australia; and noted Blanchard J's comments on it in the New Zealand Court of Appeal as discussed above.

The third case cited by Brereton J was the decision by Barrett J in *Johnston v McGrath.*[118] This was an application for leave to file an amended statement of claim in an appeal under the *Corporations Act 2001* against rejection of a proof of debt. It is unnecessary to consider the facts of the case in any detail. In his decision Barrett J noted the observations by Young CJ in EQ respecting the doctrine of fraud on the market referred to in the preceding paragraph. Barrett J considered it would have been open to the plaintiff in earlier proceedings to have sought to advance a rebuttable presumption of reliance by reference to fraud on the market theory. [119]

Whilst the authorities cited by Brereton J do not, it is suggested, support his conclusion that fraud on the market is unavailable in Australia, its acceptance here may be denied nonetheless for other reasons as discussed below.

The claims considered by Brereton J alleged a breach of section 52 of the *Trade Practices Act 1974* [120] (TPA), which proscribes misleading and deceptive conduct, and also a breach of its then Corporations Act analogue. Section 82 of the TPA [121] provided that a person who suffers loss or damage by conduct of another that was done in contravention of a section 52 of the TPA may recover the amount of the loss or damage by action against that other person. The pivotal feature of this section was, his Honour said, causation and not reliance. He said:

> [a]s a matter of principle, if causation – 'by conduct of ' – can otherwise be established, it cannot matter that reliance is not established. Thus, the statutory cause of action does not, per se, include reliance as a necessary material fact (although that is not to say that it will not be one, as a matter of fact, in the context of many, if not most, individual cases). [122]

His Honour assayed cases in which reliance on some act or omission was considered unnecessary to prove liability, and cases where it was. He said:

> The distinction drawn between the two classes of claim is that, in the first class, no act of the plaintiff contributes to the loss, and the chain of causation is complete without any act or omission on the part of the plaintiff; whereas in the second, which occurs when plaintiffs are induced by misleading representations to perform some act or omission by which they are prejudiced, the inducement of the plaintiff and his or her act or omission causing loss is an essential part of the chain.[123]

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118 [2008] NSWSC 639 (25 June 2008).

119 *Johnston v McGrath[*2008] NSWSC 639 (25 June 2008). [47].

120 Now see, *Competition and Consumer Act 2010,* schedule 2, s18.

121 Now see, *Competition and Consumer Act 2010,* schedule 2, s236. Note that the wording has changed from that of its TPA analogue. The Explanatory Memorandum to the *Trade Practices Amendment Bill 2009 says* the damages provisions in the ACL replace section 82 of the TP Act and existing jurisprudence should continue to apply-EM, 15.14. Relevantly, if a person suffers loss or damage because of the conduct of another person, and the conduct contravenes s 236, then the claimant may recover the amount of the loss or damage by action against that other person, or against any person involved in the contravention. Now the loss or damage must be **because of conduct** of a person whereas prior to the change the loss or damage must have been caused **by conduct** of another person.

122 *In the matter of HIH Insurance Limited (in liq) v McGrath* 2016] NSWSC 482 (20 April 2016) [42].

123 Ibid.[53].

His Honour noted that whilst there were no authoritative decisions conclusively holding that market causation was available, there were decisions suggesting, by way of *obiter,* that such a theory was 'available', or 'plainly arguable'. [124]

Brereton J held that the:

> chain of causation was (1) HIH released overstated financial results to the market, (2) the market was deceived into a misapprehension that HIH was trading more profitably than it really was and had greater net assets than it really had, (3) HIH shares traded on the market at an inflated price, and (4) investors paid that inflated price to acquire their shares, and thereby suffered loss. Thus, the contravening conduct materially contributed to that outcome. [125]

Whether the contravening conduct had materially contributed to investors paying an inflated price for their shares could, he said, also be tested by asking what would have happened if each contravention had not occurred? The answer, he thought, would have been that the market price of the HIH shares would have been lower, and the plaintiffs would have paid less for the shares they acquired. [126] Thus he said:

> ...I do not see how the absence of direct reliance by the plaintiffs on the overstated accounts denies that the publication of those accounts caused them loss, if they purchased shares at a price set by a market which was inflated by the contravening conduct: the contravening conduct caused the market on which the shares traded to be distorted, which in turn caused loss to investors who acquired the shares in that market at the distorted price. In the absence of any suggestion that any of the plaintiffs knew the truth about, or were indifferent to, the contravening conduct, but proceeded to buy the shares nevertheless. I conclude that 'indirect causation' is available and direct reliance need not be established. [127]

Whilst the plaintiffs could rely upon indirect causation, he said that they 'must establish, by evidence and/or inference, that the contravening conduct distorted the market price so as to cause the shares to trade at an inflated price.' [128] It is of course only loss and damage caused by the contravening conduct that may be recovered. He said, 'the contravening conduct did inflate the price for HIH shares, so that indirect causation in fact is established'[129], and he quantified the loss and damage he said had been suffered. [130]

Brereton J handed down his decision on 20April 2016. On 21 April 2016 the Full Court of the Federal Court of Australia handed down its decision in *Grant-Taylor v Babcock & Brown Limited (in liq.).* [131] This was a representative proceeding brought by 77 persons or entities who purchased shares in Babcock-Brown Limited (BBL), a listed financial services firm, between 21 February 2008 and 13 March 2009. They lost the value of their investment when BBL was placed in voluntary administration on 13 March 2009 and then into liquidation on 24 August 2009. The appellants claimed that BBL had breached its continuous disclosure obligations under s 674(2) of the Act and the ASX Listing Rule 3.1 during the period 21 February 2008 to 13 March 2009 (the non-disclosure period) in that it had failed to disclose

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[124] Ibid.[71].

[125] Ibid.[75].

[126] Ibid.[76].

[127] Ibid.[77].

[128] Ibid.[78].

[129] Ibid. [127].

[130] Ibid. [79]-[129]-for his quantification methodology.

[131] [2016] FCFCA 60 (21 April 2016)

information to the market which was not generally available and which a reasonable person would have expected to have had a material effect on the price of BBL shares.

Such allegedly non-disclosed information fell within the following three categories:

(a) First, final dividends for the years 2005 to 2007 had been paid out of capital, rather than profits, contrary to the then s 254T of the *Corporations Act 2001* and BBL's Constitution, and that its share capital had thereby been reduced contrary to s 256D (the final dividend information);

(b) Secondly, BBL's financial reports for 2005 to 2007 did not give a true and fair view of its financial position in that the reports failed to disclose that final dividends had been paid out of capital and that share capital had been reduced in each financial year (the final report information);

(c) Thirdly, BBL was insolvent on 29 November 2008 (the insolvency information).

The Court observed:

> On causation, the appellants did not advance a case or cases based on any specific reliance; rather their causation case was based on what has been described as a market-based or indirect causation theory. They claimed that the failure to disclose the said information caused them to acquire the relevant shares at an overvalue and that they were entitled to recover the difference between what they had paid for the shares and their so-called true value when acquired. [132]

The trial judge, Perram J, found that none of the information said to require disclosure was required to be disclosed by BBL and accordingly dismissed the claims. The Full Court agreed and so it was 'unnecessary in this case to deal with the important question of causation in connection with a posited failure by a listed company to disclose market sensitive information.' [133] However, speaking of causation, Perram J had said:

> None of the plaintiffs suggest that any of this information [of which complaint was made] was material to their individual decisions to acquire shares in BBL. They claim instead that the failure to disclose the information caused them to acquire the shares at an overvalue and they were therefore entitled, in accordance with the principle in Potts v Miller [1940] HCA 43; (1940) 64 CLR 282, to recover the difference between what they paid for the shares and what the shares were worth when acquired. Passing reference was made by the plaintiffs' counsel, Mr White, to the doctrine of fraud on the market which exists in the United States but it was not suggested that it was to be applied in this case. As I understood the submission, its only relevance was to show the plausibility of the outcome for which the plaintiffs contended. [134]

Potts v Miller [135] involved a claim in deceit alleging two instances of fraudulent misrepresentations arising out of the allotment of shares in a company to be formed. At trial the jury found in favour of the plaintiff on one count and awarded damages in a specified amount; and found for the defendant on the second count. The defendant appealed and the Full Court of the Supreme Court of New South Wales held that the plaintiff had failed to establish that he had suffered any damages as a result of the alleged misrepresentations, thereby failing to establish an essential element in the tort of deceit. Judgement for the

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[132] *Grant-Taylor v Babcock & Brown Limited (in liq.)* [2016] FCFCA 60 (21 April 2016 [4].

[133] Ibid. [9].

[134] *Grant-Taylor v Babcock & Brown Limited* (in liq.) [2015] FCA 149 (4 March 2015). [9].

[135] [1940] 64 CLR 282.

defendant was entered in the action. The High Court held that there was no evidence of actual loss; the evidence did not support a finding that the first alleged misrepresentation had been made; and that the second misrepresentation complained of was substantially true. It accordingly dismissed the plaintiff's appeal.

Starke J observed:

> The measure of damage in cases in which a person is induced by fraud to take up shares is the difference between the amount he subscribed or paid for the shares and the real value—not the market value—of the shares on allotment. [136]

The observation of Dixon J on the measure of damages was:

> In an action for fraudulent misrepresentation inducing the representee to purchase bank stock and pay calls thereon, Lord Campbell said that the proper mode of measuring the damages was to ascertain the difference between the purchase money and what would have been a fair price to have paid for the shares in the circumstances of the company at the time of the purchase. … The measure of damages in an action of deceit consists in the loss or expenditure incurred by the plaintiff in consequence of the inducement upon which he relied, diminished by any corresponding advantage in money or money's worth obtained by him on the other side. Lord Campbell's statement means that where the corresponding advantage consists in shares their value should be ascertained as at the time of their acquisition. [137]

The principle in *Potts v Miller* upon which the plaintiffs in *Grant-Taylor* are said to have relied may provide a measure of loss and damage in securities cases, but cannot of itself be said to provide the necessary link in the chain of causation

Loss and damage

Brereton J said in HIH, [138] indirect causation may be available to provide the necessary link in the chain of causation between conduct and loss such that direct reliance need not be established, but that does not mean that indirect causation has been established. 'The plaintiffs must establish, by evidence and/or inference, that the contravening conduct distorted the market price so as to cause the shares to trade at an inflated price', [139] and that question 'is intertwined with the quantification of the plaintiffs' damages, if any.' [140]

There are a number of ways that loss and damage may be quantified in shareholder and investor class actions.

1. The *Potts v Miller* formulation discussed above where the measure of loss is the difference between the price paid for the securities and their true value at the time of purchase. 'True value' may not be the same as market price.
2. The difference between the price paid for the shares and the market price if proper disclosure had been made, the 'but for' scenario. With respect to this manner of

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136 Ibid. 289.

137 Ibid. 297.(citation omitted)

138 *In the matter of HIH Insurance Limited (in liq.) v McGrath* [2016] NSWSC 482.(20 April 2016).

139 Ibid.[78].

140 Ibid.[78].

calculating loss, Jonathan Beach QC notes that the market price may not be the true value of the shares because:

> [t]rue 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.[141]

3. The difference between the price paid for the shares and the net amount received following their sale. This is the so called 'left in hand' approach. (The shares may not have been sold at the time of trial, in which case loss is measured by the difference between the price paid and the true value or market price at the time of trial.) This approach seemingly has its problems as suggested by Beach, namely:

   > … that 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. [142]

4. The loss occasioned by the loss of an opportunity. Here a plaintiff must prove that he, she or it would have made another more advantageous investment and would not have purchased the shares in issue if proper disclosure had been made.
5. An event study. This seeks to introduce a measure of precision into the calculation of any loss by means of statistical analysis. The volatility in a share price can result from factors other than improper disclosure. For example, things which may adversely affect the price of a share include geopolitical events ; changes in government policy, whether actual, foreshadowed or threatened; speculation by players in the market based on rumour and innuendo; the sell down of a large parcel of shares by an institutional investor irrespective of the reasons (such as the re-balancing of the portfolio); the effect of high speed trading; and the entrance or threatened entrance of new competitors into the market place. This methodology seeks to identify, by means of regression analysis , that part of a share price movement attributable to the non-disclosure of material information, thus providing a quantitative measure of that price movement.143

An investor may dispose of a parcel of shares at different points in time. Some shares may be sold at a time when the shares trade at an inflated price because of a failure to make proper disclosure. Some shares may be sold after disclosure has been made and the value has fallen. Should the fact that the investor has been advantaged by selling some shares at the inflated price be taken into account when determining what loss he, she or it has suffered by the sale of shares after disclosure? Where there have been multiple transactions various techniques have been adopted in an attempt to deal with multiple purchases at different times :-

- LIFO-last in first out. Thus, shares purchased last are held to be the shares first sold.

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141 *Class Actions -Some Causation Questions* (2011) 85 Australian Law Journal 579,588. Jonathan Beach QC.

142 Ibid.588, n 38.

143 Ibid. 586-8, Appendix: Multiple regression analysis -Simple steps.

- FIFO-first in first out. Here, shares bought first are considered to be the shares first sold.
- Netting. Sales are netted against purchases without regard to order of the purchases and sales.

Brereton J in HIH, [144] because of his finding, proceeded to quantify damages. [145] He noted that the plaintiffs' case was that, because of the conduct of which complaint was made, they paid a price for their shares greater than that which should have obtained. They were always going to buy the shares (as opposed to a case where they would not have purchased the shares but for the contravening conduct). Thus, he said,

> the measure of the plaintiffs' damages is not the difference between the price paid and the 'true value' of their shares, but the difference between the price they paid and the price they would have paid had the contravening conduct not occurred but all other factors remained constant. This necessitates determining the quantum of the impact, if any, of the contravening conduct, on the price at which HIH shares traded. In that context, 'true value' is not necessarily a proxy for what the market price would have been absent the contravening conduct, because there may have been other factors which also influenced (and distorted) the market price. [146]

Both sides called expert evidence in an attempt to show what, if any, price impact there was because of the impugned conduct. On the evidence Brereton J accepted that 'the contravening conduct did inflate the price for HIH shares, and that indirect causation in fact [was] established.' [147] He said:

> In my judgment, doing the best one can with the available material, the impact of the contravening conduct is represented by the difference between the price at which HIH shares actually traded on the market, and the hypothetical price achieved by applying the price to book value at which they traded to an adjusted book (adjusting for the Hannover Re arrangements [the re-insurance contract arrangements]). The difference can be calculated for each period from the ratio of 'adjusted book' value (adjusted for the Hannover Re transactions) to reported book value … , [148]

During final submissions the plaintiffs attempted to put forward the 'left in hand' method of valuing loss as an alternative approach to calculating loss. This was rejected by his Honour, firstly, because it had not been foreshadowed and no opportunity had been given to call evidence to address it; and, secondly, such an approach was, he said, inconsistent with the causation theory depended upon by the plaintiffs, namely, that they had suffered a loss by paying a higher price than they otherwise should have.

The manner of calculating loss in shareholder/investor cases is clearly problematical, the more so given that loss and causation are necessarily intertwined.

As a matter of interest it is noted that the American Congress has intervened in an attempt to prevent any abuse of class actions.[149] Also, it has imposed a statutory limit on the quantum of damages that may be recovered.[150] Under Australian law successful plaintiffs can recover

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[144] *In the matter of HIH Insurance Limited (in liq.) v McGrath* [2016] NSWSC 482.(20 April 2016).

[145] Ibid.[79]-[129].

[146] Ibid.[79].

[147] Ibid.[114].

[148] Ibid.[113]

[149] Above nn 43, 44.

[150] 15 USC 78U-4 (e)(1),(2)- Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price

such losses as they can prove they have suffered for a contravention of the misleading and deceptive conduct provisions under discussion here. [151] There is no good reason to believe that a similar result won't follow for a breach of the continuous disclosure laws. There may, however, be proportionate liability.[152] This of course requires evidence that the plaintiffs have contributed to their loss. It must be said, however, that it is difficult to imagine a securities class action where such a claim may be made. Any defeating conduct is more likely than not to break the chain of causation altogether, for example, purchasing the securities knowing the truth of the matter.

Comment

Until such time as a securities class action reaches the High Court the uncertainty as to the correct approach to causation in such claims will no doubt remain. The fact that these types of proceedings tend to settle before resolution by trial suggests the uncertainty may continue for some time to come.

Redress through class actions for alleged wrongful behaviour involving securities has long been a feature of the United States legal system.[153] It should come as no surprise then that the doctrine of fraud on the market should be considered in Australia. One commentator in 2006 made the following observation:

> Laws giving statutory force to the continuous disclosure rules of the Australian Stock Exchange mean that pure nondisclosure is clearly actionable. They require courts to grapple with causation where traditional reliance may be more problematic. It is not inconceivable, therefore, that Australian courts might adopt a 'fraud on the market' type theory in relation to nondisclosures in the Australian stock market. This might occur by adopting a 'but for' test of causation, which would combine existing principles of indirect or third party reliance upon misleading or deceptive statements with recognition, in appropriate cases, of the implications of the 'efficient capital markets' hypothesis for the rapid transmission of information through the market — including the consequences of a failure to rectify incorrect or outdated disclosures. [154]

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paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

(2) Exception

In any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

[151] *Marks v GIO Australia Holdings* (1998q) 196 CLR 494.

[152] *Competition and Consumer Act 2010, Part VIA, ss 87 CB-CI; Corporations Act 2001, s 1041I (1B); and Australian Securities and Investments Act 2001,* 12GF(1B).

[153] A useful discussion of the evolution of the doctrine in the United States is to be found in *Fraud on the Market: Judicial Approaches to Causation and Loss from Securities Non Disclosure in the United States , Canada and Australia*, 29 Melbourne University Law Review 621. Michael Duffy

[154] Ibid 664.

Brereton J did 'grapple' with the causation issue in HIH [155] discussed earlier (although this was not a representative proceeding and the claim was based only on misleading and deceptive conduct under the then applicable provisions of the *Trade Practices Act 1974* and the Corporations Law in its then form.) He rejected the fraud on the market doctrine as not being applicable to Australia. Whilst his reasoning may be open to challenge, based on an examination of the cases he cites in support of his conclusion, it may well be correct to say the doctrine is inapplicable to Australia for other reasons.

Damien Grave, Leigh Watterson and Helen Mould, (who were lawyers with Freehills at the time) posit, correctly it is suggested:

> [a]ny discussion of the fraud on the market theory cannot be divorced from the legislative context in which the theory developed and to which it is now confined. To do otherwise would risk creating an impression that the theory can be removed from its legislative regime and implemented with ease in another jurisdiction and legislative framework. [156]

What then are those factors which may be said to confine the applicability of the doctrine of fraud on the market to US jurisprudence?

Firstly, the doctrine was created to meet a particular evidentiary difficulty in the US. To obtain certification as a class action a plaintiff must show that questions of law or fact common to class members predominate over any questions affecting only individual members.[157] Reliance is an element of the cause of action under the relevant American provisions and provides the necessary causal connection between the misrepresentation and the claimed loss and damage.[158] The enquiry as to reliance is 'inherently individualized', as said by Thomas J in *Halliburton,* [159] thus making it impossible to show that common questions predominate. To overcome this difficulty a plaintiff who invokes the doctrine is deemed to have shown predominance as a matter of law.

There is no certification procedure in Australia. Jonathan Beach QC opines, with reference to the Australian Federal legislation,

> …under Pt 4A. Class actions automatically proceed if s 33C is satisfied. The balancing between common and non-common issues is at most a s 33N question. Moreover, the statutory causation tests do not necessarily require reliance. The US problem does not arise. The US doctrine is irrelevant.[160]

By reason of s 33C a proceeding may continue as a class action if it meets the criteria required by that section, these being that there are seven or more persons having claims against the same person; which claims are with respect to or arise out of the same, similar or related circumstances; and these claims give rise to a substantial common issue of law or fact. There is no certification requirement in Australia. The suitability of proceedings to continue as representative proceedings may be tested at any time under s 33N (and the Queensland, New South Wales and Victorian analogues). In the US the onus is on the plaintiff, at an early

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155 *In the matter of HIH Insurance Limited (in liq.) v McGrath* [2016] NSWSC 482.(20 April 2016)

156 *Causation, loss and damage: Challenges for the new shareholder class action*- (2009) 27 Companies and Securities Law Journal 483, 491. Damien Grave, Leah Watterson and Helen Mould.

157 *Federal Rules of Civil Procedure,* Rule 23(b)(3)

158 *Basic Inc v levinson* 485 US 224, 243 (1988).

159 *Halliburton Co v Erica P John Fund* 573 US___ 2014) slip op 1,12.

160 *Some Causation Questions* (2011) 85 Australian Law Journal 579, 586. Jonathan Beach QC.

practicable time, to satisfy the Court that a matter should continue as a class action. In Australia it is for a defendant to challenge the suitability of a matter to proceed as a class action.

Secondly, for the doctrine to operate in the US the alleged misrepresentations must be made 'on market' (as shareholders are presumed to have relied upon the integrity of the market) and consequently to the public. [161] This is not so in Australia as there is nothing in the statutory language which is so confining.

Thirdly, in the US a private cause of action for damages will not lie under the relevant legislative provisions in the absence of any allegation of *scienter,* that is, an intention to deceive, manipulate, or defraud on the defendant's part. [162] Actions under the Australian statutory provisions need not be premised on intent.

Fourthly, reliance is an element of a cause of action in the US under the relevant regulation (Rule 10b-5), and provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.[163] Reliance is not a necessary element of a claim under the Australian statutory provisions. Whilst actual reliance may be a sufficient requirement to establish causation, it is not a necessary one. - 'reliance is *not* a substitute … for the essential question of causation,' said the High Court in *Campbell v Backoffice Investments Pty Ltd.* [164] The case concerned the misleading and deceptive conduct provisions of the New South Wales Fair Trading Act, but the comments apply with equal vigour to cognate provisions in the Commonwealth legislation.

The American doctrine is predicated on an efficient market hypothesis. As appears from the dissenting opinions in *Basic* [165] and *Halliburton* [166] this hypothesis is not without its own controversy in the US. It must of course be shown that the market is in fact 'efficient' for the doctrine to apply. In order to decide whether a market is trading efficiently regard is had to what are known as the *'Cammer factors,'* enunciated in *Cammer v Bloom 2nd Fed.Supp 1264 (D.N.Y 1989).* These are: (1) the average weekly trading volume expressed as a percentage of total outstanding shares; (2) the number of analysts following and reporting on the stock; (3) the extent to which market makers and arbitrageurs trade in the stock; (4) the company's eligibility to file a particular form with the Securities and Exchange Commission, (SEC registration Form S-3); (5) the existence of empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price.

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[161] Basic *Inc v Levinson* 485 US 224, 248 (1988).

[162] *Ernst & Ernst v Hochfelder* 425 US 185 (1976); *Tellabs Inc v Makor Issues & Rights,Ltd* 551 US 308 (2007).

[163] *Basic Inc v levinson* 485 US 224, 243 (1988)

[164] (2009) 238 CLR 304, 351. (emphasis in original)

[165] *Basic Inc v levinson* 485 US 224 (1988).

[166] *Halliburton Co v Erica P John Fund* 573 US.____ (2014) slip op.

Beach suggests ‘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?’ [167]

It has long been established that silence may be productive of misleading and deceptive conduct. [168] This being so it doesn’t seem apposite to contend that there has been reliance in the context of a claim relating to such conduct. Brereton J noted:

> The importance of focussing on causation rather than reliance was highlighted by Giles JA (with whom Beazley JA and Ipp JA agreed) in *Smith v Noss*. His Honour said: ‘First, the essential question is causation. There may be causation from misleading or deceptive conduct if the conduct lies in failing to disclose that which in the circumstances should have been disclosed. It is not a natural use of the notion of reliance to say that there was reliance on the failure in disclosure, but causation can be found if disclosure would have caused inaction or action other than that which was taken: as was said by Besanko and Vanstone JJ in *Smith v Maloney* : ‘In a case where there has been failure to advise, as distinct from the provision of incorrect advice, it is somewhat artificial to formulate the test of causation in terms of real inducement because the court is required to consider a hypothetical question namely, what would the plaintiff have done had the defendant provided the advice he was bound to provide’. [169]

Grave *et al* note ‘[t]hat there is a line of authority, not yet tested in the context of shareholder class actions, which permits a court to draw an inference of reliance in circumstances where it is objectively likely that a transaction was induced by a misleading representation.’ [170] They suggest,

> ...the reliance inference is rebuttable; where the relevant conditions are satisfied the burden shifts to the defendant to disprove reliance. There may be difficulties in applying this principle in the context of shareholder class actions. In many situations, it would be misleading to characterise the disclosure on which a shareholder's claim is based (eg a misleading earnings guidance or an understatement of liabilities) as being ‘calculated’, or even ‘objectively likely’ to induce shareholders to purchase shares. These considerations aside it seems possible that in an appropriate case, ‘inferred’ reliance may be accepted as sufficient causation to found a shareholder compensation claim.[171]

Watson and Varghese, being plaintiffs’ lawyers [172] are, understandably, advocates for market-based causation. [173] The doctrine of fraud on the market is predicated on an efficient market hypothesis (EMH), which, as noted above, has not found universal acceptance in the US. Watson and Varghese argue that:

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

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[167] Above n 141, 586.

[168] *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31.

[169] *In the matter of HIH Limited (in liq) v McGrath [2016] NSWSC 482.* [48] (citations omitted)

[170] Above n156, 489.

[171] Ibid.490.

[172] They were at the time they authored the article referenced here, lawyers with Maurice Blackburn.

[173] The case for market-based causation: volume 32(3) University of New South Wales Law Review 948. Andrew Watson and Jacob Varghese.

> whether, as the EMH predicts, daily stock price changes follow a 'random walk.'[being the random daily movement in a share's price due only to the reception of new information]
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> …
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> Even if the market is not efficient, losses to investors through overpayment may still be the natural consequence of misinforming the market. It is one thing to show that a market falls short of efficiency and another to prove that it operates so inefficiently that information about the company has no bearing on its price or value. If the plaintiff can show that, market inefficiencies notwithstanding, as a matter of fact the misinformation had an inflationary effect on the actual price of the security, it has established market-based causation. [174]

Beach says indirect causation theory, 'steps outside the classic reliance theory.' [175] Nonetheless he suggests such a theory may be possible in Australian jurisprudence. [176] As he observes, '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.' [177]

Another commentator, Michael Duffy, argues that,

> …[t]he Janssen decision [178] suggests that Australian courts will go beyond reliance in appropriate cases. The adoption of a 'but for' causation test in a case of securities nondisclosure appears to be an approach that is open to Australian courts, as is an extended chain of third party causation (where reliance of third parties on the defendant's deception affected a securities market in a way that injured the plaintiff). The idea of 'reliance' on the market price as suggested by the 'fraud on the market' theory may indeed be merely another way of describing the same phenomenon and may ultimately be the other side of this same causal coin. [179]

The Janssen decision, it is suggested, does not, however, obviate the need for reliance. Reliance remains a requirement but here the reliance is by a third party which results in loss to the plaintiff. In this circumstance the loss complained of can be said to be the 'natural consequence' of the misleading and deceptive conduct. For Watson and Varghese even in an inefficient market 'losses to investors through overpayments may still be the natural consequence of mis-informing the market' [180]; and '[i]f 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.' [181]

With respect to the continuous disclosure obligations imposed by s 674 of the *Corporations Act 2001* Watson and Varghese suggest that a good case for market causation exists because:

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174 Ibid.962.

175 Above n141, 585.

176 Ibid. 585-6.

177 Ibid. 586.

178 *Janssen-Cilag Pty Ltd v Pfizer* 37 FCR 526. Here Pfizer made certain representations which induced members of the public and pharmacists to purchase Pfizer's drug 'Combatin' instead of Janssen's 'Vermox', thus causing Janssen to lose sales it otherwise would have made. Janssen was held to have a good claim against Pfizer even though it did not in fact rely on any misrepresentations by Pfizer.

179 Above n 153, 663.

180 Above n 173, 962.

181 Ibid.

- the section requires the disclosure of information that a reasonable person would expect to have a *material effect* upon the price or value of a security.
- a reasonable person would be taken to expect information to have a material effect on the price or value of a security 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 securities. (see s 677 *Corporations Act 2001)*
- the information is to be disclosed to the market operator for immediate release to the market so that the market is properly informed at all times.[182]

So, say Watson and Varghese, as the market must be properly informed,

> [t]his purpose [can be] given effect by looking at the effect of the contravention on the market and its collective pricing of the relevant security. There is no need to also look at the effect that the contravention had on any individual investors and their states of mind. [183]

Thus, they argue, 'an investor who purchases securities while a breach of section 674 of the Corporations Act is on foot can be said to have suffered a loss resulting from that breach simply by purchasing the over-priced securities.' [184]

Grave *et al* contend, however, that,

> … if a misleading disclosure or omission causes a share price to be inflated, it does not necessarily follow that a shareholder will suffer loss as a result. For example the shareholder would need to take active steps to suffer loss, including making a decision to invest in the securities, purchasing during the inflation period and either selling or being left holding the shares at a time when the price is no longer inflated. Cases such as Digi-Tech and Ingot. support the view that investors suffering a loss as a consequence of misleading or deceptive acts or omissions do not ordinarily suffer loss passively; rather, their entry into the transactions said to give rise to the loss, and the circumstances of their doing so, form an integral link in the chain of causation. [185]

The doctrine of fraud on the market has not as yet been advanced and definitively argued as the foundation for liability in any Australian case, and has never been subject to any in depth examination in an Australian case. The doctrine owes its existence to evidentiary hurdles thrown up by the legislative and procedural requirements governing class actions and causes of action in the United States which do not exist in Australia. It is not without significance that the US Supreme Court is divided over its acceptance, noting that some parts of the dissenting opinions are based on matters peculiar to the American legal and political systems.

The answer as to whether indirect or market-based causation should be available to a representative plaintiff in Australia seems to depend on which side of a proceeding a party happens to be. Those acting for plaintiffs urge acceptance of a market based or indirect causation; whilst those acting for defendants claim there must be evidence of actual reliance.

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182 Ibid. 958-9.

183 Ibid.

184 Ibid.

185 Above n 156, 497.

In a recent article Campbell and Entwisle said:

> …the momentum is currently with the case for market-based causation. That said, it is generally accepted (including by lawyers whose cases rely on market-based causation) that the question will not be finally resolved until it is determined by the High Court. Those who advocate against the adequacy of market-causation point to the fact that it is inconsistent with established principles of causation under Australian law which, although recognising that causation can be established through the reliance of others when the claimant is a passive sufferer of loss, require direct reliance when the claimant is not passive but rather takes the active step of entering into the transaction which gave rise to the loss. Moreover, at a conceptual level, market-based causation will inevitably lead to persons recovering who did not rely on either the integrity of the price nor the alleged contravening conduct. Among other things, the class definition will inevitably include a (potentially very large) number of investors who had little interest in the underlying value of the company but who were trading solely on the basis of short-term price movements or some form of index, or whose trades were informed solely by an 'algorithmically-programmed computer'. [186]

In their opinion:

> …if market-based causation is ultimately rejected it would significantly affect the commercial viability of shareholder class actions in their current form. That said, it is unlikely that it would be the death of shareholder class actions altogether. The most likely response is a narrowing of the classes to smaller classes of significant (primarily institutional) shareholders whose losses are sufficiently large to justify the time and resources associated with proving direct causation. That said, we expect that there would still be some promoters willing to bring claims on behalf of broader classes, despite the additional burdens associated with the need to establish individual direct causation (perhaps with the intent of seeking to settle before it becomes necessary to address those issues). [187]

It is highly unlikely that institutional investors (or sophisticated ones) will invest in any company without a detailed examination of it. Such investors will undoubtedly read and consider all statements made and all material published by a company. In this circumstance, there will be no need to have recourse to indirect or market-based causation if the company has made misleading and deceptive statements as these investors can be expected to claim to have directly relied upon the statements made and published. Small retail investors, and small to medium enterprises, probably don't have the time and resources to make any detailed research, and for these persons any losses, whilst not insignificant, may be of a magnitude making individual court action financially unrealistic. These of course are the individuals for whom class actions are of particular benefit, and it is for them that market-based or indirect causation has a particular attraction.

For all investors, where the complaint is an alleged failure to inform the market contrary to the continuous disclosure regime the question of market-based or indirect causation becomes pivotal given there can obviously be no claim to have directly relied on information not disclosed.

In so far as misleading and deceptive conduct is concerned, the position in Australia is, it is suggested, as encapsulated by Brereton J's observations in HIH as follows:

> The ultimate issue posed by TPA, s 82 (and its equivalents) is one of causation, not one of reliance, and reliance is not a substitute for the fundamental question of causation. The word 'by' signifies no more than that the loss or damage has to have been brought about by virtue (or reason) of the contravening

[186] *The Australian class action shareholder experience : are we approaching a tipping point*, Civil Justice Quarterly 2017 36(2) 177, 189. Jenny Campbell and Jeremy Entwisle .The authors describe themselves as being involved in the defence of shareholder class actions as lawyers with Allens.

[187] Ibid. 189-90.

> conduct. As a matter of principle, if causation – 'by conduct of' – can otherwise be established, it cannot matter that reliance is not established. Thus, the statutory cause of action does not, per se, include reliance as a necessary material fact (although that is not to say that it will not be one, as a matter of fact, in the context of many, if not most, individual cases). [188]

Just as the publishing of a false statement may result in an allegation of misleading and deceptive conduct, the failure to correct a wrong statement or the failure to inform the market of a fact affecting the market may also be considered to constitute misleading and deceptive conduct. Thus, a failure to make continuous disclosure could also be framed as a.misleading and deceptive conduct claim, silence being maintained when there was an obligation to 'speak'. [189]

Section 674 of the *Corporations Act 2001* imposes an obligation to keep the market informed of information, as it arises, having a material effect on the price or value of securities. The consequence for failing to do so is to be found in s 1325 of the *Corporations Act 2001.* Relevantly, it is there provided that a person who has suffered, or is likely to suffer, loss or damage **because of conduct** of another person done in contravention of the continuous disclosure provisions of Chapter 6CA may, in proceedings for that contravention, recover any such loss or damage. The language imposing liability for a breach of s 674 is analogous to the language of the provision imposing liability for misleading and deceptive conduct considered by Brereton J in HIH.[190] In cases of material non-disclosure the notion of reliance is pellucidly inapposite. It is a sin of omission. The HIH case involved the publication of misleading statements, and no claim to having read them was made. Brereton J in effect decided that, subject to satisfactory proof the impugned conduct having adversely affected price, persons who bought at that price, *ipso facto,* must be taken to have suffered a loss. They bought shares at an inflated price. No direct reliance on the misleading statements, he said, was necessary. This reasoning holds true, it is suggested, for claims under s 674 (and s 675).

It may be argued that policy considerations militate either for or against acceptance of an indirect or market-based causation.

1. *Market based causation is consonant with the policy of the Corporations Act 2001, namely, the promotion of integrity and efficiency of the market.* [191]

   In September 1991 the Companies and Securities Advisory Committee (CASAC) delivered a *Report On An Enhanced Continuous Statutory Disclosure System.* The Committee favoured the introduction of such a system. It said, 'A statutory-based system of continuous disclosure will promote investor confidence in the integrity of Australian capital markets and provide benefits to market participants, and

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188 *In the matter of HIH Limited (in liq) v McGrath [2016] NSWSC 482.* [42]

189 *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31.

190 Brereton J was concerned with s 52 of the *Trade Practices Act 1974 (*TPA*)* , but now see *S 236 , Australian Consumer Law (*ACL*).* In the case of the ACL the loss and damage must be **because of conduct** of another person as opposed to **by conduct of** another person under the TPA. The change of wording occurred upon the replacement of the TPA by the ACL, and was not intended to change the interpretation. (see n.125) See also, s12GF of the *Australian Securities and Investments Commission Act 2001* where similar language to that in the repealed TPA is to be found prohibiting misleading and deceptive conduct respecting the conduct proscribed by that Act.

191 Above n 177, 963.

management, in various interrelated way.' [192] Following on from this report the *Corporations Law Reform Act 1994* was enacted. Relevantly, it inserted s 1001A into the law then in force regulating companies, the *Corporations Law.*[193] Under section 1001A (2), the disclosing entity was not to contravene the provisions by intentionally or, recklessly or negligently failing to notify the Securities Exchange of the relevant information. The reasons given by CASAC for propounding a continuous disclosure scheme have been used to suggest the underlying policy of the changes effected to the corporations law in consequence of its Report supports market based or indirect causation.[194] This contention overlooks the fact that CASAC's reasoning was based on an assumption that the availability of timely and accurate information would encourage investors and advisors to engage in greater research of the market, and by this means would help ensure that securities prices more closely and quickly reflected underlying economic values. Of course, a shareholder / investor can only research information that is provided. Section 1001A of the *Corporations Law* has been replaced by s 674 of the *Corporations Act 2001.* Under s 674 if a company becomes aware of information that is not generally available; and that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the securities of the entity, it must notify the market operator of that information as soon as it arises. Again, the intent is clearly to have an informed market. As a general proposition, it is probably correct to say that anything which facilitates redress for a breach of the law encourages compliance with it, thus helping to maintain the integrity of the market and confidence in it. Indirect or market-based causation can, arguably, be said to foster compliance because it makes it easier for parties to sue as part of a collective. It does not seem correct to say, however, that the underlying policy of the law as proposed by CASAC supports market-based causation.

2. *Acceptance of market-based causation enables a more efficient and less costly way of resolving disputes involving many protagonists.* [195]

As noted [196] *Part IVA* of the *Federal Court of Australia Act 1976* dealing with representative proceedings was enacted following a review and Report by the Australian Law Reform Commission. The recommendations in that Report were concerned with,

- enhancing access by the individual to legal remedies
- promoting efficiency in the use of court resources
- ensuring consistency in the determination of common issues
- making the law more enforceable and effective.

Whether, as a matter of law, parties in a properly constituted group proceeding are able to prove any loss and damage claimed is a result of the impugned conduct is something

[192] Companies and Securities Advisory Committee: *A Report On An Enhanced Statutory Disclosure System* September 1991. 6-7. The interrelated ways are listed out at 7.

[193] *Part 13, s 82* of the *Corporations Act 1989.*

[194] Above n 173, 963

[195] Above n 173, 964.

[196] see Appendix.

else again. The question of causation is not resolved by the ability to bring a representative proceeding.

3. *Contrary to the beliefs of some, such an approach won't lead to undeserving plaintiffs being compensated, absent any disqualifying factor such as knowledge of or proven indifference to the true state of affairs,* because,

> [w]hether investors are fundamental or technical analysts, 'buy-and-hold' strategists, 'day-trading' tacticians or arbitrageurs, they implicitly assume that all other market participants are playing by the rules. If they suffer a loss because one market participant has breached those rules, assuming they have obtained no collateral benefit that cancels out that loss and they were not actually aware of or complicit in the breach, there seems to be no normative reason that they should be excluded from the compensatory remedy that the statute provides.[197]

Should Courts, as a matter of policy, reject indirect or market-based causation because it rewards the indolent and therefore undeserving investor? If statements and announcements are made that are misleading and deceptive, or not made at all when they should have been, the attentiveness or otherwise of the investor seems irrelevant. If the conduct of the company adversely impacts the price, then any loss and damage flowing from that conduct can be said to be **by or because of conduct** of the company as held by Brereton J in HIH.[198]

4. *Aggrieved shareholders who join class actions are in effect suing themselves.*

As to this Campbell and Entwisle observe:

> The fact that shareholders are choosing to participate in shareholder class actions may be seen as evidence that participants in the market do not consider that those costs [associated with prosecuting class actions] outweigh the benefits of shareholder class actions. That is not, however, necessarily the case. Anecdotally, the prevailing view appears to be that, if there is going to be a class action in any case, it is in the interests of any individual shareholder to join (and some institutional investors consider that they have a fiduciary obligation to join). This is obviously, on one level, rational behaviour by investors. However, this behaviour ignores the fact that, by participating, shareholders are ensuring the commercial viability of shareholder class actions and are incentivising promoters to bring more actions—potentially against companies in which they are current shareholders.[199]

Assuming there is no improper purpose driving the litigation, and the action is otherwise lawful, courts do not ordinarily concern themselves with the motives of plaintiffs.

5. *Policy considerations support the conclusion that actual reliance remains the appropriate basis for causation in securities class actions based on material non-disclosure.*

Grave et al suggest,

> If 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. If shareholders can

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197 Above n 137. 964.

198 *In the matter of HIH Limited (in liq) v McGrath [2016] NSWSC 482.*

199 Above n 186, 195.

> receive compensation even though they have not conducted any research into the listed companies into which they invest, there is little incentive for shareholders to read ASX announcements. A similar policy concern has been observed in the United States…[200]

They say also:

> The Australian jurisprudence on shareholder class actions will be built on a solid foundation if the law provides an incentive for investors to review company information and be actively involved in their investment decisions. This foundation will be strengthened if companies which have engaged in serious misconduct compensate their shareholders for contraventions of the Corporations Act but only where the misconduct has caused the losses suffered. [201]

The benefits attributed by CASAC for the introduction of a statutory disclosure regime clearly are dependent on companies making disclosure as required. If a company breaches that obligation, then there are prescribed consequences intended to promote compliance with the law and punish transgressions. The fact that it is an omission that the law punishes for breaching the continuous disclosure obligation makes a requirement of reliance to establish a breach of that law seem inapposite.

Conclusions

It is suggested, for both misleading and deceptive conduct and breaches of the continuous disclosure regime, the answer as to whether actual reliance is necessary in securities and investor class actions to found liability simply depends on the proper construction of the statutes in question. That exercise, it is suggested, results in the conclusion that actual reliance is unnecessary, and market based or indirect causation will ultimately find acceptance in Australia, absent any changes to the law. The Australian Law Reform Commission in a recent discussion paper [202] has raised for discussion the proposal that,

> [t]he Australian Government should commission a review of the legal and economic impact of the continuous disclosure obligations of entities listed on public stock exchanges and those relating to misleading and deceptive conduct contained in the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) with regards to:
>
> - the propensity for corporate entities to be the target of funded shareholder class actions in Australia;
> - the value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action;
> - and the availability and cost of directors and officers liability cover within the Australian market. [203]

What comes of this proposal remains to be seen. Any changes effected to the current law as a result of any review may well provide a legislative resolution to the vexing question of causation in securities class actions.

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200 Above n 156, 487. [footnotes and citations omitted]

201 Above n 156,505.

202 *Inquiry into Class Action Proceedings and Third Party Litigation-Funders* Discussion Paper 85. June 2018.

203 Ibid. 29, proposal 1-1.

APPENDIX

Background to Australian Class Action Regimes

1. In February 1977 the Commonwealth Attorney-General referred the question of access by the people to the court to the Australian Law Reform Commission. The final report, *Grouped Proceedings in the Federal Court* (ALRC Report 46), was tabled in Federal Parliament in December 1988. ALRC Report 46 reported that the high cost of legal proceedings effectively prevented individuals and businesses who had suffered significant but small losses from claiming compensation for those losses. Allowing a number of related claims to be dealt with in a single proceeding would reduce costs for the benefit of both sides and would ensure the most efficient use of legal resources, so the Report said.

2. ALRC Report 46 also concluded that a new grouping procedure had a number of advantages including cost effective enforcement of rights and consistency of determinations. The Federal Government adopted the recommendations of the ALRC Report with some changes and enacted the *Federal Court of Australia Amendment Act 1991* (Cth) (assented to on 4 December 1991) which introduced sections 33A-33ZJ, Part IVA, into the *Federal Court of Australia Act 1976* (Cth). New South Wales and Victoria enacted provisions in similar terms to those in the Federal Court (*Civil Procedure Act 2005* (*NSW)* Part 10 Div 2 ss155-176; *Supreme Court Act* (VIC) *1986* Part 4A ss 33A-33Y).

3. What are popularly referred to as 'class actions' are those proceedings commenced pursuant to the provisions of Part IVA of the *Federal Court of Australia Act 1976* (and cognate provisions in other jurisdictions). These provisions set out a detailed procedure for dealing with representative proceedings and can be compared to the United States Federal Court Rules dealing with class actions–see n 12. In South Australia, Western Australia, Northern Territory and the Australian Capital Territory the law relating to representative actions are derived from the English Rules promulgated after the merger of the common law and equity.

4. Prior to the merger the common law did not permit a representative proceeding. The Court of Chancery, however, did in certain cases permit such proceedings. With the merger of common law and equity, the new rules of procedures scheduled to the Supreme Court of Judicature Act 1873 (U.K.) incorporated the Chancery practice. These rules are mirrored in SA: *Supreme Court Civil Rules 2006*-Chapter 5 Part 1 Division 3 Rules 80-81 ; WA: *Rules of the Supreme Court 1971* Order 18 Rule 12; NT: *Supreme Court Rules 18.02-18.04*; ACT: *Court Procedures Rules 2006* Chapter 2 Part 2.4 Division 2.4.7 Rules 265-267. For the position in Tasmania see S*upreme Court Rules 2000* Part 10 Division 5, Rules 335-336.

5. In Queensland Rules 75-77 of the *Uniform Civil Proceedings Rules 1999* are derived from the English Rules, and although not yet repealed, have been rendered otiose by the changes to Queensland law discussed below. The lack of prescription in Queensland's UCPR, and the procedures in South Australia, Western Australia, Northern Territory, the Australian Capital Territory and Tasmania would seem to make them unsuitable to deal with the complexities of a modern class action, but see the comments of Justices Toohey and Gaudron in *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398, 422.

6. This perception of inadequacy of the rules and procedure, then extant in Queensland, appears to be the reason why Maurice Blackburn commenced the class action arising out of the Queensland floods in the Supreme Court of New South Wales rather than in the Supreme Court of Queensland.

7. The Queensland Government has now moved to remedy this perceived deficiency, and thus enable class actions to be litigated in Queensland—media statement on 5 August 2016 of the Attorney-General and Minister for Justice and Minister for Training and Skills. On 16 August 2016 the Premier introduced the *Limitations of Actions (Institutional Child Sexual Abuse) and Other Legislation Amendment Bill 2016* into the House. This Bill inserted a new Part 13A into the *Civil Proceedings Act 2011* which provides for representative proceedings in the Supreme Court. These provisions mirror those operating in the Federal Court. On 11 November 2016 the *Limitations of Actions (Child Sexual Abuse) and Other Legislation Amendment Act 2016* received assent and thus the representative proceeding provisions as foreshadowed became law, coming into operation from 1 March 2017.