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RELIANCE BY SHAREHOLDER INVESTORS ON MISREPRESENTATIONS IN FINANCIAL STATEMENTS

Caason Investments Pty Ltd v Cao [2014] FCAFC 94 – Reasons for Judgment

On 3 September 2015, the Full Federal Court published its reasons for judgment in allowing an appeal in a securities class action, *Caason Investments Pty Ltd & Anor v Simon Cao & Others* NSD 269 of 2015 ("*Caason*").

The appeal enables the applicants to plead market-based causation for claims for misstatements and omissions in an IPO and short form prospectus, as well as for misleading and deceptive conduct claims in respect of various audited financial statements issued by the company Arasor International Limited.

This means that the Applicants will not have to prove that they individually and directly relied on the contravening conduct. Instead, the claims will now include allegations that the representations formed part of the matrix of information available to investors in Arasor shares, and that investors purchased Arasor shares at an inflated price, regardless of whether or not they read the prospectuses. The price was inflated because the market was not aware of the falsity of the representations made, or the undisclosed material, which had it been known would have led to the market trading lower on the different information.

Background

Caason is a representative proceeding brought by the applicants on behalf of themselves and group members who acquired shares in Arasor International Ltd between 11 October 2006 and 12 May 2008.

The application for leave to appeal arose from the refusal of the primary judge to grant leave to amend the statement of claim so as to include pleadings of "market-based" causation, as distinct from "reliance-based" causation in the context of a claim based on s.729 of the Corporations Act 2001 (Cth) ("Corporations Act").

Section 729 of the Corporations Act provides a cause of action for any contravention of s.728(1) which prohibits offering securities under a disclosure document that contains a misleading or deceptive statement, or certain omissions.

It was the applicants' main issue of substance that, as a matter of principle, the primary judge erred in rejecting the proposed pleading amendments on the basis that the primary judge considered that reliance was a necessary element of the cause of action under s.729 of the Corporations Act and therefore necessary to be pleaded. That is to say that to successfully claim damages under s.729 in respect of a disclosure document contravening s.728, proof of reliance on that document is necessary.

As this was a pleading dispute, the relevant test was whether the applicants' contentions as to causation were arguable, and not whether those contentions would be ultimately vindicated as a correct application of principle in this case. The majority considered that the issue as to whether the applicants' contentions as to causation were arguable was a point of importance, and that both aspects of the test in *Decor Corporation Pty Ltd v Dart Industries Inc* (1991) 33 FCR 397 (being whether the decision is attended with sufficient doubt, and whether substantial justice would result if leave were refused, supporting the decision to be wrong) were made out.

Although there was some uncertainty as to whether the primary judge's reasons did in fact amount to a refusal to amend, the majority (Gilmour and Foster JJ) proceeded on the basis that the orders made by the primary judge had the effect of shutting out the applicants from pleading market-based causation and it was with respect to those orders that the current appeal was made.

Tests for Causation

The respondents submitted that comments made in three cases stood in the way of the applicants contending for market-based causation. Those cases were *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd* (2008) 73 NSWLR 653; *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 and *Woodcroft-Brown v Timbercorp Securities Ltd* (2013) 96 ACSR 307.

The majority found that none of those cases supported a submission that the applicants' causation case was unarguable. The majority distinguished the cases of *Gardiner* and *Woodcroft-Brown* on the basis that they did not deal with market-based causation issues, and also factually distinguished the Ingot decision on the basis that in that case, the plaintiff sought to recover loss or damage even though he knew the truth of the material misstatement or omission and was indifferent. In *Ingot*, the Court emphasized the distinction between where the plaintiff was a passive victim of misleading conduct and where the plaintiff acts or refrains from acting to his or her prejudice, whose conduct was brought about by the defendant's misleading conduct.

Other Decisions

Further, whilst the majority acknowledged that there was no relevant High Court or any intermediate Court of Appeal decision on point, the majority referred to single judge decisions which demonstrated that the applicants' market-based causation case was neither "futile" nor likely to be struck out. They included *Bolito v Banksia Securities Ltd* [2014] VSC 8 and C*amping Warehouse Australia Pty Ltd v Downer EDI Ltd* [2014] VSC 357, which concerned similar amendment applications which were allowed on the basis that they were not without a "reasonable prospect of success" nor were they "plainly hopeless or bound to fail". The majority also referred to the case of *Earglow Pty Ltd v Newcrest Mining Ltd* [2015] FCA 328 as implicit endorsement of a market-based causation claim being arguable.

The majority also agreed with the applicants' submission that the causal requirement in s.729(1) of the Corporations Act did not include a requirement of reliance by the applicants on a disclosure document. The majority noted that the text of the provision did not refer specifically to reliance and that, whilst reliance is a sufficient condition for establishing causation, it is not a necessary one.

Policy Considerations

In relation to policy considerations, the majority referred to the final judgment in *Grant-Taylor v Babcock & Brown Limited* (in liq) (2015) 104 ACSR 195 (delivered after the decision of the primary judge in Caason). Perram J noted (in obiter) that His Honour would likely have accepted that shareholders could recover damages or loss arising from buying shares at an inflated price caused by a listed company's failure to disclose information to the market. His Honour referred to s.674(2) of the Corporations Act requiring disclosure of price-sensitive information and noted that the provision assumed the existence of a price effect on the market in general. The majority noted that these policy considerations would be applicable in the context of a s.729 claim.

Profile Statement

The respondents submitted that reliance is an essential element of s.728 and s.729 because of the deeming provision in s.729(2) that someone who acquires securities as a result of an offer accompanied by a profile statement is taken to have done so in reliance on the profile statement and prospectus.

However, the majority accepted the applicants' submission that s.729(2), which relates to a type of "non-capital market offering where an acquirer relies on limited information", was not textual support that reliance is an essential element of the cause of action.

The majority also agreed with the applicants' submissions that the policy aim of Corporations Act Ch 6D of protecting potential investors would not be undermined by a market-based causation approach, that recognises the disclosure of material information is made to a market of potential investors, and that such information would objectively affect the acquisition decisions of persons who commonly invest in shares.

Minority Judgment of Edelman J

Edelman J disagreed with the majority's finding that the primary judge concluded that reliance on the disclosure document was an essential element in the cause of action pleaded. Edelman J found that the primary judge's reasons did not prevent the applicants from bringing a properly pleaded claim based on market-based causation, and for those reasons would have dismissed the appeal on the basis that there was no error shown in the primary judge's orders. Nonetheless, Edelman J also considered that it was at least arguable that reliance is not a required element of a claim for loss suffered under s.729(1) of the Corporations Act.

Conclusions

The Full Court's decision in *Caason* has important implications, particularly as the primary judge's decision in *Caason* saw strike-out applications being threatened in other securities class actions, such as in the *Oz Minerals*, *Treasury Wine Estates*, and *Melbourne City Investments* claims.

The reasons for judgment provides useful commentary on the potential scope of applying market-based causation claims in the context of establishing loss and damage in shareholder class actions and opens the door towards introducing a market-based causation approach into Australian law.

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