Loss Quantification in Shareholder Class Actions — Possible Application in Greenwashing Cases

Sebastian Hartford Davis
Banco Chambers

The consumer protection subcategory of climate change litigation is enjoying a renaissance. Australia's broad statutory norm against misleading or deceptive conduct contained in section 1041H(1) of the *Corporations Act 2001* (Cth), and section 12DA(1) of the *Australian Securities and Investments Commission Act 2001* (Cth), is providing fertile ground for adaptation and innovation by (so far) public interest groups and regulators. Three current cases before the Federal Court illustrate this:

- The first is *O'Donnell v Commonwealth of Australia*.[1] The applicant is the holder of, and an investor in, exchange-traded Australian Government Bonds, and seeks declarations that the Commonwealth has engaged in conduct that is misleading or deceptive by failing to disclose information about the financial risks arising from climate change.
- The second case is brought by the Australasian Centre for Corporate Responsibility against Santos Ltd. Santos is alleged to have engaged in misleading or deceptive conduct in the content of its Scope 1 & 2 net zero by 2040 plan.
- The third case is brought by ASIC against Mercer Superannuation (Australia) Limited for allegedly making misleading statements about the sustainable nature and characteristics of some of its superannuation investment options.

Neither *O'Donnell*, *Santos* or *Mercer* involves a claim for damages. That primarily reflects the public-interest motivations of the plaintiffs and ASIC in those cases. Yet, there is no reason to think that a claim for damages might not be brought for contraventions of these statutory norms. Section 1041I(1) of the *Corporations Act* provides that individuals who have suffered loss or damage by conduct of a company that is in contravention of section 1041H (that is, misleading or deceptive conduct) may recover the amount of loss or damage from the company. Section 12GF(1) of the *ASIC Act*, and section 236 of the *Australian Consumer Law* (ACL), provide individuals with similar rights of action. These provisions mean that shareholders can bring proceedings against a company where that company has made a misleading net zero commitment, or another statement related to climate change, that causes the share price of the company to inflate artificially and then fall when the misleading statement is discovered by the market.

It may only be a matter of time before a shareholder class action is commenced in respect of greenwashing. But such an action would give rise to a novel question: if liability for misleading or deceptive conduct is established, how would the courts quantify loss in greenwashing cases?

The purpose of this note is to explore this question by reference to two subsidiary issues: first, what quantification methods are used by the courts to assess loss in these types of cases; and secondly, as a matter of fact, how could share price inflation be measured in the greenwashing context?

Three quantification methods

When quantifying a plaintiff's loss under section 1041I of the *Corporations Act* (and section 236 of the ACL), courts generally employ the common law quantification methods that are used to quantify loss after a defendant has committed the torts of deceit or negligence. While the common law is 'not directly in point' when it comes to the statutory compensation provisions, it provides guidance in that it represents an accumulation of 'valuable insight and experience which may well be useful in applying the Act'.[2] Three different quantification methods have been deployed depending upon the precise circumstances of the case.[3]

First, the ordinary quantification method (associated with the decision of the High Court in *Potts v Miller*) is that the plaintiff is entitled to the purchase price of the shares less their actual value at the time of acquisition.[4] This means that a plaintiff is prima facie entitled to the difference between the amount he or she paid for the shares and their actual market value at the date of acquisition, although a court may also look to subsequent events to determine the true value of the share price. The difficulty with applying this method in a case involving shares traded on a stock exchange is that the price paid by the plaintiff is generally the same as the *actual* price, because the defendant's misstatement has influenced the market such that the market price of the shares at the date of acquisition was inflated by the misstatement.

A ***second*** method is known as the 'left in the hand' measure. It holds that the plaintiff is entitled to the difference between the price paid for the shares and what (if anything) is left in the plaintiff's hand after the sale of the shares, or if the shares continue to be held through to trial, the difference between the price paid and the true market price at the time of trial.[5] This method is controversial because

it means that the defendant is liable for the entirety of the fall in the share price between the time of acquisition and the time of sale, even if that fall does not relate to the defendant's wrong. In short, the left in hand measure tends inappropriately to provide a plaintiff with 'the benefit of any loss or depreciation in the shares which was occasioned by subsequent acts'.[6]

A ***third*** method seems the most promising. Where the defendant's misstatement has influenced the market such that the market price of the shares at the date of acquisition was inflated by the misstatement, the plaintiff's loss is measured by determining the difference between what the plaintiff paid for the shares and what the real market value of the shares would have been if no misstatement had been made.[7] Lord Browne-Wilkinson explained this method in the House of Lords decision of *Smith New Court Securities v Scrimgeour Vickers* in the following terms:

> Where the open market at the transaction date was a false market, in the sense that the price was inflated because of a misrepresentation made to the market generally *by the defendant*, the market value is not decisive: in such circumstances the 'true' value as at the transaction date has to be ascertained but with the benefit of hindsight.[8]

Bearing in mind that the third quantification method seems the most likely to be employed in greenwashing cases,[9] the next question is: how, as a matter of fact, can share price inflation be measured in this context?

How to quantify share price inflation in practice

To quantify share price inflation, plaintiffs typically advance 'event study' evidence given by a financial economist with expertise in statistical and quantitative analysis. The event study method was relatively recently endorsed by Beach J in the context of an (ultimately unsuccessful) shareholder class action in *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* (*TPT Patrol*).[10]

An event study uses statistical methods to seek to identify the impact of an event (that is, information released into the market) on share price. Although there are different ways to conduct an event study, generally three steps are taken:[11]

(1) First, the expert will identify the days of the event (that is, the date the misleading statement was made and the days, weeks or months following it) and then predict the company's share price returns on those days had the misleading statement not been made.

(2) Secondly, by using the company's actual share price as reported on those days, the expert will calculate the 'abnormal return' for each day of the event by comparing the actual share price with the predicted share price as calculated in step 1.

(3) Thirdly, the expert will assess whether these abnormal returns are statistically significant. That is, the expert will determine whether the abnormal returns can be attributed to the event itself, rather than other events such as changes in the macroeconomic environment or other random events that affect the supply and demand for a particular stock.

Beach J explained in *TPT Patrol* that the reliability of an event study is increased in cases where, among other things, the event of interest is well-defined, in the sense that the time at which the information becomes available to the market is well known.[12] Given that a net zero commitment is ordinarily publicly announced by a company at a particular time on a particular date, it seems likely that the event study method will be accepted by a court as a reliable tool to quantify a plaintiff's loss in these kinds of cases. However, it is necessary to highlight some points of contention when considering how event study evidence would be used in this context.

The first point is that event study methods are generally used to assess loss where a company has *failed to disclose* material information which inflates its share price which is, for example, contrary to section 674 of the *Corporations Act*. In these types of cases, experts are required to comment on what the true value of the share price would have been had the company made the required statement. By contrast, in greenwashing cases, experts will be required to assess the true value of the share price had no statement been made at all (as companies are not currently obliged by law to disclose their carbon emissions targets).

The second point is that the event study method assumes that the total inflation in the share price can occur over time (that is, that it will not necessarily be immediate). In most cases, the statement may cause the share price to continue to inflate over a period of days, weeks or months until the amount of inflation peaks and stabilises at a particular amount. This presents a 'confounding information' problem. During this time, other market factors, entirely unrelated to the misleading statement, could have caused the share price to inflate. To take this into account, and to isolate the inflationary effect of the defendant's wrongful conduct, experts would be required to take (and robustly defend their analysis of) the third step in an event study.

Similarly, the share price *fall* on discovery of the misleading statement is not necessarily a good proxy for the recoverable loss. Given that investor confidence in a company may decrease over a number of weeks or months, the total fall in a company's share price caused by a misleading statement being disclosed or discovered cannot be limited to the short-term price reaction following the event. Hence, if a plaintiff sells her shares while the share price is still continuing to fall, she will not have suffered the same amount of loss as someone who sells (or retains) her shares after the total fall has occurred.

What has *not* yet occurred (or at least has not yet been publicised or litigated) is a diminution of share price as a result of what is later recognised to be greenwashing. Because of the commercial significance of being perceived to be Paris-aligned, I think this is just a matter of time. However, it is necessary to notice a problem that can arise where the fall in the share price occurs over a long period of time.

The longer the period of time over which the market-correction occurs, the more likely it is that other factors unrelated to the misstatement may have negatively influenced the share price. These other factors give rise to the same 'confounding information' problem I identified when assessing share price inflation. The quantification of loss therefore needs to navigate around these causation difficulties because, as a matter of principle, defendants cannot be held liable for reductions in share price caused by other market factors.

Conclusion

As regulatory and public interest claims for greenwashing become more common, it may only be a matter of time before a shareholder class action is commenced. Although loss quantification in this context gives rise to difficult questions of fact and law, as Dixon and McTiernan JJ stated in *Fink v Fink*, '[w]here there has been an actual loss of some sort, the common law does not permit difficulties of estimating the loss in money to defeat the only remedy it provided… an award of damages'.[13] BN

ENDNOTES

1 VID482/2020. For the strike out application, see [2021] FCA 1223.

2 *Henville v Walker* (2001) 206 CLR 459, 470 [18] (Gleeson CJ).

3 For discussion of these methods, see: Jonathan Beach QC, 'Class actions: some causation questions' (2011) 85 *Australian Law Journal* 579, 588.

4 *Potts v Miller* (1940) 64 CLR 282, 289, 297 (Dixon J), 308–9 (Williams J); *Toteff v Antonas* (1952) 87 CLR 647, 650–1, 654; *Gould v Vaggels* (1984) 157 CLR 215, 220.

5 *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [987] (Rares J). See also *Smith New Court Securities v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254, 264–5 (Lord Browne-Wilkinson) (*Smith*); *Invertec Ltd v De Mol Holding BV* [2009] EWHC 2471 (Ch), [379] (Mann J).

6 *Peek v Derry* (1887) 37 Ch D 541, 592 (Cotton LJ).

7 *Potts v Miller* (1940) 64 CLR 282, 289, 289–90 (Starke J), 299 (Dixon J); *Toteff v Antonas* (1952) 87 CLR 647, 650–51 (Dixon J).

8 [1997] AC 254, 261 (his Lordship's italics).

9 Although, it should be recognised that the High Court explained in *HTW Valuers v Astonland Pty Ltd*, these common law quantification methods are not only flexible, but they are also not universally available as of right: (2004) 217 CLR 640, 656–7 [35] (Gleeson CJ, McHugh, Gummow, Kirby and Heydon JJ). See also *PPK Willoughby Pty Ltd v Baird* [2021] NSWCA 312, [57] (Leeming JA).

10 (2019) 140 ACSR 38, 43 [20]. See also *Earglow Pty Ltd v Newcrest Mining Ltd* (2015) 230 FCR 469, 488-90 (Beach J).

11 *TPT Patrol* (2019) 140 ACSR 38, 164-167 [729]-[751] (Beach J).

12 Ibid 164 [728].

13 (1946) 74 CLR 127, 143.