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Myer class action: Another good news/ bad news story?

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The Myer continuous disclosure class action decision[1] is a landmark: the first judgment in a securities class action in Australia, and the first case explicitly accepting "market-based causation" as a basis for a damages claim.

Despite that, the applicant failed to prove loss on the basis of market-based causation and so-called "inflation" of the share price.

The case underscores the difficulty of running securities class actions based on a failure to correct earnings guidance, and the vagaries of actually proving loss.

This note will focus on the learnings for "front end" decisions on when disclosure should be made under ASX Listing Rule 3.1 and s674 and s677 of the Corporations Act.

THE MAIN LESSONS FOR CONTINUOUS DISCLOSURE

There are two main take-outs:

- Senior executives should avoid making offhand comments to analysts which would likely be treated as material if made in an ASX disclosure – or if such comments are made, the effect of the comments should be published on the ASX. This is not new counsel but this case illustrates why.
- If a company publishes earnings guidance, it should promptly update it once it is determined that it is no longer reliable, even if analysts already appear to have discounted the original forecast.

The second point applies where a company publishes earnings guidance. It continues to be the case (and the Myer decision confirms) that changes in internal forecasts are not required to be disclosed because they are for internal management purposes within the Listing Rule 3.1A exception (assuming the other elements of the exception apply). Companies need to monitor analyst forecasts as setting market expectations and consider whether they should make disclosure if they consider their earnings will differ from expectations, but that is as counselled by ASX Guidance Note 8, it was not a feature of the Myer decision.

BUT THERE MAY BE MORE TO IT

The more difficult question is how far the Myer decision should be taken in informing a company's determination of whether information is material – that is, its likely effect on the share price. The case could be taken as suggesting that even if information is generally known to analysts and most market participants, and so has been factored into the share price (so its disclosure by the company will not impact the share price[2]), the information may still be material and hence required to be disclosed, at least if it is possible that the information might not be known by some investors and would influence them. That would lower the disclosure bar significantly – perhaps not on the issue of whether an event or development needs to be disclosed at all, but on the issue of the level of detail.

[1] *TPT Patrol Pty Ltd v Myer Holdings Limited* [2019] FCA 1747

[2] Cf *Masters v Lombe* (Liquidator); *Babcock & Brown* [2019] FCA 1720, a decision by Foster J of the Federal Court (in which JWS acted for the liquidator in successfully defending a continuous disclosure claim based on a claimed failure to update guidance) which was handed down in the week before the Myer decision. It was held that a revision to earnings which had effectively already been factored in to the market price was not material information requiring disclosure: "By mid-September 2008, it was apparent to any potential investor in BBL that its capacity to realise earnings of the order of $643 million for the full Financial Year 2008 had been severely circumscribed by its own circumstances and by the GFC. In my view, by mid-September 2008, such investors would not have been influenced at all by being provided with earnings guidance at the times and in the terms of those which the plaintiffs allege should have been announced to the market".

On this broader reading the take outs would be:

- Material information affecting a company should not be assumed to be factored in by the market generally just because analysts are or seem to be aware of it. In order to show that it is generally known, the information should have wide publicity that the public has ready access to.
- If in doubt, companies should disclose to the ASX – if the company is correct that the information has already been factored in, there should be no adverse share price impact. (If there might be, it would only be worse if disclosure is delayed.)

FACTS AND DECISION

Myer's policy was not to publish earnings guidance. However on 11 September 2014 the then CEO Bernie Brookes told analysts and media on a call that he expected FY15 NPAT to be higher than FY14 ($98.5m) – quintessential "soft guidance". This statement was given fairly wide publicity.

The Bloomberg consensus of analyst estimates immediately after the 11 September call was below $98.5m – analysts generally did not change their views on FY15 NPAT as a result of this "soft guidance".

At points over the subsequent 6 months, the Bloomberg consensus moved (generally) progressively lower.

On 2 March 2015, Myer had a call with analysts to introduce the new CEO (Richard Umbers) who had just been appointed on Mr Brooke's retirement. An analyst asked the Chairman Paul McClintock about whether Myer was prepared to stand behind Mr Brookes' 11 September guidance. Mr McClintock responded that Myer did not give guidance but "our disclosure obligations are linked to the Bloomberg consensus", essentially confirming that Myer's expectation at the time was consistent with Bloomberg. At the time, the Bloomberg consensus was $90m.

On 18 March 2015 the Myer board met to consider the sales results to end February and determined that FY15 NPAT would be lower than the previous internal estimates. On 19 March Myer announced that it expected its NPAT to be between $75-80m excluding one off costs. The Myer share price declined 10%.

The applicant claimed firstly that Mr Brookes (ie Myer) had no reasonable basis for the 11 September soft guidance. Beach J was not convinced that Myer did not have a reasonable basis at the time.

The applicant also claimed that Myer was aware by no later than mid-November and at subsequent points in time that the 11 September guidance would not be met. So Myer should have updated the 11 September guidance under Listing Rule 3.1 and was in breach of s674 of the Corporations Act by not doing so, and its failure to update was misleading conduct under s1041H.

Beach J found that at various points in time following 11 September, Myer's internal forecasts were for FY15 NPAT to be lower than $98.5m – Myer's internal projections generally got progressively lower. He held that by not updating the 11 September guidance at each point in time, Myer breached its continuous disclosure obligations, and engaged in misleading conduct.

The applicant claimed damages on the basis of market-based causation: in essence, the difference between the Myer share price implied by the Bloomberg consensus NPAT forecast and what the share price would have been had Myer corrected its 11 September guidance. The applicant's expert took the price fall on 19 March to imply that for every 1% reduction in the NPAT forecast there would be a 0.97% fall in the share price.

Beach J accepted the market-based causation theory advanced by the applicant.

However, since the analysts' consensus forecasts had decreased progressively after 11 September – as Beach J said, "the hard-edged scepticism of market analysts… deflated Mr Brookes' inflated views" – and the forecasts were essentially in line with Bloomberg until 19 March, if Myer had updated its forecast at each relevant point in time following 11 September, there would have been no reduction in the Bloomberg consensus. So, on the basis of the applicant's expert's theory as to the correlation between the Bloomberg consensus and the share price, there would have been be no material impact on the share price if Myer had updated its forecast at any point before 19 March.

Hence on the basis of the damages claim theory advanced by the applicant, there was no loss.

But Beach J refused to accept Myer's defence that it did not need to update the 11 September guidance because the analysts' consensus forecasts had already effectively done that:

> "…assume the company put out a false statement as to NPAT. But assume that analysts had appeared to work this out so that Bloomberg consensus roughly reflected the correct position in terms of NPAT expectation. The logic of Myer's position is to say that there would be no obligation to correct under listing rule 3.1 or s 674. This would be a bizarre outcome and the antithesis of the legislative policy. Further, it would put to nought the text and effect of, inter-alia, ss 674(2)(c)(ii) and 677."

Beach J held that Myer was in breach of its continuous disclosure obligation because, whilst investors generally would have known about Mr Brookes' 11 September guidance (because it was given fairly wide publicity) not all investors would have known about the gradually reducing consensus forecasts. Under s 674 and s677, information is material if it would influence investors in deciding whether to buy or sell. Beach J held that if Myer had updated its forecast, investors who did not have access to analysts' consensus forecasts "would likely have been influenced by a disclosure of expected NPAT of less than $98.5m" and whilst Myer was held mostly by institutional investors who had access to consensus forecasts, "there were likely to be retail investors that would or might move the price of [Myer] securities".

DISCUSSION

It is by that last finding that Beach J threaded the needle between finding no loss by the applicant (on the damages theory advanced by the applicant) but still finding Myer in breach – his surmise that (to tease it out):

a) Retail investors would not have access to analysts' reports or the Bloomberg consensus and so would only have the 11 September guidance in considering whether to invest in Myer shares. So if and when they were informed that Myer's forecast had downgraded, that would for them be new and material information and would influence them.

b) When so informed, retail investors "would or might" move the market price – presumably because they would sell, and in large numbers (otherwise the market price would not move).

c) Accordingly (in terms of s674) a reasonable person would expect the Myer guidance downgrades to have a material effect on price.

There appears to have been no expert or other evidence to the above effect.

Proposition (a) is a sweeping generalisation that retail investors are informed only by what a company itself discloses – they have no brokers or advisers, they don't read media reports which often comment on a company's share price performance and the apparent drivers, and so on. As for proposition (b) the notion that retail investors – Beach J referred to the "mums and dads" – could move a reasonably large liquid stock like Myer simply cannot be correct. Retail investors will invariably be price takers. As for proposition (c) a person's contemplation that something "might" happen (per proposition (b)) does mean they expect it to happen (albeit it is accepted that per proposition (b) Beach J said "would" as well as "might").

It is implicit in the efficient market hypothesis that underpins market-based causation, readily accepted by Beach J, that "the price of shares traded in efficient markets quickly incorporates new information about the company". Beach J said that the "presence of institutional investors is an important factor contributing to the efficiency of trading in a company's stock, with institutional investors considered to be market participants employing sophisticated and involved valuation methods" and "the substantial presence of institutional investors supports the presumption that Myer shares traded in an efficient market". It must follow then that at all relevant times before March 19, the market price fully reflected all available information as at each time.

The only "information" that Beach J considered the institutional investors to have but which was not available to the retail investors was the consensus forecasts. Myer argued that if the consensus forecasts were reduced, that can only have been because of the analysts' deductions from generally available information. But Beach J said that analysts' forecasts could not "fairly be characterised as 'deductions, conclusions or inferences made or drawn from' 'readily observable matter'". He said that analysts' forecasts are "predictions as to future events (i.e., forecast earnings) and thus are inherently matters of supposition" and that they "do not fall within the definition of 'information' for the purposes of continuous disclosure".

The insider trading provisions' definition of "information" in s1041A includes "matters of supposition" – so a person can be guilty of insider trading if they deal in securities while in possession of such information unless that information is "generally available". Information is "generally available" under s1042C if it consists of deductions, conclusions or inferences made or drawn from readily observable matter. Now Beach J surely cannot be taken to have suggested that a matter of supposition is not something deducible from "readily observable matter – that cannot be correct (and if he had, then it must follow that any institutional investors who traded after having access to the analysts' "matters of supposition" were all guilty of insider trading). Surely Beach J must be taken to have meant only that it did not necessarily follow that a reduction in the consensus forecasts must evidence that the information on which they were based was generally available.

But there was no evidence that the analysts had any information that was not generally available. Surely the analysts would not just have made up that they should reduce their Myer NPAT forecasts.

If the consensus forecasts were not "information" then their relevance to the postulated uninformed "mums and dads" could only have been that the consensus forecasts would have given them an indication of the market's expectations. However, surely the share price itself gives that signal.

So the imagined uninformed "mums and dads", who may have bought into Myer shares only on the basis of the 11 September guidance (and not the later analysts' consensus), must surely be assumed to have been motivated to buy by the market price being lower than the price suggested by the 11 September guidance. They would undertake their valuation of Myer shares then look at the market price and conclude that all the sophisticated institutional investors have got it wrong – Myer shares are actually under-priced so we will buy. (The "mums and dads" are not sufficiently worldly wise and sophisticated to obtain information beyond what the company publishes, but it seems they are assumed to be sufficiently sophisticated in financial analysis and share valuation (and sufficiently confident) to second guess the institutional investors.) Of course, none of that is plausible.

At any rate, if and when these at once uninformed but sophisticated "mums and dads" were told of the updated Myer guidance (or the consensus), the market price at that time they bought will have reflected that (since the Myer guidance was in line with the consensus). They would have paid fair value. The postulated "mums and dads" might be disappointed that they will not get the profit they had expected from betting against the institutional shareholders by buying what they thought were under-priced shares, but the price was not inflated when they bought the shares. And they would have no reason to race to the exits when the "guidance" was corrected, certainly not in such large numbers as would impact the share price.

Beach J cast doubt on the applicant's expert's assumption that the Bloomberg analyst consensus was an accurate proxy for market expectations generally or as to (in this case) Myer's FY15 NPAT, though no alternative was suggested. He observed other investors may have different views to the analysts. That is correct theoretically – but it is a long leap to the conclusion that other investors including the "mums and dads", if they were informed of the Bloomberg consensus (or Myer's own reduced forecasts, which generally were consistent with Bloomberg), would come to a significantly different view as to the value of Myer shares than the prevailing market price to the extent that they would be prepared to bet against the market.

In refuting Myer's argument that it could determine the materiality of its internal NPAT forecasts by reference to the Bloomberg consensus, Beach J referred to the s674 "reasonable person" (a reasonable person would expect the information to have a material effect on price) and said that Myer's argument was:

> "… not consistent with s674(2)(c)(ii) read in the light of s677….These statutory provisions talk about a reasonable person and what might influence them. But the Bloomberg consensus is a median or mean of a small set of analysts and their expectations. It is narrower than the "reasonable person" perspective. Indeed many investors would not even know or be aware of Bloomberg consensus. Indeed there was no one figure for this consensus. Moreover, it diverged from Myer's own version of the consensus. So, even assuming for present purposes that the consensus for the FY15 NPAT forecast was well under FY14 NPAT and that this had been so soon after the 11 September 2014 representation, that in no way denies that a reasonable person knowing of the 11 September 2014 representation would or would be likely to be influenced in deciding whether to acquire [Myer] securities if told later that Myer had changed its own forecast or reached a different opinion such that the expected FY15 NPAT was now likely to be materially under FY14 NPAT."

In effect, Beach J took these points as permitting application of his own impression of materiality. There is occasional tendency in continuous disclosure cases for judges to apply their own impressions as to what information is material notwithstanding the absence of specific evidence that it would have had an impact on the share price.

Because of the flaws in the surmise and logic in which the judgement was based, in particular that retail shareholders alone could and would move the share price, there is the possibility that the decision is applied as authority that information can be material regardless of its potential effect on the share price, if the information would influence at least some investors in the market to buy or sell[3]. Beach J kept referring to s677 as "statutory" materiality, which perhaps could be read as distinguished from "real" materiality (that is, effect on the share price). That would walk us back to the position several years ago following the *Fortescue* decision in the Full Federal Court[4]. That position was ameliorated by a revision to ASX Guidance Note 8. In footnote 20, ASX goes out of its way to reject that information that is not truly material will trigger the continuous disclosure provisions of Listing Rule 3.1 and section 674. Hopefully in a future case the ASX Guidance will be applied. Breach of s674 can give rise to criminal liability and it borders on absurd to suggest that a company (and by extension its officers) should be potentially criminally liable for not disclosing something that makes no difference to price.

[3] Cf the Full Federal Court decision in *Grant-Taylor v Babcock & Brown* [2016] FCAFC 60 which said that "persons who commonly invest in securities" (in s677) should be treated as a class description, and to do so "avoids distinctions dealing with large or small, frequent or infrequent, sophisticated or unsophisticated *individual* investors." It was said there is no reason to confine it to the sophisticated: "The unsophisticated also need protection. Likewise the small investor and likewise the infrequent investor. But not the irrational investor."
[4] *ASIC v Fortescue Metals Group* [2011] FCAFC 19

OTHER OBSERVATIONS

Some other points to note:

- (Correcting prior statements) Beach J found that NPAT guidance (including "soft guidance") was a continuing representation that required correction when Myer formed the opinion that the guidance was no longer correct. The reasoning is not easy to follow in this regard and is not, in the writers' view at least, very convincing. Taken at the flood it suggests that any statement by an ASX listed company which becomes incorrect through later developments must be positively corrected when the company forms an opinion (through its directors or officers) that the statement if made today in the same terms would be incorrect. Such a conclusion is to say the least unfortunate, and in the writers' view unnecessary. The continuous disclosure provisions have enough teeth to require companies to provide updates of truly material information. There is no explicit requirement to correct previous information if the correction is not material – that is, in its likely effect on the share price.
- (5% to 10% materiality threshold) Beach J found that a 5% variation in earnings required disclosure, despite accounting materiality invariably having a more nuanced approach - a variation of between 5% and 10% may be material, which is picked up by ASX Guidance Note 8. Beach J gives no satisfactory reasons why 5% was the percentage to be picked for Myer, when the GN 8 considerations tended to 10% as the appropriate benchmark. This raises the question of what a company has to show to justify 10% instead of 5%. A "hair-trigger" of 5% for all earnings guidance seems to be unnecessary from a point of view of policy and principle.

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