SUBMISSION TO CAMAC ON SHAREHOLDER CLAIMS AGAINST INSOLVENT COMPANIES AND IMPLICATIONS OF THE *SONS OF GWALIA* DECISION.

By Michael Duffy
Lecturer in Law
Monash University

SUMMARY

Primary submissions

a) **On balance there is no compelling case for legislative intervention following the *Sons of Gwalia* decision.**
b) **It is premature to decide whether presumed reliance analogous to a "fraud on the market" test should be introduced. It is necessary to see how the law develops in this area first. It may be that something analogous to presumed reliance (or at least causation) already exists under Australian law in situations where shares are purchased during the currency of a non disclosure.**

Summary of points in support of primary submission (a).

1. The *Sons of Gwalia* decision on its face does appear to impact somewhat adversely on unsecured trade creditors and unsecured debenture holders.
2. Such adverse effect however will be limited to the small number of cases where shareholders seek damages for misleading nondisclosure against a company in liquidation and the company is uninsured for such claims.
3. In many cases the company will be insured against such claims (eg through a professional indemnity policy that covers misleading or negligent advice) and in that situation creditors will not be adversely affected by the equal priority given to such claims by *Sons of Gwalia*. The legal theoretical justification for the subordination of such claims – maintenance of capital – will also not apply as the claims will not be met from shareholder capital but from a separate fund (insurance).
4. The various options for legislative intervention that appear in the Australian and United States literature – postponement, partial or selective postponement, tracing and discounting (see below) - are all potentially complex and confusing and likely to be onerous for liquidators. In many cases liquidators would need to investigate various substantive issues (which may overlap with issues in the shareholder proceedings themselves) and then refer matters to the court to seek guidance. This would have the effect of significantly increasing costs and delay in liquidations which would itself reduce returns for unsecured creditors.

Summary of points in support of primary submission (b)

1. The decision in *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd*,[1] suggests that s 82 of the *Trade Practices Act* allows a claim by a person who, although not himself misled by a representation, suffered injury as a direct result of a third party's reliance on the misleading or deceptive representation.
2. The case law on section 52 and section 82 of the *Trade Practices Act* has generally been persuasive in the interpretation of the cognate provisions of the *Corporations Act* and *ASIC Act* which were lifted from the *Trade Practices Act*.
3. It is arguable that, applied to the stock market, the *Janssen* decision suggests that a person could suffer loss through reliance by others (the market as a whole) on a misleading statement or a failure to correct a statement which has become inaccurate due to new developments.
4. These very points may well be determined in the upcoming decision of Justice Stone in the Federal Court in *Dorajay Pty Ltd v Aristocrat Leisure Ltd.*
5. Though it is not possible to make further submissions on this point until the law is clarified by this and any other future relevant decisions, to the extent that the outcome of these decisions raises a significant procedural barrier for investor claims then it may be appropriate at that point to revisit the question of deemed or presumed causation.

DETAILED SUBMISSION A

Background – Houldsworth and maintenance of capital

1. The pre *Sons of Gwalia* position is contained in the High Court's decision in *Webb Distributors (Aust) Pty. Ltd. v State of Victoria*[2] ("Webb"). That case had its origins partly in the House of Lords decision in *Houldsworth's Case.* The latter was summarised by Finkelstein J in *Re Media World Communications Ltd* [3]:

> *The rule which was established in Houldsworth's case (Houldsworth v City of Glasgow Bank and Liquidators (1880) 5 App Cas 317) is that a person who has subscribed for shares in a company may not, while he retains those shares (that is, if he has not renounced the contract by which he acquired those shares), recover damages against the company on the ground that he was induced to subscribe for those shares by fraud or misrepresentation.*

2. *Houldsworth* was decided in 1880, prior to both *Trevor v Whitworth*[4] in 1887 and *Saloman v Saloman & Co Ltd* in 1897.[5] *Trevor v Whitworth* is generally seen as the authority that established the rule that a company must maintain its

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[1] (1992) 37 FCR 526 ('*Janssen*').
[2] (1993) 179 CLR 15.
[3] (2005) 52 ACSR 346 at para 10
[4] (1887) 12 App Cas 409
[5] [1897] AC 22.

share capital for the protection of creditors. *Saloman v Saloman* firmly established the doctrine of the company as a separate legal entity.

3. The decision in *Trevor v Whitworth* was based on the idea that the capital of a limited liability company should be preserved for the benefit of creditors. Lord Watson stated in that case that:

> *Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.*[6]

4. Despite the rule in *Houldsworth* pre-dating *Trevor v Whitworth,* justification for the rule has been found in later cases in the capital maintenance doctrine. In *Soden and Another v. British & Commonwealth Holdings Plc and Others*[7] Lord Browne-Wilkinson, in the context of the obligation to pay calls on uncalled capital noted that if such a payment were not made the capital of the company would not be maintained and the general body of creditors would be thereby prejudiced. In *Media World* Finkelstein J stated in relation to the subordination of shareholder claims to creditor claims:

> *"The reasons for this subordination are the twin privileges of incorporation and limited liability. That is, if a member's liability is limited then the capital which he subscribes, or agrees to subscribe, to the company must be available for creditors".*[8]

5. Similarly in *Webb*[9] the maintenance of capital rule was relied upon by the majority in the High Court as one of two strands of authority supporting the *Houldsworth* approach (the other being the argument that a shareholder could not rescind a contract for purchase of shares once a winding up had begun).

6. This approach was also in accordance with the views of Professor LCB Gower who first criticised the *Houldsworth* decision as unsatisfactory in 1950[10] and later set out the view that the decision, though anomalous, may be explained by reference to the concept of a company's share capital as a "guarantee fund" for creditors. Gower suggested that this conception was at the basis of the rule that a shareholder who wishes to rescind must do so promptly since the existence of his shares may have led others to extend credit to the company.[11]

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6 (1887) 12 App Cas 409, at pp.423-424.
7 [1997] UKHL 41; [1998] AC 298; [1997] 4 All ER 353; [1997] 3 WLR 840.
8 52 ACSR 346 at para 8.
9 (1993) 179 CLR 15.
10 Gower, LCB "Notes of Cases" (1950) 13 *Modern Law Review* 362 at 367
11 Gower, LCB, Modern Company Law, 1st edition, Stevens & Sons London 1954 pp 63-64.

7. The maintenance of capital doctrine has however been criticised as defective for at least two reasons:[12] (1) there is no minimum capital requirement on registration of companies in Australia[13] - some companies are registered with a capital of only $2 (though admittedly these are generally only small proprietary companies)[14]; and (2) there is no guarantee that subscribed capital will remain – it can easily be reduced or eliminated in the course of trading.

8. In the High Court's decision in *Sons of Gwalia Ltd v Margaretic*[15] some doubt was cast upon the relevance of the doctrine of maintenance of capital in the modern era with Gleeson CJ noting.

> *Statutory manifestations of that principle have been modified over the years, and it may be doubted that it reflects the reality of modern commercial conditions, where assets and liabilities usually are more significant for creditors than paid-up capital.*[16]

9. Hayne J looked at the issue of maintenance of capital in relation to the associated issue of liability of the company to a transferee shareholder (someone who did not subscribe for the shares himself but obtained them from another shareholder) and noted in relation to the issue:

> *Maintenance of capital may be relevant to a shareholder's entitlement to recover from the company amounts that the shareholder subscribed as capital, but it has no direct relevance to the recovery from the company of damages for loss occasioned by the making of a contract to acquire existing shares in the company from a third party. It has no direct relevance to that second kind of case because the shareholder does not seek the return of what was subscribed as capital when the shares were allotted.*[17]

10. Gummow J[18] analysed the maintenance of capital issue from the perspective of the Gower view that paid up capital was a "guarantee fund" for creditors. He found that there was much to be said for the view that a company satisfying its liability in tort to a member should not be characterised as attempting an unauthorised reduction of capital. He noted that Section 13 of the *Limited Liability Act 1855* (UK) had provided that a company should be wound up once three quarters of its subscribed capital stock had been lost but that after the 1862 *UK [Companies] Act* that there was no impediment to a company carrying on business even once it had exhausted its original capital through trading. The award of damages was not charged upon any fund representing capital and though large awards may adversely affect the market value of

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12 Austin and Ramsay, *Ford's Principles of Corporations Law* 13th Edition paragraphs 20.160 and 24.360

13 It is noted that with the initial introduction of limited liability in England in 1855 there were initially minimum capital requirements necessitating a minimum of 20 shareholders each holding £10 shares paid up to at least 20 per cent. See Davies, Paul. *Gower's Principles of Modern Company Law,* Sixth Edition 1997. P 44.

14 Though as Anderson notes, even listed companies do not have minimum capitalisation requirements – Condition 8 to qualify for listing requires that entities satisfy either the Assets Test Rule in Listing Rule 1.3 or the Profit Test Rule in Listing Rule 1.3. looks at assets, an alternative to qualify for listing is the company's annual profit history (Listing Rule 1.2. See Anderson, Helen, *Corporate Directors' Liability to Creditors,* Thomson 2006 P69. See also ASX Listing Rules.

15 (2007) 232 ALR 232; (2007) 81 ALJR 525

16 At para 5.

17 At para 190.

18 At para 83.

company shares they did not actually require any return of capital. Gummow J ultimately found[19] that the "principle" of maintenance of capital attributed by the majority in *Webb* to *Houldsworth*, as the first step in their reasoning, actually reflected an attempt to rationalise that case.[20]

11. It is noted that the maintenance of capital rule (as well as the need to avoid artificial inflation of the share price through self acquisition) has given rise to the general rules that the company should not buy back its own shares, distribute capital to its members or give financial assistance in connection with the acquisition of its shares[21]. The *Corporations Act*[22] makes explicit one of the purposes of the rules in stating that they are designed to protect the interests of both shareholders and creditors by, inter alia, addressing the risk of these transactions leading to the company's insolvency. The rules are however subject to exceptions where such self acquisition is allowed subject to the general requirement that creditors' interests are not prejudiced.[23] The latter requirement appears to be consonant with the principle that maintenance of share capital is about creditor protection.

12. The question is no doubt also tied up with the wider issue of solvency which is defined in Australia as being able to pay debts as and when they become due and payable. In the United States by contrast solvency is established by the balance sheet test meaning whether the fair value of the assets of the debtor as a going concern exceeds its liabilities including the cost of liquidation[24]

13. In any event whether creditors have regard to assets and liabilities rather than paid up capital, it cannot be doubted that allowing shareholders equivalent priority to creditors will affect those assets and liabilities. In this sense the maintenance of capital argument may hint at an important issue while actually missing the point. A liability to shareholders as creditors will not actually diminish nominal paid up capital at all as the claimants' shares are unlikely to be cancelled when they receive their damages. It will however diminish the financial position of the company because it will increase a liability that might otherwise have been postponed. Thus though Gleeson J is correct in identifying assets and liabilities as the critical issue, it can be argued that recognising shareholders as creditors will in fact increase those liabilities and erode those assets. Put in another way, if the purpose of the maintenance of capital doctrine is to avoid prejudice to creditors, recognising shareholders as creditors will undoubtedly impact on that purpose. It is axiomatic that

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19 At para 86.

20 Austin and Ramsay comment that His Honour appears to be criticising a "misformulation of the law of maintenance of capital" in the "capital fund principle" rather than criticising the orthodox principle of maintenance of capital. The "orthodox principle of maintenance of capital" is said by them to be a law preventing the return of capital to the shareholders who originally subscribed that capital, rather than a law seeking to preserve the notional fund of paid-up capital, for the protection of creditors, from any diminution other than by trading activity (thus claims by shareholders who have purchased from a third party rather than subscribed do not offend the orthodox maintenance of capital principle though they do offend the capital fund principle). Elsewhere however the authors are also critical of the orthodox maintenance of capital principle. See Austin and Ramsay above n 14 para 20.160, 24.360 and 24.505.

21 S 259A of the *Corporations Act (Cth) 2001.*

22 S 256A(a) *Corporations Act (Cth) 2001.*

23 Ss 256B, 257A and 260A(1) of the *Corporations Act (Cth) 2001.*

24 Purcell, John 'The Contrasting Approach of Law and Accounting to the Defining of Solvency and Associated Directors' Declarations' (2002) 10 *Insolvency Law Journal* 192, 195. See *Bankruptcy Code*, 11 USC § 101(32) (2000).

admitting such shareholders as creditors will reduce the pool available to existing unsecured creditors. This will occur whether the maintenance of capital doctrine is flawed or not.

14. The other side of the argument of course starts with the prima facie claims in tort or statute of creditors who also happen to be shareholders. On this view their claims as creditors should not be seen as diluting the pool available to other creditors unless their position as shareholders substantively affects their standing as creditors. Further, in many cases the company will be insured against such claims (eg through a professional indemnity policy that covers misleading or negligent advice) and in that situation creditors will not be adversely affected by the equal priority given to such claims by *Sons of Gwalia*. The legal theoretical justification for the subordination of such claims – maintenance of capital – will then not apply as the claims will not be met from shareholder capital but from a separate fund (insurance). What this means in practice of course is that payment of these claims will not adversely impact upon unsecured creditors.

15. This raises the question of whether there should be a different rule according to whether a company has insurance or not. This is likely to be a highly problematic proposition and opens up numerous questions. In litigation companies are typically not obliged to disclose to a plaintiff whether they are insured or not as this is generally not a question raised by the pleadings. A requirement of such disclosure may therefore be controversial.

Possible resolutions

16. There are a number of positions between the two extremes of complete equality of shareholder creditors with other creditors, or on the other hand, complete subordination of one with the other. It is worth exploring these though it is submitted that each suffers from particular difficulties.

The following additional possibilities have been noted in the US literature[25]:

- Rescinding shareholder is preferred over general creditors to the extent he can trace the specific consideration representing his claim.
- Creditors whose claims arise subsequent to the share subscription have priority over the investors in that share subscription.
- Creditors have priority where their claims arise a reasonable time after shareholder becomes aware of his right to rescission and fails to exercise it.
- Creditors are entitled to a higher percentage of their claims than shareholders.

Further, in Australia the following options have been noted:

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25 See Slain, John J and Kripke, Homer, "The interface between securities regulation and bankruptcy – allocating the risk of illegal securities issuance between securityholders and the issuer's creditors" 48 N.Y.U.L. Rev 261 (1973) p286-287.

- Aggrieved investor claims rank behind creditors but ahead of any other shareholder claims.[26]
- Hargovan and Harris have proposed a resolution whereby only shareholders who purchased shares within a short time after misrepresentation will escape subordination.[27]

I will deal with each approach and analyse its implications.

Rescinding shareholder is preferred over general creditors to the extent he can trace the specific consideration representing his claim.

Davis indicates that this approach might be explained under the general theory of property transfers whereby in a transfer voidable by fraud, the transferee holds the property in constructive trust for the transferor.[28]

Slain and Kripke talk about the rationale for this as the court imposing a constructive trust or an equitable lien on assets where a transfer has arisen due to fraud, mistake or illegality or on the basis of unjust enrichment.[29] They also discuss assumptions that might be applied for tracing of the consideration for such issues such as first-in, first out (FIFO) or lowest intervening balance.

This option however does appear to create a significant administrative burden for liquidators in the tracing of assets and would increase the cost of liquidations to the detriment of unsecured creditors.

Only creditors whose claims arise subsequent to the share subscription have priority over the investors in that share subscription.

This is based on a theory of reliance by corporate creditors.[30] It makes an assumption that creditors have extended their credit aware of the equity holders' investment – for instance after viewing a financial statement which reflected the value of the shareholders' investment.[31] The creditor would further argue that the failure of the shareholder to rescind created a misleading appearance of regularity in the issuer's affairs whereas a shareholder's attempt to reclaim his investment by rescinding would have indicated a potential problem to credit suppliers.[32]

Given that many shareholder misrepresentation claims will arise in relation to non disclosures that are well subsequent to the original share issue and may be brought by transferee shareholders rather than original subscribers, this option may mean that most shareholder claims are postponed.

Creditors have priority where their claims arise a reasonable time after the shareholder becomes aware of his right to rescission and fails to exercise it.

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26 CAMAC Report p68.
27 Hargovan, A and Harris J, "Sons of Gwalia and statutory debt subordination: An appraisal of the North American experience" (2007) 20 AJCL 265.
28 Davis, Kenneth B, "The Status of Defrauded Securityholders in Corporate Bankruptcy" *Duke Law Journal*, Vol 1 1983.p11 summarising Slain and Kripke.
29 Slain and Kripke above n 24 p273-275
30 Slain and Kripke above n 24 p288.
31 Ibid.
32 Ibid p289.

The rationale for this view is based upon discouraging delay or laches by the shareholder to the detriment of the other creditors.[33]

This approach would require a liquidator to make enquiries about and formulate a view on whether a subscribing shareholder had a right to rescind, when she became aware of that right and what is a "reasonable time" after that point. Apart from the fact that the argument again has no relevance to transferee shareholders it places a huge responsibility on a liquidator who in all probability would need to seek guidance from the court on all these issues. The problems are compounded when the claim is not by one shareholder but by many.

Shareholder-creditor claims are discounted

The relativist view whereby senior interests such as creditors have been entitled to a higher percentage of their claims has been noted[34] and argued for.[35] Under such an approach shareholder creditor claims would be admitted equally with creditor claims but would be subject to a discount of their quantum. The level of such discount would be a matter for the legislature but would have to be at least 50 per centum to have an appreciable effect. Thus if the dividend were 20 cents in the dollar the shareholder creditor would receive 10 cents in the dollar. Such claims would be admitted to proof on this basis and voting rights in terms of value would therefore also be subject to the discount.

This approach has some merit but would likely create unfairness in relation to claims that are insured. In that situation the insurer rather than the creditors will receive the benefit of such discounting.

Aggrieved investor claims rank behind creditors but ahead of any other shareholder claims

This approach would postpone such claims behind other unsecured creditors though they would have a priority over any other claims by or residual rights of distribution to shareholders. CAMAC acknowledge however that this option may not give much practical assistance given that in the vast majority of liquidations unsecured creditors receive only a small percentage of the debt owed to them and shareholders rarely receive anything.[36]

Only shareholders who purchased shares within a short time after misrepresentation will escape subordination

Hargovan and Harris[37] argue for this option based upon at least three propositions. Firstly they argue that pre existing shareholders should be subordinated otherwise there will be an incentive for shareholders in a company approaching insolvency to improve their own position as creditors in an insolvency by attracting new

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33 Ibid p293.
34 Slain and Kripke above n 24 p262.
35 Swaine, R.T. "Reorganisation of Corporations: Certain Developments of the Last Decade", 27 *Colum.L. Rev.* 901 (1927).
36 CAMAC above n 25 p 69.
37 Hargovan and Harris, above n 26 p157.

capital. This would also include attracting capital through misleading information. It is argued that subordination of pre existing shareholders will remove this incentive. Secondly they argue further that both creditors and new shareholders may be subject to the same misleading non disclosure and therefore should rank equally. Lastly they suggest that shareholders who purchased a substantial time after the misrepresentation should be subordinated since they may have trouble establishing causation.

These views appear to presuppose both (1) a claim for damages for existing shareholders based upon a misrepresentation made subsequent to their share acquisition and (2) a claim for damages of those who purchased a substantial time after the misrepresentation. What is the first type of claim? It is clearly not a claim based upon purchase of shares in reliance upon a misrepresentation. Two possibilities suggest themselves as follows:

(a) A claim based upon a failure to disclose in a timely manner positive news. Thus if the shareholders sell at a time when the news should have been disclosed but wasn't, the news is later disclosed and the share price goes up, the former shareholder may argue that, but for the non disclosure they would have sold at a higher price. This sort of claim will not be without difficulty in any event. Firstly, there may be a problem with reliance as there cannot be reliance on non disclosure unless it is argued that there is a misrepresentation based upon earlier disclosures combined with the later silence. Otherwise it may require some alternative test of causation such as the US "fraud on the market" theory.[38] Secondly in some situations it might be argued that earlier disclosure of positive news might cause the shareholder not to have sold because positive sentiment may have changed his mood (assuming that negative sentiment made him sell). As can be seen, the question is intimately bound up with the issue of causation and reliance (which is discussed in submission B).
(b) A claim based upon a misrepresentation or failure to disclose negative news. Here the claim would be that the shareholder held onto (rather than acquired) shares based upon a misrepresentation. But for the misrepresentation/non disclosure it is argued that he could and would have sold at a higher price. This type of claim has certain logical inconsistencies however as it is likely that the same misleading reassurance that caused the plaintiff not to sell also caused the share price to remain higher. If the reassurance had not been given the plaintiff may well have sold, but likely the market would also have responded and the more favourable sale price may not have been available.

In relation to the shareholders who purchased a substantial time after the misrepresentation it is argued that these should be postponed as they may therefore have trouble establishing causation. This appears to be an argument that they may not have a claim in support of the proposition that their claim be postponed. Clearly if there is no claim then there is no need to postpone anything. Conversely, if causation can be established then lack of causation cannot be an

[38] Duffy. M "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

argument for postponing that claim. It may be therefore that the claims that this approach proposes to subordinate may not be viable claims in any event.

Conclusion

The effect of the *Sons of Gwalia* decision is undoubtedly good for shareholders however might be seen as somewhat harsh on small unsecured trade creditors. On the other hand a rule of absolute subordination of shareholder claims to the claims of unsecured creditors might be seen as neutering the recent blossoming of investor protection through civil suits and class actions.

On balance it is not clear that there is a compelling case for legislative intervention to overturn *Sons of Gwalia*. To the extent that the legislature wishes to be seen to provide some comfort for unsecured creditors there are various formulae available for a compromise position. Unfortunately these are generally burdensome and expensive for liquidators and claimants in relation to the tasks of tracing investor funds as well as determining issues of whether claims exist, how and when they arise, whether there is causation and so on. The only other compromise position – a general discounting of such claims – suffers from the fact that, in insured cases, the benefit of same will go to the insurer rather than to the unsecured creditors.

DETAILED SUBMISSION B

The "fraud on the market" theory

1. The American "fraud on the market" theory is based on the Efficient Capital Markets Hypothesis (ECMH). It was explained in *Basic v Levinson* as follows:

> *The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. ... Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. ...*[39]

2. Thus where a purchaser purchases stock that is overpriced due to a misleading statement and/or failure to disclose negative news it is unnecessary to show that the purchaser was aware of the particular misleading statement and/or failure to disclose negative news. This is because the market as a whole will be aware of same and the market price will reflect misleading statement and/or failure to disclose negative news.

3. It has been argued by the author of this submission[40] that the US "fraud on the market" theory has utility in at least four ways:

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[39] *Basic Inc v Levinson* 485 US 224, (1988) (Blackmun J) (citations omitted) 241–2 (citations omitted).
[40] Ibid

1 *It is generally supportive of a philosophy of full disclosure in securities markets;*

2 *It facilitates civil recovery by:*

i providing a rebuttable presumption of reliance or causation, even in situations where the misleading representation may not be calculated to induce or in its nature be sufficiently persuasive to induce;

ii solving certain conceptual difficulties in establishing reliance on nondisclosures; and

iii providing a causal link between unlawful conduct and the mispricing of securities;

3 *It creates a deterrent to nondisclosure by increasing the civil liability consequences; and*

4 *It goes beyond reliance and embraces the economic effects of nondisclosure on the market as a whole.*

Australian law – the *Janssen* Case

4. The decision in *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd*,[41] suggests that s 82 of the *Trade Practices Act* allows a claim by a person who, although not himself misled by a representation, suffered injury as a direct result of a third party's reliance on the misleading or deceptive representation.

5. The case was brought by a trader who had lost business when his customers were induced by the misleading representations of a competitor to patronise the competitor. The decision of Lockhart J in that case stands strongly for the principle that entitlement to recover loss or damage under s 82 is not confined to persons who rely on the representations which constitute contraventions of the Act.

6. The case law on section 52 and section 82 of the *Trade Practices Act* has generally been persuasive in the interpretation of the cognate provisions of the *Corporations Act* and *ASIC Act* which were lifted from the *Trade Practices Act*.

7. It is arguable that, applied to the stock market, the *Janssen* decision suggests that a person could suffer loss through reliance by others (the market as a whole) on a misleading statement or a failure to correct a statement which has become inaccurate due to new developments. Thus, a form of causation not requiring direct reliance may already be contemplated by Australian law, without any reference to the "fraud on the market" theory (though such an approach would require an acceptance by the courts of the Efficient Capital Markets Hypothesis – at least in the circumstances of that case).

8. Thus in a claim for loss by a purchaser of overpriced shares there may be no direct reliance at all on the nondisclosure. The chain of causation in this situation may be based on the market's response to the nondisclosure rather than that of the individual claimant. Indeed, in this type of case the claimant is

41 (1992) 37 FCR 526 ('*Janssen*').

assumed to be unaffected by nondisclosure as, implicit in his or her claim, is the assumption that he or she would still have purchased the shares (albeit at a lower price) if the true facts had been known.[42]

9. These very points may well be determined in the upcoming decision of Justice Stone in the Federal Court in *Dorajay Pty Ltd v Aristocrat Leisure Ltd.* It is therefore not really possible to make further detailed submissions on this point until the law is clarified by this and other future decisions.

10. To the extent that the outcome of these decisions raises a significant procedural barrier for investor claims then it may be appropriate at that point to revisit the question of causation. In that regard it is noted that deemed reliance already exists in the *Corporations Act* in relation to misstatements or omissions in a disclosure document.[43] Further, deemed reliance has been legislated in the four Canadian provinces that account for 95 per cent of capital market activity in Canada.[44]

Conclusion.

It is probably premature for the legislature to consider this issue this point until the law is clarified by this and any other future relevant decisions. To the extent that the outcome of these decisions raises a significant procedural barrier for investor claims then it may be appropriate at that point to revisit the question of deemed or presumed causation.

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42 Interestingly, the *Corporations Act* allows for a claim for compensation by a purchaser of overvalued shares when they were purchased from an insider holding price sensitive information: see *Corporations Act* s 1043L(4). It also appears to allow for such a claim by a purchaser of shares which are overvalued due to a takeover announcement which does not come to fruition: see *Corporations Act* s 670E.

43 See section *Corporations Act* 729(2).

44 See upcoming paper by Dr Janis Sarra "Risk Allocation and Efficient Administration: A comparative analysis of the treatment of equity securities claims in insolvency" p14 (draft paper presented at Corporate Law Teachers Conference, Sydney Australia 4th February 2008. See Ontario *Securities Act*, RSO 1990, c S-5, ss 130, 131.