US Supreme Court revises fraud on the market presumption: Ramifications for Australian shareholder class actions

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Causation in Australian shareholder class action claims based on contravention of the continuous disclosure regime and misleading conduct remains an unresolved issue. In Halliburton Co v Erica P John Fund Inc 134 S Ct 2398 (2014) the Supreme Court of the United States reconsidered the fraud on the market presumption created in Basic Inc v Levinson 485 US 224 (1988). The reconsideration is instructive for Australia as the economic theory underlying the presumption is a component of suggested tests for causation in Australian shareholder class actions that do not require direct reliance. This article explains the decision in Halliburton and examines how the reasoning of the Supreme Court of the United States may impact the development of causation requirements in Australian shareholder class actions.

INTRODUCTION

Class actions brought by shareholders in relation to contraventions of securities laws dealing with disclosure to the market are a significant form of litigation in both the United States (US), usually called securities class actions, and Australia.[1] In the US, securities class actions have been facilitated by the fraud on the market presumption that the Supreme Court of the United States approved in *Basic Inc v Levinson* 485 US 224 (1988) (*Basic*). The endorsement of the fraud on the market presumption, and its underlying economic theory – the efficient capital market hypothesis, converted the requirement of reliance under the substantive law from an individual issue to a common issue. This development meant that the US class action regime requirement that common issues must predominate over individual issues could be satisfied, which in turn allowed for a court to "certify" that the proceedings could be pursued as a class action.

In *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 (2014) (*Halliburton*) the Supreme Court of the United States reconsidered the fraud on the market presumption. The reconsideration, although not binding on Australian courts, is instructive as the underlying economic theory considered by the Supreme Court has been invoked in Australian shareholder class actions in relation to the interpretation of the causation requirements in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investment Commission Act 2001* (*the ASIC Act*).

This article explains the decision in *Halliburton* and examines how the reasoning of the Supreme Court of the United States may impact the development of causation requirements in Australian shareholder class actions.

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[1] See Coffee J, "Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation" (2006) 106 Colum L Rev 1534 at 1539 (the securities class action in the United States is regarded as the "800 pound gorilla that dominates and overshadows other forms of class action"); Morabito V, *An Empirical Study of Australia's Class Action Regimes – Third Report: Class Action Facts and Figures – Five Years Later* (Monash University, Department of Business Law and Taxation, November 2014) pp 10-12 (finding shareholder claims to be of increasing importance as class actions as they made up 5% of Federal Court class actions between 4 March 1992 and 3 March 2003 and 22.1% of Federal Court class actions between 4 March 2003 and 3 March 2014).

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US SECURITIES CLASS ACTIONS

The *Securities Exchange Act* of 1934, enacted in response to the Great Depression and the stock market crash of 1929, regulates capital markets and in particular inadequate disclosures and unfair practices in the US.[2] The securities law prohibition that is primarily utilised for private enforcement is s 10(b) of the *Securities Exchange Act* of 1934 (15 USC § 78j(b)) and r 10b-5 which provide for a general prohibition on misleading conduct.[3]

The elements of a r 10(b)(5) claim are: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance, or transaction causation; (5) economic loss; and (6) loss causation, ie, a causal connection between the material misrepresentation and the loss.[4] For the purpose of this article the causation requirements in (4) and (6) require further elaboration.

Causation has two components. Transaction causation asks whether the misrepresentation caused the plaintiff to enter into the transaction. Loss causation asks whether the misrepresentation caused the plaintiff's loss.[5] Traditionally, the transaction causation (or reliance requirement) made it virtually impossible for securities class actions to be brought. This is because r 23 of the *Federal Rules of Civil Procedure* (FRCP), which sets out the requirements for bringing a class action in the Federal Court system in the US, requires that a court certify that the requirements for commencing a class action are met. One of the requirements for a r 23(b)(3) class action, or damages class action, is that "questions of law or fact common to class members predominate over any questions affecting only individual members". Transaction causation was an individual issue that required evidence from individual plaintiffs making it difficult to satisfy the predominance of common issues requirement.[6]

However, the US Supreme Court in *Basic* endorsed the use of the fraud on the market theory as a mechanism to satisfy transaction causation. This had the effect of making it much easier for plaintiffs to succeed in having a court certify a securities class action.[7] Transaction causation went from being an individual issue to a common issue.

The fraud on the market theory is a legal application of the efficient market hypothesis and presumes that the price of shares in an open and developed market reflects all publicly available material information about those shares, including misleading statements or omissions.[8] The theory also presumes that shareholders rely on the integrity of the market price when making their investment

[2] See *United States v O'Hagan* 521 US 642 at 658 (1997); *United States v Naftalin* 441 US 768 at 775 (1979); *SEC v Zandford* 535 US 813 at 819 (2002) ("Congress sought to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.").

[3] Grundfest J, "Disimplying Private Rights of Action under the Federal Securities Laws: The Commission's Authority" (1994) 107 Harv L Rev 961 at 965; Federal Judicial Centre, *Manual for Complex Litigation* (2004) p 529; Rose A, "Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10B-5" (2008) 108 Colum L Rev 1301 at 1302.

[4] *Dura Pharmaceuticals Inc v Broudo* 544 US 336 at 341 (2005); *Amgen Inc v Connecticut Retirement Plans and Trust Funds* 133 S Ct 1184 at 1192 (2013).

[5] See *Lattanzio v Deloitte & Touche LLP* 476 F3d 147 at 157 (2d Cir, 2007).

[6] Cox J, "Understanding Causation in Private Securities Lawsuits: Building on Amgen" (2013) 66 Vand L Rev 1719 at 1739-1740; Fed R Civ P 23 advisory comm nn 1966 Amendment.

[7] *Amgen Inc v Connecticut Retirement Plans and Trust Funds* 133 S Ct 1184 at 1192 (2013) ("We have recognized, however, that requiring proof of direct reliance 'would place an unnecessarily unrealistic evidentiary burden on [a] plaintiff who has traded on an impersonal market'."); Nagareda R, "Class Certification in the Age of Aggregate Proof" (2009) 84 NYU L Rev 97 at 116.

[8] *Basic Inc v Levinson* 485 US 224 at 241-242 (1988). The concept of the Efficient Markets Hypothesis is generally traced back to a 1970 academic article, Fama E, "Efficient Capital Markets: A Review of Theory and Empirical Work" (1970) 25 *Journal of Finance* 383. See generally, Duffy M, "Fraud on the Market: Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada and Australia" (2005) 29 Melb Univ L Rev 621.

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decisions, so that a misleading statement or omission affects all shareholders through the share price and thus proof of individual reliance is not required.[9]

The US Supreme Court held that the presumptions may be invoked when a plaintiff alleges and proves each of the following requirements:

(a) the defendant made public misrepresentations;
(b) the misrepresentations were material;
(c) the shares were traded on an efficient market; and
(d) the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.[10]

The requirements are the link between the underlying economic theory and the presumptions endorsed by the US Supreme Court in *Basic*. If one of the requirements cannot be proved then the presumptions do not arise. Further, the court in *Basic* allowed for the presumption to be rebutted:[11]

> Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.

However, the reasoning in *Basic*, especially in terms of its reliance on economic theory, which was nascent at the time, has since been subject to substantial criticism.[12] In *Amgen Inc v Connecticut Retirement Plans and Trust Funds* 133 S Ct 1184 (2013), Alito J in a concurring opinion warned that the theory "may rest on a faulty economic premise".[13] Further, Thomas, Kennedy, and Scalia JJ, in dissent, called it "questionable".[14] Despite the criticism of the fraud on the market theory, it was not until 2014 that the US Supreme Court was directly asked to consider overruling the fraud on the market presumption in the *Halliburton* case.

HALLIBURTON CO V ERICA P JOHN FUND INC

Background

The *Halliburton* case has a long history that spans back to 2002. In 2002 a class of investors (*the Plaintiffs*) sued Halliburton Company and its CEO, President and Chairman of the Board, David Lesar (collectively referred to as *the Defendants*). The Plaintiffs bought common stock in Halliburton and allege that between 3 June 1999 and 7 December 2001 the Defendants made fraudulent misrepresentations in an effort to inflate Halliburton's stock price. The alleged misrepresentations downplayed the company's estimated asbestos liabilities, falsified earning statements and overstated the benefits of its 1998 merger with Dresser Industries. The Plaintiffs allege that once the corrective disclosures were made in relation to the misleading statements, the stock price consequently dropped, causing loss to those who purchased the stock in the relevant timeframe. By making these misrepresentations, the Plaintiffs' contend, the Defendants breached ss 10(b) and 20(a) of the *Securities Exchange Act* of 1934 and r 10b-5.

Before the lower courts Halliburton submitted that the proceeding should not be certified as a class action because Halliburton's evidence revealed that the alleged fraud did not affect the market price of the stock; that is, its alleged misrepresentation did not cause a "price impact" or "price

[9] *Basic Inc v Levinson* 485 US 224 at 247 (1988).

[10] *Basic Inc v Levinson* 485 US 224 at 248, fn 27 (1988).

[11] *Basic Inc v Levinson* 485 US 224 at 248(1988); *Peil v Speiser* 806 F2d 1154 at 1161 (3d Cir, 1986).

[12] See Langevoot DC, "Basic at Twenty: Re-thinking Fraud on the Market" (2009) Wis L Rev 151 at 175; Cox J, n 6 at 1719-1754; Lev B and de Villiers M, "Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis" (1994-1995) 47(1) Stan L Rev 7-38; Brav A and Heaton JB, "Market Indeterminacy" (2003) 28(4) J Corp L 517 at 521; Macey J, Miller G, Mitchell M and Netter J, "Lessons from Financial Economics: Materiality, Reliance and Extending the Reach of Basic v Levinson" (1991) 77(5) Va L Rev 1017 at 1018; Stout LA, "The Mechanisms of Market Inefficiency: An Introduction to New Finance" (2003) 28(4) J Corp L 635 at 667-669.

[13] *Amgen Inc v Connecticut Retirement Plans and Trust Funds* 133 S Ct 1184 at 1204 (2013).

[14] *Amgen Inc v Connecticut Retirement Plans and Trust Funds* 133 S Ct 1184 at 1208, fn 4 (2013).

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distortion". Halliburton further submitted that if they were allowed to run such an argument, they would be able to establish that the common issues among class members do not predominate and that class certification was inappropriate. The Fifth Circuit court of appeals rejected Halliburton's claim as it found evidence of price impact to rebut the presumption of fraud on the market is not appropriately dealt with at the class certification stage, but rather, should be dealt with on the merits after the class is certified.[15]

Summary of the judgment

In light of the unfavourable finding that Halliburton received from the Fifth Circuit, Halliburton sought and was granted leave to appeal to the Supreme Court.[16] The Supreme Court granted certiorari to answer the following two questions: (1) whether the court should overrule or substantially modify the holding of *Basic* to the extent that it recognises a presumption of class wide reliance derived from fraud-on-the-market theory and (2) whether in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock.

The majority of the court, Roberts CJ, Kennedy, Ginsburg, Breyer, Sotomayor and Kagan JJ, held that the court would not overrule the *Basic* presumption.[17] Further, the court rejected Halliburton's alternative submission that a plaintiff, who has successfully invoked the *Basic* presumption, should be required to prove that the defendant's misrepresentation actually affected the stock price.[18]

However, the court accepted Halliburton's second alternative submission that defendants may rebut the presumption with direct evidence of no price impact at the class certification stage.[19] If price impact is not proven then the fraud-on-the-market theory underlying the *Basic* presumption collapses and the class may not be certified. Previously defendants could only adduce evidence of the contravention having no or little impact on the stock price for the purpose of proving the market was not efficient

The concurring judgment by Thomas J, with whom Scalia and Alito JJ joined (also referred to here as the minority judgment), disagreed with the majority and contended that the *Basic* presumption should be overruled.[20]

Revisiting basic and economic theory

The pivotal argument put forward by the plaintiff was that the *Basic* presumption is undermined by contemporary mainstream economic theory. Halliburton attacked the "efficient capital markets hypothesis", which entails a "robust view of market efficiency", as no longer tenable in the face of "overwhelming" empirical evidence which now "suggests that capital markets are not fundamentally efficient".[21] To support this contention, Halliburton cited studies purporting to show that "public information is often not incorporated immediately (much less rationally) into market prices".[22] Halliburton argued that market efficiency should not be seen in binary terms (ie as efficient or inefficient) as markets for some securities are more efficient than 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.

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[15] *Archdiocese of Milwaukee Supporting Fund Inc v Halliburton Co* 2012 US Dist LEXIS 24823 (ND Tex 2012); *Erica P John Fund Inc v Halliburton Co* 718 F3d 423 at 427, 435 (5th Cir 2013).

[16] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 (2014).

[17] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2407-2413, 2417 (2014).

[18] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2414.

[19] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2416-2417 (2014).

[20] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2418 (2014).

[21] Brief for Petitioners in *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398, 14-16 quoting Lev and de Villiers, n 12 at 20.

[22] Brief for Petitioners in *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398, 16-20; Brief for Law Professors as Amicus Curiae in *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398, 15-18.

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The majority of the Supreme Court held that Halliburton's argument was not new and noted that the *Basic* Court had both acknowledged it but declined to "enter the fray".[23] The *Basic* 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".[24] The *Halliburton* Court found that *Basic*'s presumption of reliance does not rest on a "binary" view of market efficiency by making the presumption rebuttable. Rather, it considered that *Basic* recognised that market efficiency is a matter of degree and properly to be treated as a matter of proof.[25] Further, the court stated that even the foremost critics of the efficient capital market hypothesis acknowledge that public information generally affects stock prices and noted that Halliburton conceded as much, both in its reply brief and at oral argument.[26] The majority concluded 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.

In contrast, the minority of the court agreed with Halliburton, stating that while at the time of *Basic* the efficient capital markets hypothesis was "widely accepted" this "view of market efficiency has since lost its luster".[27] The minority contended that empirical evidence now shows that "well-developed markets" do not uniformly incorporate information into market prices with high speed and do not incorporate public information accurately.[28] As such, the minority concluded that *Basic*'s claim that "common sense and probability" support a presumption of reliance now rests on "shaky footing".[29]

Halliburton further contested the validity of the notion that underpins the *Basic* presumption – that is, investors "invest 'in reliance on the integrity of [the market] price'".[30] Halliburton identified a number of classes of investors for whom "price integrity" is "marginal or irrelevant", the primary example being the value investor who believes that certain stock are undervalued or overvalued and attempts to "beat the market" by buying the undervalued stocks and selling overvalued stocks.[31] However, the court stated that *Basic* never denied the existence of such investors and instead the presumption is that *most* investor's rely on the integrity of the price.[32] Further, the majority considered that even a value investor is not completely indifferent to the price of stock because underlying a value investor's actions is the assumption that the stock's market price will eventually reflect material information.

The minority judgment disagreed with the majority of the court on this point as well and labelled the *Basic* Court's analysis of price integrity as "rather superficial" and one which "does not withstand scrutiny".[33] In accepting the Halliburton argument, the minority went so far as to describe *Basic*'s assumption that all investors rely on price integrity as "simply wrong" and only based on a "judicial hunch".[34] The minority considered that there are many investors that trade stock because they think the stock does *not* accurately reflect its value and the market has either over or under valued the stock. The minority also noted that many investors trade for reasons unrelated to price, for instance to

[23] *Halliburton Co v Erica P John Fund Inc* 134 S.Ct 2398 at 2410 (2014).

[24] *Basic Inc v Levinson* 485 US 224 at 247 (1988).

[25] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2424 (2014).

[26] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2410 (2014).

[27] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[28] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[29] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[30] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 (2014) citing *Basic Inc v Levinson* 485 US 224, 247 (1988).

[31] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[32] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[33] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[34] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

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address changing liquidity needs, tax concerns or portfolio balancing requirements.[35] These investment decisions, made with indifference to price, are squarely at odds with the court's reasoning in *Basic* as to what motivates investment decisions.

Further, the minority dismissed the majority's view that a value investor buys or sells on the assumption that the stock price, which may be over or under-priced at the time of the transaction, will eventually reflect its true value. The minority considered such a view as "unsupported" and beside the point. In the minority's opinion, if an investor does not believe that the market price reflects public information *at the time he or she transacts* then the investor cannot claim that a public misstatement induced his or her transaction by distorting the market price if he or she did not buy at that price while believing that it accurately incorporated that public information.[36]

The minority also attacked the majority's argument that the *Basic* Court only said that "*most* investors" rely on price integrity by responding that this "gloss is difficult to square with *Basic*'s own language".[37] It cited, by way of example, the *Basic* Court's statements that: "[I]t is hard to imagine that there ever is a buyer or seller who does not rely on market integrity"[38] and "an investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price".[39]

Further, the minority expressed concern at the inability of a defendant to rebut the presumption. This concern arises from the representative nature of the class action. Only the representative party is before the court and provides evidence. Any rebuttal from the defendant can only be directed at the representative party. Counsel only needs to find one class member who can withstand any challenge to its evidence of reliance. Group members who traded in circumstances where the premises do not hold can shelter behind the representative party and a lack of reliance will not prevent them recovering. The minority concluded that without a functional reliance requirement, the "essential element" that ensures the plaintiff has actually been defrauded becomes a "scheme of investor's insurance", that the rebuttable presumption was supposed to prevent.[40] On this point, the minority would have overruled *Basic* and required proof of actual reliance.

Ramifications for Australia

Most Australian shareholder class actions have relied on alleged contraventions of the continuous disclosure regime in Ch 6CA of the *Corporations Act 2001* (Cth) which contains "financial services civil penalty provisions" or the prohibitions on misleading or deceptive conduct, most notably s 1041H of the *Corporations Act* and s 12DA of the ASIC Act.[41]

Contravention of these provisions gives rise to an ability to seek damages or compensation. The statutory wording of "resulted from", "by" and "because" that is used in the relevant provisions[42] has been interpreted as necessitating proof of causation.[43]

The High Court subsequently considered the meaning of "by" in other misleading and deceptive conduct cases, as well as statutory causation more generally, thus elucidating the manner in which causation operates in statutory contexts. In summary, the High Court has held:

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[35] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2422 (2014).

[36] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2422 (2014).

[37] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014).

[38] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014) citing *Basic Inc v Levinson* 485 US 224 at 245 (1988).

[39] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2421 (2014) citing *Basic Inc v Levinson* 485 US 224 at 247 (1988).

[40] *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398 at 2424 (2014).

[41] Legg M, "Shareholder Class Actions in Australia – the Perfect Storm?" (2008) 31 (3) UNSWLJ 669 at 675-687; Legg M, "Shareholder Protection and Class Actions" (Paper presented at the Supreme Court of New South Wales Corporate Law Conference, Banco Court, Sydney, 29 July 2014).

[42] *Corporations Act 2001* (Cth) ss 1041I (by), 1317HA(1) (resulted from), 1325(2) (because); *Australian Securities and Investments Commission Act 2001* (Cth) s 12GF (by).

[43] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525 (Mason CJ).

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(a) in order to prove causation there must be a causal connection between the conduct and the loss for which the applicant seeks to be compensated;[44]

(b) causation at law involves questions of fact into which value judgments and policy considerations necessarily enter.[45] However, this does not invite judges to engage in value judgments at large – the relevant norms must be derived from legal principles;[46]

(c) the common sense approach to causation applies to statutory claims except where that concept is modified or supplemented expressly or impliedly by the provisions of the legislation;[47]

(d) the "but for" test of causation is a useful negativing criterion but is not determinative of causation;[48]

(e) common law "rules" surrounding causation can provide a useful analogy, but the particular statute has primacy as causation is a question of statutory construction;[49]

(f) "notions of 'cause' as involved in a particular statutory regime are to be understood by reference to the statutory subject, scope and purpose";[50]

(g) the legal concept of causation is not reducible to a neat or single formula and cannot be reduced to a test that "can be applied across the spectrum";[51] and

(h) "[it] is now clear that there are cases in which the answer to a question of causation will differ according to the purpose for which the question is asked".[52]

The above principles have clarified the courts' task in relation to statutory causation. Nonetheless, the word "by" has been described as a "bare preposition",[53] "elastic",[54] and "Delphic".[55] Consequently, when the principles have been applied to novel statutory schemes such as continuous disclosure, debate has arisen as to the appropriate test or tests for causation. Not surprisingly, with the requirements for causation being unsettled the pleadings initiating shareholder class actions have sought to prove causation in a number of ways: direct reliance, indirect reliance and through the fraud on the market theory.[56]

[44] *Marks v GIO Australia Holdings* (1998) 196 CLR 494; 158 ALR 33, [38], [42].

[45] *March v Stramare (E & MH) Pty Ltd* (1991) 171 CLR 506; 99 ALR 423.

[46] *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, [28]-[29].

[47] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525.

[48] *Marks v GIO Australia Holdings* (1998) 196 CLR 494; 158 ALR 33, [42].

[49] *Elna Australia Pty Ltd v International Computers Pty Ltd (No 2)* (1987) 16 FCR 410 at 418-419; 75 ALR 271 at 279-280; *Marks v GIO Australia Holdings* (1998) 196 CLR 494; 158 ALR 33, [41]; *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525; *Adler v Australian Securities and Investment Commission* (2003) 179 FLR 1, [710].

[50] *Allianz Australia Insurance Ltd v GSF Australia Pty Ltd* (2005) 221 CLR 568, [99]; see also *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, [26]; *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, [28], [49].

[51] *Henville v Walker* (2001) 206 CLR 459; (2001) 182 ALR 37, [105]; *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, [59], [62]; *Fitzgerald v Penn* (1954) 91 CLR 268 at 278; [1955] ALR 1 at 7.

[52] *Travel Compensation Fund v Tambree* (2005) 224 CLR 627, [45]; see also *Henville v Walker* (2001) 206 CLR 459; (2001) 182 ALR 37, [96].

[53] Price R and Griggs L, "Causation, Contributory Negligence and Misleading and Deceptive Conduct – a Modest Proposal for Change" (2010) 18 CCLJ 93 at 107.

[54] *Beehag v Star Dreamer Holdings Pty Ltd* [2014] NSWSC 1162, [34].

[55] Dietrich J and Middleton T, "Statutory Remedies and Equitable Remedies" (2006) 28 ABR 136 at 154.

[56] See *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061, [11]; *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029, [15]-[17]; *Hobbs Anderson Investments Pty Ltd v Oz Minerals Ltd* [2011] FCA 801, [9]-[10]; *Kirby v Centro Properties Ltd (No 6)* [2012] FCA 650, [4]; *Pathway Investments Pty Ltd v National Australia Bank Ltd (No 3)* [2012] VSC 625, [11]-[12]; *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357, [35]-[61].

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Direct reliance

Direct reliance is the traditional or conventional test for causation and in the shareholder class action context would require each group member to prove that they relied on the misleading disclosure in deciding to buy securities.[57] In terms of a class action this would mean that causation was an individual issue, and not a common issue.

Guidance on the application of direct reliance in shareholder class actions has been sought from *Digi-Tech (Australia) v Brand* (2004) 62 IPR 184 and *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 73 NSWLR 653. Both cases considered the precursors to ss 1317HA and 1041I which have been employed in shareholder class actions, ie s 82 of the *Trade Practices Act 1974* (Cth) and s 1005 of the *Corporations Law 1991* (Cth), as well as arguments for indirect reliance that were rejected.[58]

In *Digi-Tech* the plaintiffs alleged that Digi-Tech made a misleading or deceptive representation to an accounting firm, which then provided an erroneous valuation, on which the plaintiff relied in entering into an unfavourable transaction. The NSW Court of Appeal stated:[59]

> whatever might be the position in other contexts, in cases of this kind (misrepresentation inducing a transaction) the courts have required reliance by or on behalf of the plaintiff on the misrepresentation as being essential to the proof of causation as required by s 82(1) of the TP Act. Persons who claim damages under s 82(1) on the ground that they entered into transactions induced by the misrepresentations of other persons must prove that they relied on such misrepresentations and, therefore, "by" that conduct, they suffered loss or damage. … were it otherwise, representees could succeed even though they knew the truth, or were indifferent to the subject matter of the representation.

The above reasoning was considered and followed in relation to s 1005 by the NSW Court of Appeal in *Ingot*. Giles JA explained:[60]

> The distinction drawn in *Digi-Tech (Australia) v Brand* is between cases where conduct on the part of the plaintiff "forms a link in the causation chain" (at 54,242 [156]) and where it does not. Where it does, there must be reliance on the misleading conduct in the manner next explained. Where it does not, there may be recovery if the act of the innocent party induced by the misleading conduct "by its very nature, causes the plaintiff's loss" (at 54,242 [155]), but that is where the plaintiff passively suffers loss from another's act (as in *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526 at 529-530, where consumers were led by the misleading conduct to buy less of the plaintiff's product).
>
> In saying that in a case of "misrepresentation inducing a transaction" reliance on the misrepresentation was required for proof of causation (at … [159]), from the facts before them and their Honour's discussion they meant a case where the plaintiff was not a passive sufferer from another's act, but was someone who made a decision to enter into the transaction to which the representation was material. Their Honours did not mean direct inducement, but that the decision and the materiality to it of the representation was a link in the causal chain.

The distinction between the position in *Janssen-Cilag* on the one hand, and *Digi-Tech* and *Ingot* on the other, was further explained by the Full Federal Court as a distinction "between cases where a plaintiff is a passive sufferer of the loss and cases where the plaintiff is not passive but makes a positive decision to enter into a transaction to which a misrepresentation is said to be material".[61]

The crucial but undecided question in shareholder class actions is whether the *Digi-Tech* and *Ingot* reasoning on causation is applicable to causes of action based on the statutory provisions governing representations about securities listed on the share market. Attempts to distinguish the

[57] Beach J, "Class Actions: Some Causation Questions" (2011) 85 ALJ 579 at 584. This is also the case in the United States: see *Erica P John Fund, Inc v Halliburton Co* 131 S Ct 2179 at 2185 (2011) ("The traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction – eg, purchasing common stock – based on that specific misrepresentation.").

[58] Drinnan R and Campbell J, "Causation in Class Actions" (2009) 32 UNSWLJ 928; Craddock G, "Causation in Securities Litigation" (2012) 86 ALJ 813 at 813.

[59] *Digi-Tech (Australia) v Brand* (2004) 62 IPR 184, [159].

[60] *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 73 NSWLR 653, [12]-[13], [615], [617].

[61] *De Bortoli Wines Pty Ltd v HIH Insurance Ltd (in liq)* [2012] FCAFC 28, [63].

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Digi-Tech (Australia) and *Ingot* reasoning point out that the facts and context in those cases are different from the shareholder class action involving obligations to the market as a whole. It cannot be assumed that the test for causation under a broad statutory provision will be the same regardless of context. Further, the distinction between "passive" suffering of loss and inducement to enter a transaction is illusory and substitutes a different enquiry to that which is required by the legislative provisions.[62]

Fraud on the market theory

The requirement for disclosure to the market, via the market operator, in relation to continuous disclosure has seen plaintiffs consider the US fraud on the market theory. Fraud on the market has been referred to in Australian cases, but has not yet been the subject of judicial finding in Australia. In the Multiplex class action, Finkelstein J observed:[63]

> 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.

Fraud on the market has also been raised in other pleadings as the way in which causation would be addressed.[64] While fraud on the market may be imported into Australian law, it appears more likely the economic reasoning underlying fraud on the market will be employed as part of the construction of the legislative causes of action in conjunction with some form of indirect reliance.

Indirect reliance

The Full Federal Court has explained that "[t]here is no bright-line principle that it is insufficient for a plaintiff to prove that some other person relied on the alleged misleading conduct and that that person's reliance led to the plaintiff suffering loss".[65] Further, "the entitlement to recover loss or damage in a case of misleading and deceptive conduct is not confined to persons who relied on the conduct".[66] Specific evidence of reliance is not essential for proof of causation in s 82 cases: "such evidence [ie evidence of reliance] may be one strand, perhaps an important one … but causation may be found without it".[67]

The question of indirect reliance (also called third party reliance) as a viable means of causation in trade practices litigation was considered in *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526. In that case, A (the plaintiff) and B (the defendant) were rival pharmaceutical companies vying for the same customer base, C. Causation was established by proving B misled C which caused C to purchase more of B's product and less of A's. A suffered loss as a result of C's reliance on B's misleading conduct – albeit A was not misled by B at any stage. In short, B misleads C causing loss to A.

Drawing on this approach, in the shareholder class action context, it has sought to be argued by some that, by analogy, class members should be able to *prove* causation simply by showing that the

[62] *Caason Investments Pty Ltd v Cao* [2014] FCA 1410, [60], [62]; Watson A and Varghese J, "The Case for Market-Based Causation" (2009) 32 UNSWLJ 948 at 954-960.

[63] *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111, [10]-[11].

[64] *Johnston v McGrath* (2008) 67 ACSR 169, [16]; *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357, [35]; *Caason Investments Pty Ltd v Cao* [2014] FCA 1410, [102]; *Bonham v Iluka Resources Limited* [2015] FCA 713, [71].

[65] *ABN AMRO Bank NV v Bathurst Regional Council* (2014) 309 ALR 445, [1375].

[66] *ABN AMRO Bank NV v Bathurst Regional Council* (2014) 309 ALR 445, [1376].

[67] *Smith v Noss* [2006] NSWCA 37, [27].

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corporate defendant (B) engaged in misleading or deceptive conduct, or contraventions of the continuous disclosure requirements by making misleading representations or omissions to the market (C), that such conduct caused the market price of the defendant's shares to be inflated, and that by purchasing shares at an inflated price on the market, the plaintiffs (A) incur loss.

Another approach, especially in relation to s 1317HA and the continuous disclosure regime, has been to rely on statutory construction and the purpose of the legislation, rather than analogy with earlier case law. During the hearing of the Aristocrat class action, the applicant argued that in the context of continuous disclosure the causes of action and right to recover losses are aimed at promoting the disclosure of price-sensitive information to the market, so as to foster an efficient market where the price of a security reflects its underlying economic value. Consequently, investors should be entitled to compensation for losses that result from a contravention of the continuous disclosure requirements inflating the price of a security.[68]

The argument for indirect reliance was critically examined in the Arasor International Ltd shareholder class action in the context of an application to amend pleadings to rely on "market based causation". The primary judge accepted that:[69]

> The entitlement to recover loss or damage occasioned "by" misleading and deceptive conduct under s 82 of the TPA does not depend on the person claiming damage having relied on the conduct; reliance by a third party on a misrepresentation can be a sufficient "link in the causal chain" between contravention and loss for the purposes of s 82 of the TPA.

The primary judge's decision was appealed due to confusion over whether market-based causation could be properly pleaded in relation to ss 728 and 729 of the *Corporations Act* which addresses recovery of loss or damage in relation to misleading statements or omissions in a disclosure document. The Full Federal Court found such a pleading was arguable as it was neither futile nor likely to be struck out.[70] The finding that market-based causation was arguable effectively relied on analogy and statutory construction as explained above.[71] The Full Court also reiterated that a requirement for causation does not equate with reliance, causation may be proved in another way.[72] However, Edelman J also highlighted the need to identify how the causal mechanism was said to operate, ie how did the relevant conduct affect the market price? or what were the links in the chain of causation?[73]

In *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357, in the context of an application to strike out the statement of claim, Sifris J explained the statutory construction contended for by the plaintiff in that case as meaning that it was not necessary for individual holders of securities to show that particular representations were made to them, or that they "relied" upon them. Reliance did not need to be pleaded.[74]

Indirect reliance was endorsed in obiter comments in *Grant-Taylor v Babcock & Brown Ltd (in liq)* [2015] FCA 149 where Perram J in a non-class action stated that he "would accept that a party

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[68] *Dorajay Pty Ltd v Aristocrat Leisure Ltd* NSD 362 of 2004, Federal Court of Australia, Transcript 29 October 2007, 499-500. The argument was also made in *Caason Investments Pty Ltd v Cao* [2014] FCA 1410, [79]-[86]. For a contrary view of the purpose of the legislation see Grave D, Watterson L and Mould H, "Causation, Loss and Damage: Challenges for the New Shareholder Class Action" (2009) 27 C&SLJ 483 at 487.

[69] *Caason Investments Pty Ltd v Cao* [2014] FCA 1410, [87] relying on *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526 at 529-530; *ABN AMRO Bank NV v Bathurst Regional Council* (2014) 309 ALR 445, [1376].

[70] *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94, [65] (Gilmour and Foster JJ), [187] (Edelman J).

[71] See *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94, [68], [78]-[80] (Gilmour and Foster JJ), [153]-[154], [169] (Edelman J).

[72] See *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94, [62]-[63] (Gilmour and Foster JJ), [153] (Edelman J).

[73] *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94, [112], [131]-[132], [184] (Edelman J).

[74] *Camping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357, [35]-[36], [38], [40]-[43].

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who acquires shares on a stock exchange can recover compensation for price inflation arising from a failure to disclose material required by s 674 to be disclosed”.[75]

Indirect reliance as a theory of causation is put forward by arguing by analogy to earlier case law dealing with s 82 of the *Trade Practices Act* and by reference to principles of statutory construction. The three recent decisions above considered these arguments on either interlocutory applications, where the arguments only needed to be arguable, or in obiter comments so no authoritative decision was rendered. However, central to any argument of indirect reliance is a link between the contravention and the loss. The link, like for fraud on the market, is an efficient market and rational investors making decisions based on the integrity of the share price. It is these assumptions which explain how misleading information impacts the share price that detrimentally affects investors.[76]

Ramifications of Halliburton for causation in Australian shareholder class actions

When the Australian courts come to consider indirect reliance or fraud on the market they will do so from a different position to that faced by the US Supreme Court. Unlike the US Supreme Court, the Australian courts do not need to defend a judicially created doctrine that has been a precedent for over 25 years and has been regarded as essential to allowing shareholders to utilise the class action.[77] However, *Halliburton* contains clear lessons for Australia, namely:

(a) the decision to retain *Basic* was based on specific American policy considerations and is not an endorsement of the economic theory underlying the fraud on the market presumption;

(b) if direct reliance is not required then a nuanced framework including presumptions and opportunities to rebut the presumptions is required, but may not be supported by Australian legislation; and

(c) the fraud on the market presumption in operating at the class or group level may allow individual investors who did not rely on the share price to recover.

The fraud on the market theory is grounded in the efficient capital markets hypothesis and has drawn significant strength from its ability to be seen as aligned with economic theory.[78] However, the US Supreme Court, although referring to economic theory in *Basic*, never relied solely on economic theory for its acceptance that reliance can be presumed in an efficient market. As Blackmun J said in *Basic*:[79]

> Our task, of course, is not to assess the general validity of the theory, but to consider whether it was proper for the courts below to apply a rebuttable presumption of reliance, supported in part by the fraud-on-the-market theory.

Moreover, the adoption of a rebuttable presumption was based on “fairness, public policy, … probability [and] judicial economy” as well as being “supported by common sense”.[80] A range of factors that for the most part are separate from the economic theory.

The US Supreme Court’s decision in *Halliburton* steps further away from seeking support for the fraud on the market presumption in economic theory. For example, Thomas J accepted that the theory was flawed and did not reflect reality. The Chief Justice accepted that the theory does not comport

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[75] *Grant-Taylor v Babcock & Brown Ltd (in liq)* [2015] FCA 149, [219]-[220].

[76] See eg *Grant-Taylor v Babcock & Brown Ltd (in liq)* [2015] FCA 149, [78] where the expert’s first step in opining on whether information had a material effect on the price or value of the shares of a listed corporation was to argue that the market for the shares for the corporation was an efficient market to which the efficient market hypothesis could be applied.

[77] Legg M and Schaffer R, “Sons of Gwalia v Margaretic: Encouraging Shareholder Claims and the Fraud on the Market Theory” (2007) 35 ABLR 390 at 395-396; Beach, n 57 at 586; Gershman J, “A Subdued Year for Securities Class Actions”, *The Wall Street Journal Law Blog* (27 January 2015) (referring to fraud on the market as “a quarter-century-old precedent that had served as the legal linchpin of the modern investor class-action lawsuit”).

[78] Duffy, n 8 at 631.

[79] *Basic Inc v Levinson* 485 US 224 at 242 (1988).

[80] *Basic Inc v Levinson* 485 US 224 at 245-246 (1988).

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with reality in all circumstances but accepted the fraud on the market presumption should continue as some sort of approximation or rule of thumb. However, the departure by the court is not yet wholly complete.

Halliburton reflects the Supreme Court's latest attempt to reconcile the requirements of the American class action (predominance is required) and securities law causes of action (eg reliance) in a manner that permits securities class actions.[81] Blackmun J explained the problem in *Basic*:[82]

> Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.

Arguably, the continued support in *Halliburton* for the presumption derived from *Basic* should be seen to obtain its foundation from an application of judicial policy rather than the result of the considered application of economic theory. It is, in effect, a deliberate – albeit not entirely comfortable – navigation by the Supreme Court of the doctrine that lies between two problem shores: one where the demise of securities class actions would have resulted if *Basic* were overruled, and the other where, if *Basic* remained unaffected, defendants would have continued to be hindered in their ability to end class actions early where no adverse price impact resulted from defendant conduct.[83]

The Australian class action does not impose the high hurdle of predominance found in r 23 of the FRCP. Section 33C of the *Federal Court of Australia Act 1976* (Cth) allows for a class action to be commenced where (a) there are seven or more persons with claims against the same person; (b) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and (c) the claims of all those persons give rise to a substantial common issue of law or fact. Section 33C, and its subsequent judicial interpretation, has allowed group members with differences in their claims to band together and share costs in a single class action proceeding.[84] This approach means that there may be a range of individual issues in addition to the common issue of law or fact required by s 33C. Indeed, ss 33Q, 33R and 33P accept the existence of differences amongst group members and create a regime to address the resolution of subgroup or individual issues.[85]

The question of individual issues was of central importance in *Bright v Femcare Ltd* (2002) 195 ALR 574 where the respondents sought to have the proceedings discontinued as a class action pursuant to s 33N of the *Federal Court of Australia Act*. Section 33N gives the court a discretion, upon its own motion or on application by the respondent, to terminate the class action where the court is satisfied that it is in the interests of justice to do so because, inter alia, the class action "will not provide an efficient and effective means of dealing with the claims of group members" or where it is "otherwise inappropriate" that the claims be pursued by means of a class action.[86] In *Bright v Femcare*

[81] *Basic Inc v Levinson* 485 US 224 at, 291, 296, 299.

[82] *Basic Inc v Levinson* 485 US 224 at 242 (1988); see also *Wal-Mart Stores Inc v Dukes* 131 S Ct 2541 at 2552, n 6 (2011) (referring to predominance being "an insuperable barrier to class certification" where each of the individual investors has to prove reliance on the alleged misrepresentation).

[83] Harvard Law Review, "Class Actions – Presumption of Reliance under SEC Rule 10B-5 – Halliburton Co v Erica P John Fund Inc" (2014) 128 Harv L Rev 291 at 291 ("Although Halliburton II implicates substantive issues at the intersection of economic theory, financial markets, and securities regulation, the case was not decided on those terms. Instead, the outcome reflects adherence to stare decisis and reluctance to fundamentally alter securities class action practice.").

[84] See *Wong v Silkfield Pty Ltd* (1999) 199 CLR 255, [28] (interpreting "substantial" so as not to mean a large or significant issue but instead "directed to issues which are 'real or of substance'"); *Finance Sector Union of Australia v Commonwealth Bank of Australia* (1999) 94 FCR 179, [13] ("It is a fundamental mistake to argue that the existence of some non-common issues takes a case outside s 33C(1)(c) of the Federal Court Act."); *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515, [48] ("It is the nature of such proceedings that there are differences between the positions of the parties. That is why there is needed a relatedness of circumstances, rather than exactly the same circumstances, in the claims of the group members.").

[85] *Cash Converters International Ltd v Gray* [2014] FCAFC 111, [25] (Jacobson, Middleton and Gordon JJ) (citing ss 33Q and 33R, amongst other provisions, as expressly acknowledging "variation between claimants in a representative proceeding").

[86] *Federal Court of Australia Act 1976* (Cth) s 33N(1), *Bright v Femcare Ltd* (2002) 195 ALR 574; *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275, [13]-[15], [121]-[122].

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Ltd Lindgren J observed:[87]

> let it be assumed that in respect of the resolution of each woman's claim, two-thirds of the time to be spent will have to be devoted to issues unique to that claim and one-third to issues which are common to all claims. Is it still not preferable that the common issues be heard and determined once so as to be binding as between each claimant and the respondents rather than many times?

Kiefel J made the following observation:[88]

> In a case of misrepresentation, it may be thought that the nature of the misrepresentation itself might have something to say on the question of reliance, or that a determination as to the quality of the conduct in question was nevertheless of real benefit to the other claims. In any event, even though proof of causation might involve a considerable part of the evidence and substantial argument in each case, the possibility of other findings being useful is not foreclosed. It will be necessary to assess what might be proved by them.

The interpretation placed on the above class action legislative provisions has meant that Australian shareholder class actions have not been discontinued because of the existence of individual issues.[89] Fraud on the market or indirect reliance is not required for the survival of the shareholder class action in Australia.

The US reliance on policy in relation to causation is also recognised in Australian law which accepts that value judgments and policy may be considered provided they are derived from legal principles. However, an important difference is that causation in the context of the Australian shareholder class action depends on specific provisions in legislation.

The *Halliburton* decision illustrates that the underlying economic theory, the efficient market hypothesis, does not align with reality. The most that can be said, drawing on the decision of Roberts CJ, is that public information "generally" affects share prices and that "most" investors rely on the market price. In any specific situation, public information may not affect share price and investors may not rely on the market price when trading.[90] Ultimately, the US Supreme Court has determined to address this balance between the interests of shareholders and defendants through requirements for the presumption to apply[91] and by allowing for rebuttal of the presumption.

In the Australian context, it is not clear that the borrowed fraud on the market theory or indirect reliance seek to adopt a nuanced framework that requires proof of certain requirements for reliance to exist or considers how reliance may be rebutted.[92] However, they seem to accept that there is a need

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[87] *Bright v Femcare Ltd* (2002) 195 ALR 574, [77]; see also *Brisbane Broncos Leagues Club v Alleasing Finance Australia Pty Ltd* [2011] FCA 106, [83].

[88] *Bright v Femcare Ltd* (2002) 195 ALR 574, [138].

[89] See eg *Guglielmin v Trescowthick (No 2)* (2005) 220 ALR 515, [66] ("Each of those claims will involve different considerations of reliance and loss, simply because each claim group member may have different circumstances. Nevertheless, in my view, there is shown to be commonality in those issues of fact and law to which I have referred, and they will arise in respect of the claims of each group member against each respondent."); *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2005) 147 FCR 394, [129] ("The test for misleading or deceptive conduct is objective. Similarly, whether disclosures ought to have been made will involve issues that can be determined without considering the circumstances of individual claimants. Those aspects of the claims of each group member can be determined in a representative proceeding even though the question whether a group member suffered loss because of those representations would have to be determined individually."); *Hall v Australian Finance Direct Ltd (No 2)* [2007] VSC 233, [48] ("Similarly, in Dorajay Pty Ltd v Aristocrat Leisure Ltd and Guglielmin v Trescowthick (No 2), applications under s 33N were unsuccessful, notwithstanding the significant individual elements of the misrepresentation claims, because the utility of the group proceeding had not been exhausted at the time of the applications.").

[90] See Duffy, n 8 at 638.

[91] *Basic Inc v Levinson* 485 US 224 at 248 (1988). See also *Cammer v Bloom*, 711 F Supp 1264 at 1285-1287 (DNJ 1989) which set out a five-factor test for determining whether the market for a stock is sufficiently efficient to invoke the presumption of reliance: (1) average weekly trading volume, (2) the number of securities analysts who follow the stock, (3) the number of market makers active in the stock, (4) the company's eligibility to file an S-3 registration statement, and (5) a historical showing of immediate price response to unexpected events or financial releases). Some courts have adopted additional factors such as market capitalisation, bid-ask spread, percentage of stock held by insiders, and presence of institutional investors. See Fisher W, "Does the Efficient Capital Markets Hypothesis Do Us Justice in a Time of Madness?" (2005) 54 Emory LJ 843 at 862.

[92] Grave, Watterson and Mould, n 68 at 495-497.

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to prove that the alleged contraventions caused the market price of the share to be inflated.[93] The difficult issue for Australian courts is to devise a workable test for causation that is consistent with the statutory language of the above causes of action and the realities of the market place. Adopting the American fraud on the market test may be contrary to existing statutory requirements.[94] Indeed, devising criteria for reliance to be presumed and rebutted would require a court to read a great deal into "resulted from", "by" and "because". However, simply allowing indirect reliance in every case where securities are traded on a stock exchange would be to ignore the frailties of the economic theory that underpins indirect reliance.

A further concern is that in the context of a class action that focuses on the representative party, as occurs in both the US and Australia, other investors who do not rely on the share price are able to stay in the shadows and only come forward to participate in a settlement. The fraud on the market presumption is over inclusive and may allow investors who did not suffer loss because the continuous disclosure regime was not complied with, or who were not misled, to recover compensation.[95] The connection between a respondent's misrepresentation and an applicant's injury may not exist. Fraud on the market, or indirect reliance, may remove the need for causation rather than altering how it may be proved. Is compensating those who have not suffered loss caused by alleged contraventions the price of efficiently compensating those who have?

CONCLUSION

Causation in Australian shareholder class action claims based on contravention of the continuous disclosure regime and misleading conduct remains an unresolved issue. However, causation has been pleaded in a range of ways including that fraud on the market makes proof of reliance unnecessary or that indirect reliance is sufficient. Central to these approaches to causation are the assumptions of an efficient market and rational investors making decisions based on the integrity of the share price that were found not to reflect reality at all times in *Halliburton*.

Australian courts need to consider whether an approximation or rule of thumb dressed up as economic theory that gets it right only some of the time, is a desirable development. If causation remains as an individual issue, this does not prevent Australian class actions from continuing and common issues being resolved. The stark choice faced by the US Supreme Court between creating a new test for causation or making the pursuit of securities causes of actions through class actions impossible does not arise in Australia.

To assist in achieving its policy decision the Supreme Court fashioned a presumption that arose on proof of certain matters by the representative party, but which could be rebutted by a defendant. This approach provides a framework that tests whether the assumptions of an efficient market and rational investors making decisions based on the integrity of the share price hold in a particular case. It is not clear whether in the Australian context the tests for causation through means other than direct reliance recognise the limitations of assumptions about efficient markets and rational investors. Further, if the recognition is made, then a question arises as to how presumptions and the like can be developed based on the existing statutory requirements. Moreover, finding that the rational investor assumption holds for the representative party does not mean that it holds for all group members.

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[93] *Pathway Investments Pty Ltd v National Australia Bank Ltd (No 3)* [2012] VSC 625, [11]; *Grant-Taylor v Babcock & Brown Ltd (in liq)* [2015] FCA 149, [219 (iv)]; *Caason Investments Pty Ltd v Cao* [2015] FCAFC 94, [112], [184] (Edelman J). Presumably this approach will require expert evidence that seeks to distinguish between share price inflation caused by the alleged contravention and other extraneous factors. See *Grant-Taylor v Babcock & Brown Ltd (in liq)* [2015] FCA 149, [65].

[94] Beach, n 57 at 586 (observing that the fraud on the market theory if adopted in Australia "would impermissibly rewrite the statutory causation tests").

[95] See *Caason Investments Pty Ltd v Cao* [2014] FCA 1410, [56], [69], [104] where the pleading was to be amended so that group member who knew the truth of a misrepresentation could not recover, thus removing some of the group members who did not rely on the integrity of the share price.

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