INVESTOR LOSS FROM SECURITIES NON-DISCLOSURE: A STATUTORY PRESUMPTION OF CAUSATION ON THE CANADIAN MODEL?

MICHAEL J DUFFY∗

I INTRODUCTION – THE PROBLEM

The application of class action procedural machinery to investor claims has caused a minor revolution for shareholder litigation in Australia. This has been added to by the decisions of the High Court in *Sons of Gwalia Ltd v Margaretic*[1] to recognise defrauded or misled shareholders as creditors in a winding up and the decision in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd*[2] to tolerate litigation funding. Depending upon one's perspective, this has greatly increased corporations and officers' risk of facing large professionally organised claims from disgruntled investors[3] and/or greatly increased the prospects of affordable redress for defrauded or misled investors through the courts.[4] In either case, one of the battles yet to be fully to be played out in the area is the question of burden of proof in relation to causation of loss. The matter is significant as it goes partly to the viability of such mass claims. In the absence of a theory that explains how loss can occur though the effect of misleading conduct and non-disclosure on the market price, plaintiffs may be left with the logistical nightmare of adducing reliance evidence from thousands of investors. Such a problem for plaintiffs would ultimately also become a problem for court administration and would see increased costs for defendants too. While it is possible that the problem will be resolved through application of existing principles by the courts, there is also the possibility of legislative intervention as recently canvassed by the Companies and Markets Advisory Committee ('CAMAC'). This paper examines the issue, with

∗ B.Com, LL.B, LL.M, Barrister and Solicitor, Lecturer in Company and Commercial Law, Department of Business Law and Taxation, Monash University.

1 *Sons of Gwalia Ltd v Margaretic; ING Investment Management LLC v Margaretic* (2007) 231 CLR 160 ('*Sons of Gwalia*').

2 *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

3 See, eg, Michael J Legg, 'Shareholder Class Actions in Australia – The Perfect Storm?' (2008) 31(3) *University of New South Wales Law Journal* 669.

4 See, eg, Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30 *Melbourne University Law Review* 399.

focus on statutory presumed causation provisions that have been enacted in Canada.

II THE CAMAC PROCESS

The decision of the High Court in *Sons of Gwalia* was widely interpreted as strengthening the rights of shareholders in relation to insolvent companies, to some degree at the expense of creditors of such companies.[5] As a consequence CAMAC was asked by the Federal Government in 2007 to consider, inter alia, whether shareholders with misleading and deceptive conduct claims against a company should be allowed to claim as unsecured creditors in the insolvency of that company.[6] As part of that brief, CAMAC was also asked to consider whether there were any reforms to the statutory scheme that would better protect shareholders from the risk of acquiring shares based upon misleading information.[7]

CAMAC circulated a discussion paper in September 2007 which, aside from the direct issues of priority of shareholder claims, discussed the possibility of a statutory amendment to facilitate proof of aggrieved investor claims by establishing a rebuttable presumption of reliance along the lines of the United States' 'fraud on the market' theory.[8] The 'fraud on the market' theory, which was formally adopted by the US Supreme Court in 1988 in *Basic Inc v Levinson*,[9] has facilitated class actions in the United States under rule 10b-5 of the *Securities and Exchange Act of 1933*,[10] by providing a presumption of causation of loss where securities were traded on an efficient market. It does this by presuming that any misleading statements or non-disclosures are reflected in the price of the shares and that misleading statements can therefore defraud purchasers of those shares even if the purchasers did not directly rely on the misstatements.[11] It makes this presumption by utilising the Efficient Capital Markets Hypothesis ('ECMH'), which states that stock markets are generally efficient in relation to publicly available information.[12] This means that through share trading on listed

---

5 See, eg, Andrew Trounson, 'Historic Win for Duped Investors', *The Australian* (Sydney), 1 February 2007.

6 CAMAC, *Shareholder Claims Against Insolvent Companies – Implications of the Sons of Gwalia decision*, Discussion Paper (September 2007) 9.

7 Ibid.

8 Ibid 81. See generally Michael Duffy, ''Fraud on the Market': Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada and Australia' (2005) 29 *Melbourne University Law Review* 621. See also Michael Legg and Ron Schaffer, 'Sons of Gwalia Ltd v Margaretic: Encouraging Shareholders' Claims and the Fraud on the Market Theory' (2007) 35 *Australian Business Law Review* 390.

9 485 US 224 (1988) ('*Basic*').

10 15 USC §§77a–77aa (1933).

11 *Peil v Speiser*, 806 F 2d 1154, 1160–1 (3rd Cir, 1986). Referred to with approval by Blackmun J in *Basic*, 485 US 224 (1988).

12 See generally Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *Journal of Finance* 383.

markets, publicly available information is rapidly impounded into the price of shares.[13]

Submissions were requested and received by CAMAC and, in December 2008, CAMAC presented its report to the government.[14] On the question of legislating a rebuttable presumption of reliance, CAMAC's report noted that such a move would have significant implications for recovery actions generally; it suggested that the concept should not be considered only in the limited context of shareholder claims against insolvent companies. CAMAC concluded that the matter would require careful analysis going beyond the scope of that particular review.[15]

Some of the submissions to CAMAC suggested that causation without individual reliance might already exist under Australian law under principles of causation established in cases under the *Trade Practices Act 1974* (Cth).[16] In particular, the case of *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd*[17] had already established that a person could suffer loss through the reliance of others on misleading representations, even though the person himself did not rely on such representations (the case concerned a trader who had lost business when his customers were induced by the misleading representations of a competitor, to patronise the competitor). By analogy therefore, it might be argued that a shareholder could suffer loss if other shareholders relied on a misleading statement of favourable news about a company and that their resultant trading caused the share price of the company to rise. A person who bought at the inflated share price might argue that he had lost the commercial opportunity to

13 There is considerable academic literature about whether the ECMH is 'valid', particularly in its most popular form – the semi-strong version. The semi-strong form of the ECMH asserts that share prices reflect all public information (but not non-public information). It thus suggests that public information is rapidly reflected in security prices: see Fama, above n 12. The ECMH was well accepted in the 1970s and 1980s. However, in more recent times the development of behavioural finance has cast some doubt upon whether markets are always efficient or whether behavioural factors affecting market participants (particularly for instance the psychology of investors in a 'bubble' market) mean that market prices may not accurately reflect the best publicly available information about fundamental values. A more modern assessment of the value of the ECMH is not so much to analyse whether a market is perfectly efficient as to analyse 'whether efficiency theory provides useful insights into price behaviour'. See Graham Peirson et al, *Peirson and Bird's Business Finance* (7th ed, 1998) 715.

14 CAMAC, *Shareholder Claims Against Insolvent Companies – Implications of the Sons of Gwalia Decision Report* (December 2008).

15 Ibid 83–4.

16 CAMAC, *Submissions – Shareholder Claims against Insolvent Companies: Implications of the Sons of Gwalia Decision* (2008), Submission No 7 (Jason Harris and Anil Hargovan), 2; Submission No 9 (IMF (Australia) Ltd), 13 and 17; and Submission No 19 (Michael Duffy), 11 and 12 <http://www.camac.gov.au/CAMAC/camac.nsf/byHeadline/SubmissionsSons+of+Gwalia?openDocument> at 22 September 2009 ('Submissions to CAMAC').

17 (1992) 37 FCR 526 ('*Janssen-Cilag*').

buy at a lower (true value) price and that this loss was caused by the misleading statements.[18]

Many of the submissions to CAMAC did not address the question of a statutory presumption of causation. Of those that did, some were opposed[19] whilst other submissions were prepared to countenance 'fraud on the market' reliance if the priority of creditors was restored by a statutory reversal of the *Sons of Gwalia* decision.[20] For its part, the Australian Securities and Investments Commission ('ASIC'), which opposed any statutory reversal of *Sons of Gwalia*, said the suggestion of introducing a statutory 'fraud on the market' doctrine into Australia warranted further detailed consideration, but this should take place outside the limited context of a review of claims against insolvent companies.[21]

III RECENT CASE LAW

Overall though, there was perhaps a less than fulsome debate about presumed or 'fraud on the market' causation, probably due to the fact that this was not the central issue of CAMAC's review. It is also notable that at the time of CAMAC's review, the question of causation in the context of securities non-disclosure was before the Federal Court in the representative (class action) proceeding of *Dorajay Pty Ltd v Aristocrat Leisure Ltd*,[22] and it might be speculated that some of the stakeholders on this issue may have been more circumspect as a result.[23] Some submissions to CAMAC specifically suggested that it was premature to introduce legislation until the outcome of the *Dorajay* case clarified the law.[24] However, that case settled after trial but before judgment, with the result that relatively fulsome submissions by both plaintiff and defendant on the issue did not result in any definitive exposition of law by the judge in that case.[25]

---

18 The cases under s 82 of the *Trade Practices Act 1974* (Cth) make it clear that a person can seek damages for the 'loss' of a 'commercial opportunity' caused by a breach of inter alia, s 52 of that Act: *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 350 (Mason CJ, Dawson, Toohey and Gaudron JJ). Such principles appear to apply to loss from negligence as well. See *Malec v J C Hutton Pty Ltd* (1990) 169 CLR 638, 639–40 (Brennan and Dawson JJ), 642–3 (Deane, Gaudron and McHugh JJ); *Naxakis v Western General Hospital* (1998) 197 CLR 269, 278 (Gaudron J).

19 Submissions to CAMAC, above n 16, Submission No 4 (Chartered Secretaries Australia Ltd) 5–6.

20 Ibid Submission No 12 (Australian Financial Markets Association) 12; Submission No 13 (Australian Bankers' Association) 17.

21 Ibid Submission No 8 (Australian Securities & Investments Commission) 1, 4.

22 See *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2008) 67 ACSR 569 ('*Dorajay*') (decision approving settlement of the proceeding).

23 The 'stakeholders' would include the parties to that case but also clearly includes the lawyers and their clients (as well as insurers and litigation funders) who practice in the area of such litigation. See Submissions to CAMAC, above n 16, Submission No 15 (Insolvency Practitioners Association) 2; Submission No 7 (Jason Harris and Anil Hargovan) 2; Submission No 19 (Michael Duffy) 12.

24 Ibid Submission No 16 (QBE Insurance Group Limited) 2; Submission No 7 (Jason Harris and Anil Hargovan) 2; Submission No 19 (Michael Duffy) 12.

25 See Transcript of Proceedings, *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (Federal Court, Stone J, 29 October 2007).

The issue has also been complicated by the decision of the New South Wales Court of Appeal in *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd*,[26] which, building upon an earlier decision of the court in *Digi-Tech (Aust) Ltd v Brand*[27] may have circumscribed somewhat the *Janssen-Cilag* concept of causation without individual reliance. The case concerned allegedly misleading representations made by members of a due diligence committee and others in respect of a prospectus issue. It was argued by the plaintiffs that in the absence of these misrepresentations, the directors of a listed company would not have approved the allotment of securities and that the plaintiffs would therefore not have suffered loss (which occurred when the securities became worthless on the collapse of that company). It was argued that causation was established even though the plaintiffs themselves were not misled. Both Ipp and Giles JJA endorsed the approach of the Court of Appeal in *Digi-Tech*, and emphasised the distinction between circumstances where, on the one hand, the plaintiff is a passive victim of misleading conduct (the *Janssen-Cilag* category of case) and, on the other, where the plaintiff acts or refrains from acting to his or her prejudice by reason of the conduct of a third party, whose conduct is brought about by the defendant's misleading conduct. In the latter situation, their Honours considered that the plaintiff's conduct was itself a necessary link in the chain of causation[28] and therefore (at least on the facts in those cases) apparently broke the chain.

Thus, plaintiffs who claim to have suffered loss brought about by their own actions or omissions, coupled with misleading conduct by the defendants, could not claim.[29] One of the rationales of this decision may be to exclude from the range of claimants persons who know that representations were false and perhaps those who do not read disclosure documents and are therefore perhaps themselves to be deemed careless or negligent in their investment decisions. In his analysis, Giles JA states specifically that 'the vice is not issuing misleading prospectuses, but misleading investors by issuing misleading prospectuses …

26 (2008) 252 ALR 659 ('*Ingot Capital*').

27 [2004] ATPR ¶46-248 ('*Digi-Tech*').

28 See *Ingot Capital* (2008) 252 ALR 659, 765 (Ipp JA).

29 Ibid. The High Court has said that the 'common-sense' approach to causation which is applicable in tort is also applicable when considering a claim for relief under s 82 of the *Trade Practices Act 2001* (Cth). See *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ). In *March v Stramare (E and M H) Pty Ltd* (1991) 171 CLR 506, 515, Mason CJ commented on the causation issue as follows:

> Commentators subdivide the issue of causation in a given case into two questions: the question of causation in fact – to be determined by the application of the 'but for' test – and the further question whether a defendant is in law responsible for damage which his or her negligence has played some part in producing: see, for example, Fleming, The Law of Torts, 7th ed. (1987), 172–173; Hart and Honor , Causation in the Law, 2nd ed. (1985), 110. It is said that, in determining this second question, considerations of policy have a prominent part to play, as do accepted value judgments: see Fleming, 173. However, this approach to the issue of causation (a) places rather too much weight on the 'but for' test to the exclusion of the 'common sense' approach which the common law has always favoured; and (b) implies, or seems to imply, that value judgment has, or should have, no part to play in resolving causation as an issue of fact. As Dixon CJ, Fullagar and Kitto JJ remarked in *Fitzgerald v Penn* (at 277): 'it is all ultimately a matter of common sense' and '(i)n truth the conception in question (ie, causation) is not susceptible of reduction to a satisfactory formula': at 278.

compensation is to be recovered not simply because a misleading prospectus was issued, but because the investor was misled by its issue.'[30]

That decision is therefore clearly at odds with the 'fraud on the market' approach which springs from an entirely different view – that individual investors (particularly unsophisticated or retail investors) should not necessarily be expected to read every Australian Securities Exchange release by the company, but that they should be entitled to expect that there has been accurate disclosure to the market. If the market is large enough and liquid enough, they may reasonably expect (based on the ECMH) that enough professional and other investors and traders (such as superannuation funds, banks, insurance companies, stock analysts, licensed financial advisers and others) will have read all the company disclosures and that their trading decisions will cause the market price to reflect those disclosures.

In the absence of such a doctrine, it of course remains open for defendants to argue in a securities class action that evidence of reliance from each individual class member is a prerequisite for recovery. In class actions involving thousands of shareholders, this is obviously administratively difficult and burdensome for all parties as well as for the court hearing the matter.[31] The situation was well described by Mansfield J in *Guglielmin v Trescowthick (No 2)*,[32] a class action involving some 11 300 group member claimants and some 77 disclosure documents issued over a five year period. Justice Mansfield noted that 'the determination of reliance by a potentially significant number of persons, with a large number of documents over a five-year time frame may be extremely difficult and tedious.'[33] He went on to note that 'ultimately, each individual group claimant's circumstances will have to be addressed to determine whether those persons did in fact rely upon some or all of the communications pleaded to their detriment' and that this would be 'an extensive, complex and expensive inquiry' and 'could potentially become a very involved, costly and time-consuming process.'[34]

In the absence of a decision in the Aristocrat action, there is also the question of uncertainty in the law. It is notable that the plaintiffs in that case asserted that existing Australian law did not require individual reliance for there to be causation,[35] whereas the defendants asserted not only that proof of individual

30 *Ingot Capital* (2008) 252 ALR 659, 672 (Giles JA).

31 In some cases, it may even require evidence from both from the legal and beneficial owner of the shares – depending upon who made decisions to sell or purchase.

32 (2005) 220 ALR 515.

33 Ibid 531.

34 Ibid 532.

35 Arguing that reliance was not necessary to establish causation but, to the extent it was necessary, that reliance by 'the market' was adequate reliance. See Transcript of Proceedings, *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (Federal Court, 29 October 2007) 497 (Submission of Mr Gageler SC).

reliance was necessary,[36] but that any change to that position would need to be implemented by legislation as had occurred in Canada.[37]

IV EXISTING AUSTRALIAN STATUTORY PROVISIONS THAT AFFECT CAUSATION

There are already examples of statutory provisions in Australia that arguably connote some elements of causation of investor loss without direct reliance. These may demonstrate an acceptance by the legislature that individual reliance is not sacrosanct.

A Prospectus Type Documents

In the case of new securities offerings, persons who suffer loss or damage because of a misleading statement or omissions from a disclosure document (usually long or short form prospectus or offer information statement) are entitled to recover damages from various persons under section 729 of the *Corporations Act 2001* (Cth). Those persons include the company, its directors, underwriters and other persons who consensually make statements in the disclosure document. Though the section requires that investors suffer loss 'because' of the disclosure contravention (suggesting that causation needs to be proven), it also allows recovery from such a person 'even if the person did not commit, and was not involved, in the contravention'.[38]

The meaning of the latter suggests that it is not necessary to prove that the investor relied upon those particular persons or the particular statements of those persons.[39] The clause is explicable on the basis that the company, directors, proposed directors and underwriters are all liable under section 729(1) for 'any contravention of section 728(1) in relation to the disclosure document'. By contrast, other persons who make statements in the document or contravene section 728(1) are only liable for the inclusion of those particular statements or for the contravention. The concept is therefore based on an effective 'joint liability' of companies, their directors and underwriters for the content of a prospectus. One of the effects may be that liability does not depend upon reliance on a particular statement of a particular director or the underwriter (or the company) though there must clearly still be causation of the loss – probably by reliance on a misstatement

36 The defendants sought to distinguish *Janssen-Cilag* due to the argument that a shareholder's decision to purchase the shares breaks the chain of causation whereas there was no such intervening decision causing loss by the plaintiff retailer in *Janssen-Cilag*. Ibid 546.

37 Ibid 552 (Submission of Mr Finch SC).

38 *Corporations Act 2001* (Cth) s 729(1).

39 *Corporations Act 2001* (Cth) s 729(1). Though the table listing people liable on the disclosure document does refer in its second column to 'loss or damage caused by...'

or omission by one or any of them in the prospectus.[40] It thus seems that reliance on a misleading statement by one director in the prospectus (such as the chief executive officer for instance) is sufficient causation for claims against all directors, the company and the underwriter. In the case of non-disclosures, a possible rationale for this would be that all these defendants are liable as they had a duty to warn and to make the prospectus accurate and failed to do so. This would be consistent with the various defences of lack of knowledge and reasonable reliance which are made available to exonerate such persons.[41] Nevertheless, the section does illustrate the problem of demonstrating individual reliance on non-disclosures as opposed to misleading representations, which is itself another argument in favour of a presumption of causation.[42]

In terms of other aids to causation, it is also noted that where ASIC approves under section 709(2) the preparation of a profile statement (a simplified form of disclosure document described in section 714) then section 729(2) creates a form of 'deemed reliance' on the prospectus as well as the profile statement (this appears to apply even though the investor received a copy of the profile statement but did not receive or seek a copy of the prospectus).

B Takeover Documents

Similar to prospectus type documents, persons who suffer loss or damage as a result of a misleading statement or omission from various takeover disclosure documents (such as bidder's statement, takeover offer, target statement, compulsory acquisition notice or a report accompanying any of these) are entitled to recover damages from various persons under section 670B. Those persons include the company making the statement or notice, its directors and other persons who consensually make statements in the documents. The section requires that investors suffer loss 'that results from' the contravention (suggesting that causation needs to be proven) but again too allows recovery from such a person 'even if the person did not commit, and was not involved, in the contravention.'[43] As for prospectus type documents, various defences, including lack of knowledge and reasonable reliance on others, are available to persons sued.[44]

---

40 Sections 728 and 729 of the *Corporations Act 2001* (Cth) were introduced by the *Corporate Law Economic Reform Program Act 1999* (Cth). Clause 8.22 of the Explanatory Memorandum to the Bill for the Act states that 'the issuer of a disclosure document, the directors and proposed directors and underwriters will be liable in relation to the disclosure document as a whole. Other persons will only be liable for statements in the disclosure document that they have made or which are based on their statements.': Explanatory Memorandum, Corporate Law Economic Reform Bill 1998 (Cth) 59.

41 *Corporations Act 2001* (Cth) ss 731, 732, 733.

42 In the United States, the problem has been stated in the following terms: 'Since nothing is affirmatively represented in a nondisclosure case, demanding proof of reliance would require the plaintiff to demonstrate that he had in mind the converse of the omitted facts, which would be virtually impossible to demonstrate in most cases.' See Note, 'The Reliance Requirement in Private Actions under Rule 10b-5' (1975) 88 *Harvard Law Review* 584, 590.

43 *Corporations Act 2001* (Cth) s 670B(1).

44 *Corporations Act 2001* (Cth) ss 670D, 670F.

C Insider Trading Loss Causation

It may be argued that the insider trading provisions of the *Corporations Act 2001* (Cth) also implicitly make some assumptions about causation of loss that are consistent with the 'fraud on the market' theory (and/or the ECMH on which it is based). These talk in terms of the 'difference, if any' between the price of securities when material information is generally available and when it is not available.[45]

V THE CANADIAN POSITION

The position in Canada is instructive for Australia in relation to the question of a statutory presumption of causation for securities non-disclosure. This is so for various reasons, including the close similarities of Canada's common law system and jurisprudence, and the size and level of sophistication of the Canadian securities market. More particularly, whilst class actions have a long history in the United States[46] but no real development in the United Kingdom,[47] Canada, like Australia, has relatively recently developed comprehensive statutory procedures to facilitate such actions (though these have initially developed at a provincial rather than a national level in Canada).[48]

---

45 Section 1043L(4) of the *Corporations Act 2001* (Cth) is the most closely analogous to the 'fraud on the market' theory, as I have discussed it above. Under s 1043L(4), an acquirer of securities may recover as compensation from a person with inside information the difference, if any, between the price at which the securities were disposed of by the insider and the price 'at which they would have been likely to have been disposed of' if the information had been generally available (for a good general discussion about recovery of loss from insider trading, see Hui Huang, 'Compensation for Insider Trading: Who Should be Eligible Claimants?' (2006) 20 *Australian Journal of Corporate Law* 84). This section therefore necessitates that the court come to a conclusion about what price shares 'would have' traded at if information had been generally available. This is essentially no different from a court making a finding about what price shares 'would have' traded at if undisclosed information had been disclosed by the company or misleading information had been corrected. Though the section talks about an amount of loss 'if any', the provisions do suggest an implicit assumption that disclosure of material information to make it 'generally available' is likely to impact the price of shares. Though the making of this assumption certainly does not amount to a complete endorsement of the ECMH, it does imply the likelihood of some level of efficiency in the market whereby such a disclosure will be transmitted into the market price.

46 In the United States, the procedural mechanisms for class (or group) actions have also existed since at least 1938 (under r 23 of the *Federal Equity Rules* and the *Federal Rules of Civil Procedure*). See Alba Conte and Herbert B Newberg, *Newberg on Class Actions* (3rd ed, 1992) [1.09].

47 There is no direct United Kingdom equivalent of the United States 'class action', though there are various forms of collective action and certain other mechanisms for pursuing 'group complaints'.

48 The first province to introduce class action legislation was Quebec in 1978 (*An Act Respecting the Class Action*, RSQ c R-2.1). Ontario followed in 1992 (*Class Proceedings Act*, 1992, SO 1992, c 6), British Columbia in 1996 (*Class Proceedings Act*, RSBC 1996, c 50), Saskatchewan in 2001 (*Class Actions Act*, SS 2001, c C-12.01), Newfoundland and Labrador in 2001 (*Class Actions Act*, SN 2001, c C-18.1), Manitoba in 2002 (*Class Proceedings Act*, SM 2002, c 14), Alberta in 2003 (*Class Proceedings Act*, SA 2003, c C-16.5), and New Brunswick in 2006 (*Class Proceedings Act*, SNB 2006, c C-5.15). Federal procedures were created in 2002 under the *Federal Court Rules* SOR/98-106.

A Case Law

Further, attempts to invoke the US 'fraud on the market' theory have been made in cases in Canada and failed. In *Carom v Bre-X Minerals Ltd*,[49] the plaintiff shareholders in Bre-X Minerals Ltd ('Bre-X') sued to recover losses from purchasing shares at an inflated price after Bre-X had made a series of announcements describing the level of gold deposits in Busang in East Kalimantan province in Indonesia. This caused the Bre-X share price to rise from \$0.50 in May 1993 to \$228.00 in May 1996. The share price later plummeted, following an independent discovery that the size of the deposits was significantly less than that which was represented. The plaintiffs asserted causes of action in, inter alia, negligent and fraudulent misrepresentation, conspiracy and breach of fiduciary duty. In 1998, the plaintiffs sought to amend their claims to integrate the US 'fraud on the market' doctrine. On 4 November 1998, Winkler J of the Ontario Court (General Division) gave judgment refusing the proposed amendments.[50] The plaintiffs had argued that whether the 'fraud on the market' theory could be invoked in Ontario was a 'novel point' and an 'open question'.[51] Justice Winkler disagreed with this.[52] His Honour noted that reliance was an essential element of their claims in negligent and fraudulent misrepresentation and said:

> The theory is advanced out of the statutory context in which it was developed. It is put forward absent the surrounding qualifications and conditions with which it is circumscribed in the United States. Moreover, the plaintiffs' submission would require a redefinition of the common law torts of fraudulent and negligent misrepresentation as developed by the Supreme Court of Canada.[53]

Part of the rationale for Justice Winkler's decision appears to be that US class action legislation required a 'predominance of common issues' but that, significantly, this test did not pertain to class proceedings under the *Class Proceedings Act* in Ontario.[54] Thus, refusing the amendments would not necessarily have been fatal to certification of the class action in the manner it may have been in the United States. Justice Winkler went on to note the distinction between Rule 10b-5[55] actions and common law claims in the United States, noting that United States courts had rejected the 'fraud on the market' theory in common law misrepresentation or deceit claims.[56]

---

49 (1998) 41 OR (3d) 780 ('*Bre-X*'); affirmed in *Carom v Bre-X Minerals Ltd* (1999) 46 OR (3d) 315.

50 *Bre-X* (1998) 41 OR (3d) 780, 795.

51 Ibid 786.

52 Ibid.

53 Ibid.

54 Ibid 789. His Honour later (at 794) referred to Moldaver J in *Abdool v Anaheim Management Ltd* (1995) 21 OR (3d) 453, 471, who stated:

> I must respectfully disagree with [the] statement that the Act was not intended to be used in circumstances where the individual issues to be determined could be said to predominate the common issues … I cannot accept that the legislature intended to incorporate the predominate issue test into the Act.

55 Under the US *Securities and Exchange Act of 1933*, 15 USC §§77a–77aa (1933).

56 *Bre-X* (1998) 41 OR (3d) 780, 789.

In the decision of the Ontario Superior Court of Justice in *Mondor v Fisherman*,[57] the plaintiffs conceded that the US 'fraud on the market' doctrine was generally not available in Canada.[58] However, the court did suggest that an inference of reliance might be drawn based on the facts of a particular case and that the defendant might then have the onus of rebutting same.[59] It is noteworthy that some elements of statutory causation already existed in Ontario at the time of the *Bre-X* decision though only in relation to prospectuses and circulars which were not at issue in that case.

More recently in the Quebec Superior Court, a securities class action was certified against CP Ships Limited and others in 2008 alleging various faults and omissions in some 19 public documents.[60] These faults and omissions were said to 'artificially inflate the market price of the shares of CP Ships Limited … with the result that all the persons having purchased shares of the defendant … [between certain dates in 2003 and 2004] suffered damages as a direct result of such faults and omissions.'[61] The case does not mention the 'fraud on the market' theory or the ECMH, yet the pleading effectively relies upon such an approach. The decision not only certified the action but went so far as to find that causation was a common rather than an individual issue (that is, it affected class members collectively and identically rather than being differential to each class member). Justice Barakett stated:

> In the present case, the fact of having misled the market, if such is the case, causes exactly the same damage per share, the only variable being the number of shares held and not the amount of damage per share … it is not necessary in the present case to conclude that the inconveniences vary. In fact, the inflated price per share is exactly the same in every case and, not only does the inflated price per share remain the same from one individual to another, but the fault causing the inflated price, if proven, is exactly the same for each individual in the group described … The key issue is not finding out whether or not an individual has been duped, but rather if the public, as a whole, (the market) was duped by public information that influenced the price on the stock market.[62]

The decision of the Quebec Superior Court to certify the class action was appealed to the Supreme Court of Canada and on 5 March 2009, the Supreme Court refused leave to appeal.[63] In the meantime however there has been considerable legislative development in Canada which I will now discuss.

57 (2001) 15 CPR (4th) 289.

58 Quebec may be an exception to this. In *Yves Beaudoin et al. v. Avantage Link Inc.et al*, [2002] JQ No 4575 (Que SC) a plaintiff class was certified which was not limited to those who had relied upon a misleading press release.

59 *Mondor v Fisherman*, (2001) 15 CPR (4th) 289 [65]–[69].

60 *Nguyen v CP Ships Ltd*, 2008 QCCS 3817.

61 Ibid [6].

62 Ibid [34], [35], [37].

63 *CP Ships Limited, Raymond Miles, Frank Halliwell and Ian Webber v Anh D Nguyen and Charline Duguay*, 2009 SCC. Canadian Legal Information Institute ('CanLII') <http://www.canlii.org/en/ca/scc-l/doc/2009/2009canlii8843/2009canlii8843.html> at 5 September 2009.

B Presumed Reliance Under Canadian Legislation

1 *Prospectuses and Takeover Circulars*

Ontario was the first Canadian province to introduce a form of statutory presumed causation. Section 130 of the *Securities Act*[64] of Ontario enacted in 1990 provided that purchasers who purchased a security offered under a prospectus containing a misrepresentation during the period of distribution 'shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase.' Similarly, section 131 provided that, where a takeover bid circular sent to security holders contained a misrepresentation, every such security holder 'shall be deemed to have relied on the misrepresentation' and may elect to exercise a right of action for rescission or damages against persons specified in the section.[65]

The presumption appeared to have assisted the certification of a securities class action in relation to an Offering Circular in the case of *Maxwell v MLG Ventures Ltd.*[66] In that case, the defendant corporation made an offer in an issuer bid (share buyback) to purchase all outstanding shares of Maple Leaf Gardens Ltd. As required under the Ontario *Securities Act*, Maple Leaf Gardens Ltd included an information circular with the distribution of its issuer bid. The class action was commenced on the basis of misrepresentations in the information circular. The deemed reliance provision of section 131 of the *Securities Act* saw the plaintiffs easily overcome the common hurdle to class action certification.

In the more recent decision of *Kerr v Danier Leather Inc* ('*Danier*')[67] however, despite the benefit of deemed reliance under section 131, the Ontario Court of Appeal raised a number of other hurdles for securities class actions. The case involved an initial public offering through a prospectus, which contained a forecast of Danier's projected results for the fourth quarter. Meanwhile, an internal company analysis was prepared before the public offering closed, which showed that Danier's fourth quarter results were lagging behind its forecast. The trial judge found that the prospectus impliedly represented that the forecast was objectively reasonable, both on the date the prospectus was filed and on the date the public offering closed, and that the poor fourth quarter results were material facts required by section 130(1) to be disclosed before closing. On appeal however, the Court of Appeal found that only material changes needed to be disclosed and that these were not material changes.[68] An appeal to the Supreme

64 RSO 1990, c S.5.

65 As can be seen, the sections focus on 'misrepresentation' (as opposed to the Australian 'misleading or deceptive' representation or conduct). Misrepresentation is defined under the interpretation section contained in s 1(1) of the Ontario *Securities Act* to mean '(a) an untrue statement of material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made; ('présentation inexacte des faits')': see *Securities Act*, RSO 1990, c. S.5, s 1(1).

66 (1995) 7 CCLS 155 (Ont Gen Div).

67 [2007] 3 SCR 331.

68 A 'material change' is defined as 'a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer': see *Securities Act,* RSO 1990, c. S.5, s 1(1).

Court of Canada by the investors was dismissed. The decision thus represented a softer standard for forward looking statements.

It has been suggested that the effect of the *Danier* decision, combined with various new procedural hurdles and modifications (see below), will, despite the benefit of presumed reliance, lead to less rather than more securities class actions in Canada.[69]

2 *Extension to Other Misrepresentations and Continuous Disclosure*

In 2002, further amendments were made to the Ontario *Securities Act*.[70] These included certain changes to the wording of sections 130 and 131,[71] as well as the introduction of section 138.3, which extends presumed reliance further. Sections 138.3(1) and (2) of the Act give persons or companies who acquire or dispose of shares during the currency of a misrepresentation a right of action for damages against various people 'without regard to whether the person or company relied on the misrepresentation'. The range of people against whom damages can be claimed include the issuer company, its officers, influential persons who influence the company in making the misrepresentation and experts. Similar provisions apply to statements made by influential persons or their agents (for which the company may also be liable if it permitted or acquiesced in these) (section 138.3(3)) and failures by the company to make timely disclosure (section 138.3(4)).[72] In the last case, the presumption allows persons or companies to sue 'without regard to whether the person or company relied on the responsible issuer having complied with its disclosure requirements'.[73]

The legislation distinguishes between 'core documents' on the one hand and non-core documents and verbal statements on the other. The former include a prospectus and circulars in relation to take-over bids, issuer bids (buybacks) or rights offerings, management analysis, annual information form, information circular, annual or interim financial statements.[74] In core documents, liability is

69 Erik S Knutsen, *Closing the Gate on Ontario Securities Class Actions* (2006) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1164262> at 5 September 2009. See also Deborah A Glendinning and Bruce Blain, 'Securities Class Actions: Likely Not the Next Wave' (Paper presented at 13th Queen's Annual Business Law Symposium, Kingston Ontario, 29 September 2006).

70 Bill 198, *An Act to implement Budget measures and other initiatives of the Government*, 3d Sess., 37th Leg., Ontario 2002 (assented to on 9 December 2002).

71 The changes bring the wording into alignment with the newly added sections in section 138.3. Thus the relevant presumed reliance provisions provide that where a prospectus or offering circular contain a misrepresentation, a purchaser who purchases a security offered by the prospectus or offering circular during the period of distribution to the public has, 'without regard to whether the purchaser relied on the misrepresentation', a right of action for damages against various persons set out in the legislation.

72 The 'timely disclosure' provision is in addition to but perhaps overlaps with the older Continuous Disclosure provision in s 75(1) of that Act which provides that 'where a material change occurs in the affairs of a reporting issuer, it shall forthwith issue and file a news release authorised by a senior officer disclosing the nature and substance of the change.': *Securities Act*, RSO 1990, c. S.5, s 75(1); 1994, c 11, s 349.

73 *Securities Act*, RSO 1990, c. S.5, s 138.3(4).

74 *Securities Act*, RSO 1990, c. S.5, s 138.1.

imposed unless a due diligence defence is established.[75] In non-core documents, a plaintiff will need to show knowledge of falsity or gross misconduct.[76] There is also a defence if the defendant can prove that the plaintiff knew of the falsity of a representation.[77] It has been observed that the latter may open up the possibility of individual reliance issues being raised at the certification stage to so as to defeat the common issue requirements for certification.[78] Others have suggested that the provisions do not provide opportunities to rebut presumptions of reliance but are merely a means of ensuring that plaintiffs who are aware of misrepresentations cannot capitalise on errors or omissions (intentional or otherwise) in disclosure.[79]

One of the rationales for removing the reliance requirement in the Ottawa statute appears, ironically enough, to have been to move the focus away from compensation of investors to deterrence of securities non-disclosure.[80] The law arose from a lengthy process of reports and consultation beginning with the Allen Committee, set up by the Toronto Stock Exchange in 1994, to examine the issue of corporate disclosure (which issued an interim report in 1995[81] and a final report in March, 1997[82]), draft legislation and amended draft legislation promoted by the Canadian Securities Administrators ('CSA')[83] released in May 1998 and 2000[84] respectively and the Report of the Five Year Review Committee (the 'Crawford Report') in 2002.[85] The latter Committee endorsed the CSA proposal to create a statutory civil liability regime for continuous disclosure, urging the Government of Ontario to adopt a regime as contemplated in the CSA draft legislation.[86] The re-drafted legislative scheme released in 2000 had been described by the CSA as 'a specific and comprehensive code', in contrast with

---

75 Such as proof of the undertaking of reasonable investigations: *Securities Act*, RSO 1990, c. S.5, s 138.4(6).

76 *Securities Act*, RSO 1990, c. S.5, s 138.4.

77 *Securities Act*, RSO 1990, c. S.5, s 138.4(5).

78 Glendinning and Blain, above n 69, 131.

79 Thomas G Heintzman and Katherine Hensel, 'Civil Liability in the Secondary Market' (Paper presented at the Law Society of Upper Canada Conference, *Bill 198: Dealing with Ontario's Proposed New Securities Law Regime*, Toronto, 19 March 2003) 13. The writers suggest that the intent is to deter plaintiffs motivated by the 'strategic reasons' as 'strategic suits' would not further the deterrent and regulatory purposes of the legislation.

80 See generally Heintzman and Hensel, ibid.

81 Toronto Stock Exchange Committee on Corporate Disclosure, *Toward Improved Disclosure: A Search for Balance in Corporate Disclosure. Interim Report of the Committee on Corporate Disclosure*, 1 December 1995 ('Allen Report 1995').

82 Toronto Stock Exchange, *Responsible Corporate Disclosure: A Search for Balance: Final Report of the Committee on Corporate Disclosure,* March, 1997 ('Allen Report 1997').

83 An association of the 13 Canadian provincial and territorial securities regulators.

84 Canadian Securities Administrators ('CSA'), 'Notice 53-302: Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change"' (2000) 23 *Ontario Securities Commission Bulletin* 1 < http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/csa_20001103_53-302.pdf> at 5 September 2009.

85 Five Year Committee, Parliament of Ontario, *Draft Report: Reviewing the Securities Act (Ontario)* (2002) (the 'Crawford Report').

86 Ibid 75–6.

the US Rule 10b-5, which it described as a 'general anti-fraud rule from which US courts have implied a right of action and which has evolved and been variously interpreted by US courts over the past several decades.'[87] In October 2002, the Government of Ontario accepted that recommendation and announced that it would be introducing legislation imposing civil liability on issuers and key related persons for misrepresentations or failures to make timely disclosure.[88]

The Allen Committee had concluded that, where the objectives of deterrence and compensation conflict, deterrence should be the paramount objective:

> Faced with the task of designing recommendations from the perspective of strengthening deterrence or compensating injured investors, the Committee has adopted deterrence as its primary goal. It has done so in the belief that, logically, effective deterrence will reduce the need for investor compensation.[89]

The CSA also adopted the Allen Committee's preference for deterrence over compensation in its draft legislation, noting that it was the company that ultimately bore the cost of providing compensation.[90]

Heintzman and Hensel[91] comment that the emphasis on deterrence over compensation distinguishes the statutory framework for liability from common law remedies. It is said to focus the courts' assessment of liability exclusively on the conduct of the defendants rather than the causal relationship between the harm suffered by the plaintiff and conduct of the defendant, and therefore eliminates the requirement that plaintiffs prove reliance.[92] The new laws also placed a cap on damages for unknowing conduct (as discussed further below),[93] and those writers argued that this therefore partly rejects the compensatory model adopted in tort law.[94] They conclude that, instead of providing a recourse for plaintiffs to right a wrong done in the context of a private relationship, the civil liability provisions provide a tool for private citizens to participate in securities enforcement.[95]

As has been seen, the removal of reliance partly replicates the 1990 prospectus provisions. The Allen Committee had noted in 1997 that:

---

87 CSA, above n 84, 8.

88 Ontario Ministry of Finance, 'Eves Government Announces Measures to Protect Public Confidence' (News Release, 30 October 2002) < http://ogov.newswire.ca/ontario/GPOE/2002/12/09/c1454.html?lmatch=&lang=_e.html> at 6 September 2009.

89 Allen Report 1997, above n 82, 6.

90 CSA , above n 84, 8.

91 Heintzman and Hensel, above n 79.

92 Ibid. They state further 'If the purpose of the remedy is to address and deter the defendant's conduct, rather than making the plaintiff whole, then a remedy may well ignore causation and reliance. Hence, it is the defendant's conduct and only that conduct, rather than the plaintiff's reliance on the conduct, that gives rise to the cause of action under the proposed s. 138.3.'

93 *Securities Act*, RSO 1990, c S.5, ss 138.1, 138.7.

94 Whether this distinguishes the laws from Australia's misleading and deceptive conduct and continuous disclosure laws is arguable. While both these laws do not require intention, actions against directors who are 'knowingly concerned' do require some element of knowledge. See *Yorke v Lucas* (1985) 158 CLR 661.

95 Heintzman and Hensel, above n 79, 8.

> The practical difficulties in bringing an action for deceit or negligent misrepresentation mean that there is no effective remedy for most investors who suffer losses resulting from misleading continuous disclosure.[96]

It therefore recommended that any secondary market civil liability regime should remove the requirement that plaintiffs prove reliance and instead recommended that the draft legislation 'deem' reliance. The Committee noted that, while reliance would be deemed, defendants could avoid liability by proving that the plaintiffs knew of the misrepresentation.[97] The CSA did adopt 'deeming' language in its 1998 draft legislation.[98] However, public responses to the 1998 CSA draft included a comment that 'deemed reliance' imposed a firmer presumption than the rebuttable presumption of reliance imposed in US under the 'fraud on the market' theory.[99] There was some debate as to whether 'deemed' reliance imposed a conclusive presumption or a rebuttable presumption,[100] and perhaps in order to avoid this debate[101] the 'deeming' language was, between the 1998 and 2000 CSA drafts, replaced with the arguably stronger language of 'without regard to whether the person or company relied' (on the misrepresentation or failure to make timely disclosure).[102]

In adopting this language, it has been argued that the new provisions do not actually 'deem' plaintiffs' reliance but, rather, make reliance irrelevant.[103] In using language that excludes considerations of reliance, the new provisions are argued to go further than either the 'fraud on the market' theory, section 130 of the *Securities Act*, or the Allen Report's recommendations in removing reliance as an obstacle for plaintiffs.[104]

Other Canadian provinces have followed Ontario's lead and introduced similar presumed reliance provisions in relation to what is described as 'primary market' disclosure (essentially the main, or core documents sent to share acquirers such as prospectuses). More recently, they have adopted presumed reliance in relation to 'secondary market disclosure' including information that should have been disclosed pursuant to continuous disclosure requirements.[105]

---

96 Allen Report 1997, above n 82, 12.

97 Ibid.

98 CSA, 'Proposal for a Statutory Civil Remedy for Investors in the Secondary Market' (May 1998) ss 2(1), (2).

99 CSA, above n 84, 28.

100 The issue of onus of proof in the case of negligent misrepresentation was discussed by Sopinka J of the Canadian Supreme Court in *Rainbow Industrial Caterers v Canadian National Railway* [1991] 3 SCR 3.

101 Heintzman and Hensel, above n 79, 10.

102 CSA, above n 84, 28.

103 Heintzman and Hensel, above n 79, 13.

104 Ibid.

105 Alberta *Securities Act*, RSA 2000, c. S.4, s 203(1) (prospectus), s 204(1) (offering memorandum), s 205(1) (circular), s 211.03 (secondary market disclosure); Quebec *Securities Act*, RSQ c V-1.1 s 225.0.2 (takeover or issuer documents) s 225.12 (secondary market disclosure); British Columbia *Securities Act*, RSBC 1996, c 418 s 131 (prospectus), s 132 (circular or notice), s 132.1 (prescribed disclosure document), s 140.3 (secondary market disclosure). The amendments establishing presumed reliance in relation to continuous disclosure became effective from 31 December 2006 in Alberta, 9 November 2007 in Quebec, and 4 July 2008 in British Columbia.

These legislative changes were seen by some as opening the door to securities class actions in Canada and there has been a rise in the number of securities class actions filed in Canada to 2008.[106] On the other hand, some commentators have argued that despite the introduction of presumed reliance, other provisions enacted at the same time create significant procedural hurdles to the commencement of a securities class action.[107] Ontario's laws are the template for the legislation in most of the other provinces[108] and these include threshold requirements of establishing both 'good faith' and 'substantive merits'.[109] This requires that the plaintiff produce evidence to satisfy the court of such good faith and of a reasonable possibility that the action will be resolved at trial in favour of the plaintiff (and that such evidence be produced before the plaintiff has had the benefit of obtaining discovery of documents from the defendants). This is in addition to the threshold hurdles for certification of the class under class action legislation.[110]

3 *Loss Calculation*

Complementing statutory causation under the Canadian laws are statutory formulas to calculate loss. These are necessary because a presumption of reliance can create some uncertainty where there are various types of loss, as it may not be clear which loss is presumed to be caused by the misrepresentation or non-disclosure. Section 138.5 of the Ontario legislation calculates damages based on the premise that there is a public correction of a misrepresentation or a disclosure of a previously undisclosed material change. In that case, damages will be calculated according to whether and when the shares were disposed of. In general terms[111] the formulae are as follows:

(a) If the shareholder disposes of the shares within 10 days of the correction or disclosure, then damages will be the difference between the price paid for the shares and the price received upon the disposition.

(b) If the shareholder disposes of the shares 10 days or more after the correction or disclosure, then damages will be the lesser of (i) the difference between the price paid for the securities and the price received upon the disposition or (ii) the difference between the price paid for the

106 Nine such actions were filed in 2008, with four filings in each of the years 2004 through 2007. There were two filings in each of 2002 and 2001 and one filing in 2000. See Mark L Berenblut, Bradley A Heys and Svetlana Starykh, *Trends in Canadian Securities Class Actions: 1997–2008 Canada Strikes Its Own Course – Class Action Filings on the Rise* (Paper produced for National Economic Research Associates ('NERA') Consulting, January 2009) 4.

107 Knutsen, above n 69. See also Glendinning and Blain, above n 69.

108 Quebec's legislation is somewhat different.

109 *Securities Act*, RSO 1990, c. S.5, s 138.8(1).

110 *Class Proceedings Act*, SO 1992, c.6, s 5. These relate to showing common issues, an identifiable class, that the class proceeding is the preferable procedure and that the plaintiff adequately represents the class. See Peter Cashman, *Class Action Law and Practice* (2007) 645.

111 The formulae include in the 'price paid' any commissions paid in respect thereof and do not deduct any commissions paid in respect of the 'price received'. The 'price received' is also calculated taking into account the result of hedging or other risk limitation transactions.

securities and the published market price of the shares for the 10 trading days following the public correction or disclosure (or if there is no published market price then an amount that the court considers just).

(c) If the shareholder has not disposed of the shares, then damages will be the difference between the price paid for the securities and the published market price of the shares for the 10 trading days following the public correction or disclosure (or if there is no published market price then an amount that the court considers just).[112]

The new laws also cap damages payable by the issuer company at the greater of five per cent of the issuer's market capitalisation or $1 million. The caps will not apply where a person made a misrepresentation or non-disclosure with knowledge that it was a misrepresentation or non-disclosure (which may raise some interesting questions about corporate intent and the directing mind and will doctrine).[113] If a non-disclosure relates to a heavily traded stock and covers a long period, there is clearly potential for an extremely large claim. Claims of a certain magnitude may even therefore threaten the financial viability of a corporation.[114] This appears to be the rationale behind the damages cap.[115]

The damages calculation is effectively based on a rebuttable presumption that the misrepresentation or non-disclosure caused the change in market price. Section 138.5(3) makes it clear, however, that this can be rebutted in that assessed damages will not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the misrepresentation or non-disclosure. This effectively clarifies the reverse onus nature of the proof. It would presumably enable a defendant to adduce evidence that changes in price related to market sentiment or other factors. It is not clear, however, if this provision would allow a defendant to argue that a particular

112 The provisions are somewhat similar to, though arguably less sophisticated than the US '90-day rule', under which damages awards are calculated as the difference in price based on a 90-day average price after corrective information is released to the market. See *Private Securities Litigation Reform Act*, tit I, 15 USC §78u-4(e) (1995).

113 *Securities Act*, RSO 1990, c. S.5, ss 138.5, 138.6, 138.7. There are also various other caps in s 138.1 for directors, influential persons and experts.

114 The view was that for the system to have deterrent value damage exposure must be sufficient to make it worthwhile for the plaintiff to undertake an action but on the other hand reflect an issuers ability to pay and recognise that it is non plaintiff shareholders who ultimately bear the economic burden of providing compensation: CSA, above n 83, 7. Heintzman and Hensel comment that 'This exemption may reflect the drafters' impulse not to penalise non plaintiff shareholders of the responsible issuer with an award of damages that would render their shares worthless.': Heintzman and Hensel, above n 79, 20.

115 What would be the practical effects of such a damages cap in Australia? The two largest payouts in securities class actions to date appear to be the $112 million settlement in the GIO action (*King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980 (Unreported, Moore J, 17 September 2003) and the $144.5 million settlement in the Aristocrat action (*Dorajay Pty Ltd v Aristocrat Leisure Limited* (2008) 67 ACSR 569. The GIO payout equates to roughly just under one cent of AMP's current market capitalisation of some $12 billion (though the case was originally brought against the smaller GIO Australia Holdings Ltd, which only later became a wholly owned subsidiary of the larger AMP). The Aristocrat payout is more significant, coming to some six per cent of Aristocrat's current market capitalisation of some $2.4 billion. For market capitalisations figures, see Australian Securities Exchange <http://www.asx.com.au> at 6 September 2009.

market was not liquid or efficient,[116] as efficiency appears to be an assumption underlying the section itself.

Interestingly, the laws do not contemplate claims by those who sell at undervalue during the currency of non-disclosure of positive news.

The provisions also allow for the possibility that multiple representations which have a common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation.[117] Further, in line with the trend in civil liability worldwide, they include proportionate liability allowing respective liability amongst the various defendants to be apportioned, which can limit the liability of individual defendants.[118]

As can be seen, the Canadian provisions have some complexity but tend generally to follow the concepts developed by the US courts in *Basic*. They also tend to illustrate the tendency of democratic legislatures to provide something for all constituencies in matching provisions facilitating claims, with other provisions setting new hurdles and providing due diligence defences.[119]

VI DOES AUSTRALIA NEED A CANADIAN STYLE STATUTORY PRESUMPTION OF CAUSATION?

The writer has argued elsewhere that a presumption of reliance in accordance with the US 'fraud on the market' theory has utility in several ways.[120] These are, that it:

- is generally supportive of a philosophy of full disclosure in securities markets;
- facilitates civil recovery for investors;
- solves certain conceptual difficulties in establishing reliance on non-disclosures;
- provides a causal link between unlawful conduct and the mispricing of securities;
- creates a deterrent to non-disclosure by increasing the civil liability consequences; and
- goes beyond reliance and embraces the economic effects (including misallocation of resources) of non-disclosure on the market as a whole.

---

116 Which is one of the matters a plaintiff must prove under the *Basic* formula.

117 *Securities Act,* RSO 1990, c.S.5, s 138.3(6). This is another problem identified by the decision in *Guglielmin v Trescowthick* (2005) 220 ALR 515. It has been partly dealt with in Australia in practice through the pleading of 'implied representations'. See Duffy, above n 8, 648.

118 *Securities Act*, RSO 1990, c. S.5, s 138.6. As to proportionate liability in general, see Barbara McDonald, 'Proportionate Liability in Australia: The Devil in the Detail' (2005) 26 *Australian Bar Review* 29, 33.

119 This tendency seems to have been implicit in the brief to CAMAC. Insofar as it was to consider reversing *Sons of Gwalia* to the detriment of some shareholders, it was asked to consider offsetting this with measures to assist shareholders (such as presumed causation).

120 Duffy, above n 8, 643.

Presumed causation under the Canadian provisions appears to incorporate many of the implicit assumptions of the 'fraud on the market' theory. The formula for calculation of the damages appears to accept the validity of the ECMH in the sense that, it is assumed that a misleading statement or non-disclosure has fed into the market price, and that, likewise, a corrective disclosure will also feed into the market price.[121] The effect of section 138.5(3), however, is that a defendant may attempt to remove the effect of other factors that might be affecting price, such as general market or industry sentiment, changed economic circumstances or indeed other firm specific disclosures. This would likely require expert evidence, which has traditionally taken the form of 'event' studies. These are statistical analyses that isolate the effects of an event on a security's price and measure the likelihood that the effect could have been due to the normal random fluctuations of the security's price, as opposed to being due to a particular event.[122]

Though it is a defence under the Canadian provisions if the defendant can prove that the plaintiff knew of the falsity of a representation, it is not clear that a rebuttal of presumed causation is available in all cases where there is other evidence that severs the link between the misrepresentation and the stock price.[123] In the US, such evidence has included evidence that (1) the stock market price was not 'actually affected' by the alleged fraud; (2) plaintiffs would have purchased the stock even with knowledge of the non-disclosure; or (3) plaintiffs actually knew the information that had not been publicly disclosed.[124] Whilst it is possible that the defences in section 138.5(3) cover the first situation and that section 138.4(5) covers the second and third situation, this is not completely clear.

In Australia, the 'fraud on the market' presumption has also been criticised as being inappropriate when applied to certain sophisticated investors, such as day traders, arbitrageurs who hedge their positions (with opposing type trades) and certain types of speculators.[125] It is asserted that many of these investors do not rely on the market price as reflecting underlying value (and in fact theorise that the underlying value – or perhaps the future value – is at variance with the market price). Though the point has some merit, such an argument, applied *in extremis*, might suggest that hardly anyone relies on the market price, as most investors buy in the expectation of a rise in the market price that will lead them to

121 The CSA note that the 2000 draft legislation effectively creates a presumption of causation if the market price following the correction of the representation is different from the market price at the time the representation was made (or the time at which the disclosure should have been made in the case of an omission). CSA, above n 84, 9.

122 A Craig Mackinlay, 'Event Studies in Economics and Finance' (1997) 35 *Journal of Economic Literature* 13, 13. Referred to in Frederick C Dunbar and Dana Heller, 'Fraud on the Market Meets Behavioural Finance' (2006) 31 *Delaware Journal of Corporate Law* 455, 468. See also Peirson et al, above n 13, 512.

123 Which under *Basic* will rebut the presumption. See *Basic*, 485 US 224, 248 (1988).

124 See *Fine v American Solar King Corp*, 919 F 2d 290, 299 (5th Cir, 1990).

125 Ashley Black, 'Commentary' in the Hon Justice K E Lindgren (ed), *Investor Class Actions* (Ross Parsons Centre of Commercial, Corporate and Taxation Law (2009) 105–6.

make a profit (or in the case of short selling, a fall in the market price). The question may be, however, whether investors are betting that stocks are *currently* mispriced or that *future* events will move in their favour.[126]

Lastly, the 'fraud on the market' theory has suffered from increased reservations about the ECMH itself. One of the main challenges to the ECMH in recent years has been developments in the theory of behavioural finance. Behavioural finance tends to be informed by the observation that financial markets are dominated by human beings rather than logical computer programs and that this makes a difference to the way they operate.[127] Whilst the ECMH suggests that stock prices accurately price business value (because all public information is impounded into the stock price), behavioural finance challenges this assertion by suggesting that the actors who are supposed to perform the function of transmitting information into the stock price may not behave completely rationally, may not accurately perceive underlying business values and may thus produce prices that do not reflect those values. Instead, investor sentiment rather than rational economic calculation plays a large part in price formation.[128]

Some examples of such deviation from rationality include both overconfidence – said to be a failing of experts even more so than of inexperienced investors[129] – and overreaction – where markets react quickly but excessively to unexpected new or sudden information[130] (but also under-react where there is accumulating but undramatic evidence).[131] Other factors at work include 'noise' – said to include hype, inaccurate ideas, inaccurate data or information that hasn't arrived yet[132] – and rational bubbles. When the latter occur, rational traders can create a price that does not reflect the underlying value of the company because it is rational to overpay for stock where the trader believes that she can recoup the overpayment by selling on to someone else at an even greater price.[133] In a bubble, irrational behaviour is not corrected by the contrary behaviour of rational investors because it is too risky for the rational

126 It has been argued that a stock price is not a current underlying value but is an unbiased estimate of future value: James H Lorie and Mary T Hamilton, *The Stock Market: Theories and Evidence* (1973) 72. The argument leads to some uncertainty however as there will be an almost infinite number of future values depending upon the extent of the future time horizon the investor uses.

127 Richard H Thaler (ed), *Advances in Behavioural Finance* (1993) xv.

128 Lawrence A Cunningham, 'Behavioural Finance and Investor Governance' (2002) 59 *Washington and Lee Law Review* 767, 769.

129 Marc Albert and Howard Raiffa, 'A Progress Report on the Training of Probability Assessors' in Daniel Kaheneman, Paul Slovic and Amos Tversky (eds), *Judgment under Uncertainty: Heuristics and Biases* (1982) 294. Referred to in Dunbar and Heller, above n 122, 490.

130 Werner F M De Bondt and Richard H Thaler, 'Does the Stock Market Overreact?' in Thaler (ed), above n 127, 263.

131 Entcho Raykovski, 'Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market? (2004) 30 *Monash University Law Review* 269, 272.

132 Fisher Black, 'Noise' in Thaler (ed), above n 127.

133 Olivier J Blanchard and Mark W Watson, 'Bubbles, Rational Expectations and Financial Markets' (Working Paper No 945, National Bureau of Economic Research, 1982). Referred to in Dunbar and Heller, above n 122, 491.

investor to take a contrary position, as it is too uncertain when the irrational state of the market will be corrected. Thus, in the words of John Maynard Keynes, 'there is nothing so disastrous as a rational investment policy in an irrational world.'[134]

Where these behavioural forces come into play, it is said that the stock price will not reflect the fundamental value of the company, and in that sense, the ECMH will not hold true. The debate about the ECMH does however tend to suffer from undue polarisation. Whilst some claims to perfect efficiency of securities markets and strong form efficiency (where prices are even claimed to reflect all non public information) can be fanciful, the existence of behavioural and other factors does not preclude the general tendency of markets to continually move price levels towards underlying values.[135] In any event, in *Basic*, the court found that the 'fraud on the market' theory could only be invoked if efficiency of the market was first established and this may be a useful requirement for any statutory scheme (this may entail the use of expert evidence).[136]

VII CONCLUSION

CAMAC has raised the question of whether Australia needs a statutory presumption of causation to assist shareholders recover in cases of misleading and deceptive conduct or non-disclosure. Australia already has a number of specific provisions facilitating recovery for non-disclosure in the case of prospectuses and takeover documents, though these still essentially require proof of causation of loss. Commencing in 1990, with Ontario leading the way, a number of the Canadian provinces have implemented detailed statutory regimes for investor recovery which essentially incorporate the assumption that misleading and non-disclosures feed into share prices and cause investors to purchase shares at potentially inflated prices. This presumption, which is similar to the US 'fraud on the market' theory, is rebuttable where it can be shown that other factors caused the share price change.

The Canadian legislation also includes various other threshold and other requirements for investor claims, due diligence defences for persons sued and damages caps, and in that sense has not been universally seen as a fillip for shareholder claims. In Australia it is still unclear whether a statutory presumption would provide a new benefit to investors or whether causation through the effect

---

134 Donald C Langevoort, 'Taming the Animal Spirits of the Stock Markets: A Behavioural Approach to Securities Regulation' (2002) 97 *Northwestern University Law Review* 135, 148.

135 So that efficiency theory still provides useful insights into price behaviour. See Peirson et al, above n 13.

136 The case approved the formulation of the Court of Appeals that, in order to invoke the presumption, a plaintiff must allege and prove that: (a) the defendant made public misrepresentations; (b) the misrepresentations were material; (c) the shares were traded on an efficient market; (d) the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (e) the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. See *Basic*, 485 US 224, 248 (1988).

of non-disclosures on the market can be established under existing principles of causation (particularly case law interpreting the *Trade Practices Act 1974* (Cth)). On the other hand there is undoubtedly some uncertainty about the law in this area and legislative intervention would clarify this. Certainly, recent challenges to such a theory of causation based upon questioning of the ECMH do not appear likely to fundamentally confound such an approach. The ECMH, despite its limitations, still appears to provide a fundamental insight into the way information tends to be reflected in price in relatively liquid securities markets.