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Update to Securities Class Actions White Paper

in Australia

Update to the Chubb D&O White Paper – Clyde & Co Australia

In our White Paper we made a number of future predictions for shareholder class actions in the next five years and we are starting to see more developments which correspond with our predictions.

First securities class action decision

One of our predictions was that a superior Court in Australia would rule on whether a class can rely on indirect or market based causation in establishing reliance in a shareholder class action. We said that the outcome of such a decision in the future may impact the willingness of parties to run class actions to judgment, rather than settling.

Whilst we continue to await a decision from a superior Court in Australia, the Myer shareholder class action became the first securities class action to proceed to judgment on 24 October 2019.[1] The Court found that Myer had breached its continuous disclosure obligations by failing to disclose to the market that it was not likely to reach its forecasted net profit after tax (**NPAT**), and had engaged in misleading or deceptive conduct. However, it was not accepted that the Applicant and Group Members had suffered any loss.

The Applicant (for itself and on behalf of Group Members) only advanced a market based causation theory and an inflation based measure for its loss analysis. Its claim for damages failed because the market price of Myer's shares at the time these contraventions occurred already factored in an impact below what had been forecast.

This decision illustrates that these cases are fact specific in determining:

1. threshold liability questions, being whether there is any information that was material to investors that was not disclosed to the market, and if there was whether any exceptions to disclosure under the listing rules apply; and
2. that expert evidence on loss and quantum will continue to be a central battleground on which these cases are fought beyond the threshold liability questions.

The reason the Court found that the shareholders did not suffer any loss by reason of the contraventions was because the market had already factored in an expected NPAT well below the forecast by the time the contraventions occurred. For that reason, even if a corrective statement had been made it was likely to have had no or no material effect on the market.

In terms of causation, market based causation was accepted as being an appropriate foundation for a claim for compensation. There are already some first instance decisions of Australian courts outside of the class action context which have suggested that market based causation is available.[2] However, this is the first Australian securities class action where a court has decided that causation can be established even if there is no specific reliance by individual investors on any misrepresentation made by the company.

In addition to expert evidence, contemporaneous evidence sourced from market analyst reports was critical. In determining whether the shareholders suffered any loss by reason of Myer's contraventions, the Court undertook a review of reports that analysts produced following the Myer representation. That review demonstrated that analysts did not treat what was said by Myer's CEO as being accurate guidance, and that analysts doubted the likelihood of profit growth in FY2015. Ultimately, the Court found that analysts had already factored in and come to an expectation that Myer was not going to perform as well as it did in FY2014: *'the hard-edged scepticism of market analysts and market makers at the time of the contravention had already deflated [Myer's CEO's] inflated views'*.[3]

The case illustrates that even though market based causation is pursued by applicants, caution needs to be exercised by plaintiffs and funders in identifying potential claims to ensure they are taking into account what is already known and factored in to the share price (based on the assessment of analyst reports and commentary from other market commentators). The Court must decide what would have happened had the disclosures been made, or other counterfactual disclosures. The event study framework (which was given support by the trial judge) can be used to assess the effect on a share price of information disclosed by a company. However, the role of contemporaneous evidence from analysts, as well as the consideration of hypothetical counterfactual disclosures as illustrated in event studies, is of paramount importance.

What next?

It remains to be seen if an appeal will be filed. Whilst the Myer securities class action was the first to proceed to judgment in Australia, our prediction is that it will not be the last. Only the week before the judgment in Myer, his Honour Justice Foster (in the Federal Court of Australia) held that the question of whether market based causation may be invoked in any given case depends upon the facts of that case.

Some jurisprudence in such an active part of the commercial litigation market is welcome given shareholder claims have dominated class actions in the past decade. But in and of itself a first instance decision of a single judge is not expected to provide market clarity on whether market based causation or indirect causation is available to shareholders in securities claims and the appropriate loss methodology in these cases. [4]

Until there is a body of case law, including authoritative statements from appeal courts and the High Court, we expect uncertainty to continue on central questions in these claims relating to such matters as causation and loss.

1 *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747 (**Myer**).
2 For example, see *Edelman J in Caason Investments Pty Ltd v Cao* (2015) 236 FCR 322 at [145] to [182] and *Brereton J in Re HIH Insurance Limited (in liq)* (2016) 335 ALR 320.
3 *Myer* at [20].
4 *Masters v Lombe (Liquidator); In the Matter of Babcock & Brown Limited (In Liq)* [2019] FCA 1720. See at [382]-[389].

Court interference in funding commissions

We also predicted as part of the ALRC reform process that explicit Court powers may be introduced to regulate and intervene in private contractual arrangements between litigation funders and group members in class action proceedings. Whilst the timing of any reform remains uncertain, the Federal Court of Australia continues to demonstrate its interventionist approach. This is illustrated by the settlement approval application in the Murray Goulburn class action, funded by IMF Bentham, which was heard by his Honour Justice Murphy of the Federal Court of Australia on 16 October 2019. Although Murphy J considered the settlement agreement to be "plainly fair and reasonable", court approval was not granted at the time as Murphy J rejected IMF's commission rate of 32% as being too high. His Honour's opinion is that a funding commission in the region of 25% was more appropriate. IMF has been ordered to inform the Court of the position it will adopt in response to this ruling and the next settlement hearing is set down for 18 November 2019. If IMF is seeking to maintain the proposed commission rate, then it appears a contradictor is to be appointed to argue against IMF.

Murphy J's refusal to approve the Murray Goulburn settlement on this basis is notable in respect of the question as to whether courts may interfere in funding agreements in respect of the commission to be levied. The argument advanced by litigation funders is that the funding agreement is executed between the funder and the group members, and such interference by the courts offends the principle of privity of contract. This will no doubt have a significant impact on the business model of litigation funders as they will need to determine whether it is economically viable to continue funding large scale litigation at potentially a rate lower than that currently levied.

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